Privilege Waiver Risks From Reps & Warranties Insurance Use

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Over the last several years, representations and warranties insurance has become an increasingly popular alternative or supplement to traditional indemnification in mergers and acquisitions transactions.[1]

According to a 2019 Forbes article, representations and warranties insurance is used "to protect against losses arising due to the seller's breach of certain of its representations in the acquisition agreement."[2]

And according to a 2013 Westlaw article, parties are drawn to representations and warranties insurance policies because they "help bridge the distance between the buyer and seller and mitigate risk exposure" in an otherwise drawn-out and contentious process.[3]

The use of representations and warranties insurance does not come without its risks, however, particularly when it comes to preserving information protected by the attorney-client privilege.

Protected Information

Like policyholders in other contexts, representations and warranties insurance policyholders are often asked to provide documentation to insurance companies that could include information protected by the attorney-client privilege.

There are two different stages in the repre sentations and warranties insurancer elationship when the insurer may have access to this type of information.

The first instance occurs when the policyholder applies for representations and warranties insurance coverage. In underwriting the coverage, the insurer typically requests information related to the transaction and due diligence conducted by the buyer.[4]

The second potential point of disclosure occurs when a claim arises. During this time, the insurer may ask for privileged information regarding counsel's investigation, prosecution or defense of the claim.[5]

When parties produce information in response to these requests, they run the risk of waiving the attorney-client privilege.[6]

Traditionally, when a party discloses privileged information to a third party, the party waives the right to assert the privilege. One exception to this general rule is the common interest doctrine.

Although the exact requirements for the common interest doctrine vary by state, the general idea is that courts will not find waiver following disclosure of privileged information to a third party "if the privilege holder and the third party share a common interest."[7]

Given the relationship between the policyholder and the insurer, many courts have held that disclosure of privileged information to an insurer does not result in waiver under the common interest doctrine.

This exception can be used as both a sword and a shield when litigation implicating the representations and warranties is commenced.[8] On one hand, the exception is used as a sword when the insurer argues "the insured must disclose privileged information to the insurer because the insurer and the insured have a common interest in defending the suit."[9]

On the other hand, the exception can also be used as a "shield to protect information that an insured shares with an insurer" when a third-party plaintiff argues that the insured has voluntarily waived the privilege.[10]

State Precedent

Generally, whether the common interest exception applies in the insurance context depends on the state.[11] For instance, Delaware courts refer to the common interest doctrine as either the "joint client" or "common interest" exception.[12]

In Delaware, courts have considered the application of this exception where the insurer uses the common interest doctrine as a sword against the insured to gain access to otherwise privileged information.

In Hoechst Celanese Corp. v. National Union Fire Insurance Co. of Pittsburgh,[13] the Delaware Superior Court in 1992 held that an insurance company and a policyholder have a common interest in "reducing or eliminating" the policyholder's underlying liability.[14] As a result, policyholders may not be able to block an insurer's access to otherwise privileged information under this exception.

In Ambac Assurance Corp. v. Countrywide Home Loans Inc., the New York Court of Appeals determined in 2016 that the common interest doctrine is narrower and only applies to communications related to pending or anticipated litigation.[15]

Consequently, "disclosures of privileged information to insurers may result in waiver if they are not made in connection with pending or anticipated litigation."[16]

Tennessee courts refer to the common interest doctrine as the common interest privilege. For example, in Boyd v. Comdata Network Inc., the Court of Appeals of Tennessee in Nashville held to this language.[17]

Although Tennessee courts have not applied the common interest doctrine to the insurance setting, the privilege requires its holder to demonstrate "that the otherwise privileged information was disclosed due to actual or anticipated litigation," Judge William Koch Jr., wrote in the 2002 Boyd opinion.[18]

Given that states vary on how courts apply the common interest doctrine, it is difficult for policyholders to avoid the risk of waiver upon disclosure.[19]

Thus, representations and warranties insurance policyholders should try to minimize that risk before a potential disclosure occurs. There are a number of things policyholders can do to try to minimize the risk both when negotiating the insurance policy and after a claim arises.[20]

For instance, in order to minimize the risk of waiver when purchasing the representations and warranties insurance coverage, policyholders can:

- Negotiate for an express provision stating that the policyholder is not required to disclose privileged information to the insurer under any circumstances;
- Request a provision stating that the policyholder is not required to disclose privileged information if it reasonably believes that disclosure of privileged information would result in waiver;
- Request a provision stating that disclosure is not required where maintaining the privilege cannot be reasonably assured; or
- At minimum, request a provision that requires the insurer to make a good faith effort to preserve the policyholder's privilege.[21]

Additionally, policyholders can minimize the risk of waiver after a claim arises by:

- Executing a common interest agreement with the insurer;
- Entering into a nonwaiver agreement with the insurer stating that disclosure of some privileged information does not operate as waiver as to other privileged information that was not disclosed and that the insurer will not attempt to gain access to nondisclosed privileged information based on any waiver;
- Avoiding disclosure of privileged information altogether; or
- Agreeing to produce comparable documents or information while withholding the documents that are privileged.[22]

Conclusion

As the prevalence of representations and warranties insurance insurance increases, it may become more clear how big of a risk parties face from such a disclosure. Regardless, parties are cautioned to be aware of this risk and take steps to reduce it.

