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NEWSLETTER

Illinois Court Requires Policyholder to Produce Privileged Documents Bearing on Prior Knowledge Exclusion

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An Illinois appellate court has held that a policyholder is required to produce to its insurer in coverage litigation privileged documents relevant to the issue of whether it had knowledge of potential claims at the time it applied for coverage. *Sharp v. Trans Union L.L.C.*, 2006 WL 177248 (Ill. Ct. App. Jan. 25, 2006).

In the early and late 1990s, the policyholder, a consumer credit reporting company, had complaints filed against it by the Federal Trade Commission (FTC) and private parties regarding the company's practice of reselling consumer credit information. The company later obtained professional liability coverage from the insurer following lengthy negotiations concerning policy terms. The company did not initially disclose the suits. After the policy incepted, the company provided a "no known loss" letter that disclosed the prior litigation. The insurer did not alter its decision to provide coverage, but it told the company that no coverage would be afforded for the claims made prior to the start of the policy.

The policy provided that any loss would be excluded if the chief financial officer (or later the general counsel) knew that the underlying acts or omissions "might be expected to be basis of a Claim." In addition, the policy stated that "[a]ll Claims arising out of the same, continuing or related Professional Services shall be considered a single Claim. . . ." Furthermore, the policy included a requirement that the company "co-operate with the Underwriters in all investigations, including investigations regarding the application and coverage under this Policy."

Three months after the policy was executed, fourteen more lawsuits were filed against the company alleging similar credit law violations. The insurer instituted a declaratory judgment action, arguing that the fourteen lawsuits were not covered under the policy because they were related claims to the suits filed before inception of the policy. In addition, the insurer sought to exclude coverage under the known-loss doctrine.

As part of its discovery, the insurer served the company with a request for production of documents related to the suits filed before the inception of the policy, including materials prepared by the company's corporate and outside counsel. The company argued that those documents were protected by attorney-client privilege and

the work product doctrine. The insurer moved to compel disclosure, and the court agreed with the insurer, finding that the duty to cooperate trumped the privilege against disclosure in this case.

The appellate court initially noted that the attorney client privilege, while necessary to promote free and full communication between parties and their counsel, is only an exception to the rule promoting disclosure in discovery. As an exception, it is to be construed in the narrowest manner possible. In the case of insurance relationships, in particular, the court observed that Illinois has a strong policy in favor of disclosure, "with an eye towards ascertaining the truth which is essential to the proper disposition of a lawsuit."

The court, citing *Waste Management, Inc. v. International Surplus Lines Insurance Co.*, 579 N.E.2d 322 (Ill. 1991), explained that policyholders have a broad duty to disclose information to the insurer when the policy contains a cooperation requirement. The court found that the policy's cooperation clause, read together with the policy's exclusion of losses that should have been known or expected by the policyholder, required disclosure of documents related to the litigation. It reasoned that if there were no disclosure of the materials, the insurer would have no way of determining whether the company had reason to know that the acts at issue might be the basis of a claim.

The court also noted that the policy expressly required cooperation in investigations regarding coverage. Because the policy contains this broad cooperation requirement, the court stated that the company agreed to disclose information that would otherwise have been privileged. This interpretation, the court explained, was harmonious with Illinois public policy, which encourages disclosure of information between insurers and policyholders. Such disclosure is necessary to prevent fraud, especially in cases involving known losses. Although the company asserted that the policy was a contract of adhesion, the court rejected this argument, noting that the policy language was negotiated and modified extensively before the agreement was executed.

Finally, the company argued that even if there was a legal basis for compelling it to disclose the requested documents, the court should delay compulsion of such disclosure because it would prejudice the company in the underlying lawsuits. The court declined to do so, and stated that resolution of disclosure issues in this suit did not go to the ultimate issue of conduct in violation of the applicable credit laws. The court also noted that the insurer had agreed to a protective order concerning the documents, which would avoid a prejudicial impact from disclosure of the materials to the insurer.