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Court of Appeals No. 38921-5-II

IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

BY RONALD H. CARPENTER

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RECORDED
SUPERIOR COURT
STREET

CURT

BRUCE CEDELL, a single man,

Plaintiff/Petitioner,

v.

FARMERS INSURANCE COMPANY OF WASHINGTON,

Defendant/Respondent

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DEC 21 2010
CLERK OF THE SUPREME COURT
STATE OF WASHINGTON
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APPEAL FROM COURT OF APPEALS DIVISION II
OF THE STATE OF WASHINGTON NO. 38921-5-II

**ANSWER TO THE PETITION FOR REVIEW
TO THE SUPREME COURT**

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RULES

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I. IDENTITY OF RESPONDENT

Defendant/respondent, Farmers Insurance Company of Washington, requests the Court deny plaintiff's/petitioner's Petition for Review of the Court of Appeals decision below.

II. DECISION

The Court of Appeals filed its decision in this case on October 21, 2010. A copy of this decision is attached as Appendix A to petitioner's Petition.

III. ISSUES PRESENTED FOR REVIEW

Should the Court deny the Petition for Discretionary Review, where the decision of the Court of Appeals is consistent with applicable Washington law?

IV. STATEMENT OF THE CASE

Respondent, Farmers, asks that the Court deny petitioner's Petition for Review. The Court of Appeals properly reversed the superior court's order, which effectively concluded that no insurer is entitled to the protections afforded under the attorney-client privilege whenever the plaintiff merely alleges bad faith.

This case involves an insurance coverage dispute that arises from a suspicious fire occurring at the petitioner's residence.

A. Factual Background.

Farmers issued a Homeowners Policy to petitioner, Mr. Bruce Cedell insuring his residence and contents against certain covered losses, including fire. CP 364-65. On November 24, 2006, Mr. Cedell's property caught fire. CP 365-68. On the day of the loss, Mr. Cedell was at his residence with his girlfriend, Melissa Ackley. *Id.*

Mr. Cedell reported the loss to Farmers 5 days later, and Farmers began its investigation. *Id.* During Farmers' investigation, however, Mr. Cedell and Ms. Ackley provided false information to Farmers' investigator. *Id.* They had also provided inconsistent stories in their Examinations Under Oath. *Id.* Ms. Ackley also admitted to engaging in criminal activity at the residence on the day of loss. *Id.*

Given Mr. Cedell's failure to immediately report the loss, his failure to provide truthful testimony to Farmers regarding the loss (both required under the policy), CP 364-65, and his admission that criminal activity had occurred in close proximity – in both location and time – to the loss, Farmers undertook a lengthy investigation and was unable to make an immediate coverage determination. CP 365-68. Farmers also retained counsel to advise it on legal issues in making a coverage determination. *Id.*

Ultimately, through its investigation, Farmers estimated that the cost to repair or replace the damaged property was between \$56,498.84 and \$90,000. CP 458-60.

Despite the numerous bases on which to deny coverage pursuant to the Policy, Farmers offered \$30,000 to Mr. Cedell in compromise of his disputed claim. CP 458; *see also* CP 465-68. The offer was made as a “one-time only offer” and remained open for 10 days. *Id.*

On November 5, 2007, Mr. Cedell filed suit in Grays Harbor County Superior Court against Farmers for breach of contract and bad faith. CP 336-40; 331-335.

B. Discovery Dispute and Motion Practice.

During discovery, Mr. Cedell propounded Interrogatories and Requests for Production to Farmers. CP 9-18. The discovery requests sought both privileged and non-privileged materials. *Id.*

In response, Farmers produced its entire claim file, redacting or withholding only those portions protected by the attorney-client privilege and work product doctrine. CP 9-313.¹ Farmers included a privilege log identifying those documents withheld or redacted and the basis for the withholding or redaction. CP 341-61.

¹Farmers also redacted “reserve” information from the claim file on the basis of relevance. *Id.* The superior court ordered Farmers to produce “reserve” information even though plaintiff did not specifically seek that information in his Motion to Compel. CP 490-96.

Over one year later, on January 28, 2009, Mr. Cedell moved to compel the production of the redacted, privileged information, CP 1-8, arguing that no insurer is entitled to protections afforded by the attorney-client privilege or work product protection in any bad faith litigation. CP 2-3; *see also* CP 6 (“Farmers claimed the attorney-client privilege, which we believe does not apply in this bad faith litigation.”).

In its opposition to the motion and its Cross-Motion for Protective Order Re: Privileged Information, CP 63-76, Farmers argued that insurers are afforded the same protections under the attorney-client privilege and work product doctrine in bad faith litigation as any other client in any other litigation. CP 369-76.