As in other instances where a party may need to discuss privileged information with a third party — e.g., an insurer, a buyer, an adviser or otherwise — parties are encouraged to share the information verbally if possible.

If an insured party waives the attorney-client privilege, courts can compel the party to reveal confidential communications involving legal advice.

Moreover, parties should be wary of waiving the privilege regarding information shared with an insurer because it could potentially result in a subject matter waiver of other related privileged information.[23]

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[1] Syed S. Ahmad, Richard Warren & Patrick M. McDermott, Representations & Warranties Insurance and Privilege, FC&S Legal: The Ins. Coverage L. Info. Ctr. (2018); see also Representation & Warranty (R&W) Insurance – Current Market Trends, Cooley M&A (Dec. 3, 2019), https://cooleyma.com/2019/12/03/representation-warranty-rw-insurance-current-market-trends/.

[2] Richard D. Harroch, David E. Weiss & Richard V. Smith, A Guide to M&A Representations And Warranties Insurance in Mergers and Acquisitions, Forbes (Jan. 23, 2019), https://www.forbes.com/sites/allbusiness/2019/01/23/guide-mergers-acquisitions-representations-warranties-insurance/?sh=301b3a67f313.

[3] D. Stephen Antion & Philip Lang, Representations and Warranties Insurance: An Innovative Solution, Westlaw J. Del. Corp., Nov. 25, 2013, at 1, 2013 WL 6159323.

[4] Harroch, supra note 2; see also John J. McGuire, Representations and Warranties Insurance Policies in the Middle Market Are Here To Stay (Finally), Mergers & Acquisition L., Dec. 2015, 2015 WL 9875593 ("[I]nsurers and their counsel also typically gain access to any and all due diligence memoranda prepared by counsel for the buyer, which raises a host of attorney-client privilege issues that would form the base of a separate and equally scintillating chapter.").

[5] Ahmad, supra note 1.

[6] Id. ("As a general matter, when an entity discloses privileged information to a third party, courts may find waiver of the privilege.").

[7] Id.

[8] See Lindsay Fisher, D&O Insurance: The Tension Between Cooperating with the Insurance Company and Protecting Privileged Information from Third Party Plaintiffs, 32 Seattle U. L. Rev. 201, 213 (2008).

[9] Id. ("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.").

[10] Id. at 213–14 ("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 the litigation.").

[11] Ahmad, supra note 1.

[12] Hoechst Celanese Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., 623 A.2d 1118, 1123 (Del. Super. Ct. 1992).

[13] In this case, the defendant insurance company stopped paying the plaintiff's defense costs after plaintiff was found liable in a products liability action. Id. at 1120. In plaintiff's subsequent declaratory judgement action against the insurance company, plaintiff argued that documents regarding plaintiff's investigation, defense, and settlement of the underlying products liability action were privileged. Id. at 1121.

[14] Id. at 1124 (holding, however, that the joint client exception requires actual joint consultation in addition to common interest under Delaware law). Additionally, Delaware law requires that the common interest be legal rather than commercial in nature. See Titan Inv. Fund II, LP v. Freedom Mortg. Corp., No. 09C-10-259 WCC, 2011 WL 532011, at *4 (Del. Super. Ct. Feb. 2, 2011) ("As a general rule, application of the common interest privilege is appropriate where it is clear that the parties were collaborating and sharing information in furtherance of a joint legal strategy or objective, rather than simply seeking legal advice with regard to a commercial transaction.").

[15] Ambac Assur. Corp. v. Countrywide Home Loans, Inc., 57 N.E.3d 30, 38 (N.Y. 2016) ("[W]e do not perceive a need to extend the common interest doctrine to communications made in the absence of pending or anticipated litigation.").

[16] Ahmad, supra note 1.

[17] Boyd v. Comdata Network, Inc., 88 S.W.3d 203, 214 (Tenn. Ct. App. 2002).

[18] Id. at 214. Under Tennessee law, the proponent of the common interest privilege must prove the following elements: "(1) that the otherwise privileged information was disclosed due to actual or anticipated litigation, (2) that the disclosure was made for the purpose of furthering a common interest in the actual or anticipated litigation, (3) that the disclosure was made in a manner not inconsistent with maintaining its confidentiality against adverse parties, and (4) that the person disclosing the information has not otherwise waived the attorney-client privilege for the disclosed information." Id. at 214–15.

[19] Ahmad, supra note 1.

[20] Id.

[21] Id.

[22] Id.

[23] See Jennifer A. Hardgrove, Scope of Waiver of Attorney-Client Privilege: Articulating A Standard That Will Afford Guidance to Courts, 1998 U. Ill. L. Rev. 643, 644 (1998) ("The approach followed by most courts in the case of voluntary disclosure is that waiver as to one particular communication constitutes a waiver as to other privileged documents of that subject matter.").