Mr. Cedell then filed a supplemental “Memorandum Re: Attorney-Client Privilege Work Product / Protective Order,” and abandoned his argument that the attorney-client privilege and work product doctrine do not apply. CP 456-65. Instead, he acknowledged that the privilege and protection do apply, but argued that the fraud exception should apply in the context of his lawsuit. CP 461-65. Mr. Cedell indicated that he “suspected” (VRP 5:2) that Farmers attempted to commit a civil fraud, because (1) it had given him a “one time offer only” that he felt was insufficient; CP 464, ll. 22-32; and (2) Farmers’ valuation of the damaged property “proved

to be wholly inadequate and possibly even fraudulent”; CP 458, ll. 18-19. *See generally*, 456-471; Verbatim Report of Proceedings (VRP) 2-25.

At oral argument on February 23, 2009, petitioner again acknowledged that the privilege and protection apply, but argued that he had met the factual showing necessary to invoke the fraud exception to the privileges. VRP 2-3. Farmers argued that petitioner was not entitled to the redacted or withheld information, because it was protected by the attorney-client privilege. VRP 10-17. Relying on *Escalante v. Sentry Ins. Co.*, 49 Wn. App. 375, 743 P.2d 832 (1987), Farmers argued that the fraud exception to the privilege did not apply, because petitioner had failed to present a sufficient factual showing adequate to establish a good faith belief by a reasonable person that wrongful conduct rising to the level of civil fraud had occurred, VRP 13:12 – 17:13.

C. Grays Harbor County Superior Court’s “Order Re: In Camera Review of Claim File,” dated March 2, 2009.

In its oral ruling of February 23, 2009, the superior court judge implicitly found that the privilege applied, but ruled that Mr. Cedell had made a factual showing adequate to support a good faith belief by a reasonable person that wrongful conduct sufficient to

invoke the fraud exception to the attorney-client privilege had occurred. VRP 20:20 – 21:8.

I'm going to order that [the documents] be produced for an *in camera* inspection by me. I do not agree with your [Mr. Guadagno's] summary of *Escalante*. *Escalante* doesn't require that I make a – a finding of civil fraud. **It requires that – that the Court find that there is at least some found – some foundation and [sic] fact to support a good faith belief by reasonable person that – that there may have been wrongful conduct which could invoke the fraud exception** and the facts recited here, particularly surrounding the offer from Mr. Hall and – and how inconsistent it appeared to be with Farmers own appraisal evidence and the fact that it – there was a very short time placed on – on the offer.

VRP 20:20 – 21:8 (emphasis added).

On February 25, 2009, Farmers complied with the superior court's order and produced its entire claim file with no redactions. CP 510. On the same day, the superior court judge conducted an *in camera* review of the redacted portions of Farmers' claim file. *Id.* The following day, the superior court judge issued a letter ruling, which was later entered as an "Order Re: *In Camera* Review of Claim File" on March 2, 2009. CP 509-14. The superior court judge did **not** find that the information reviewed *in camera* established a "foundation in fact" for the charge of civil fraud. *See generally, id.* Instead, the order effectively finds that insurers are

never entitled to the protection afforded under the attorney-client privilege or work product doctrine in bad faith litigation. *Id.*

The present litigation arises from a fire damage claim and not a UIM claim. The decision in *Escalante* may have limited application to the facts and circumstances of the present case.

In the context of a claim arising from a residential fire, the insurer owes the insured a heightened duty – a fiduciary duty, which by its nature is not, and should not be, adversarial. Under such circumstances, the insured is entitled to discover the entire claims file kept by the insured without exceptions for any claims of attorney-clients privilege.

CP 511-12 (emphasis added).

The superior court judge then ordered Farmers to produce all privileged communications to Mr. Cedell and his counsel by Friday, March 6, 2009. CP 513-14. The superior court judge also imposed terms in the amount of \$15,000 to be paid to Mr. Cedell and sanctions of \$25,000 to be paid to the court.^{2 3}*Id.*

² With respect to petitioner's discovery requests seeking non-privileged materials, the superior court found that Farmers' objections and answers violated CR 11 and CR 26 and imposed up to \$7,500 in sanctions. *Id.* This portion of the superior court's orders was *not* at issue in the appeal to the Court of Appeals as Farmers paid \$5,000 in sanctions to the Grays Harbor County Superior Court and does not challenge the \$2,500 in terms awarded to Mr. Cedell.

³ The superior court did not indicate what portion of the terms or sanctions applied to which of two alleged violations ("reserve" information withheld and attorney-client communications and work product, which the court concluded were not protected). *Id.* The portion of the sanctions that were imposed due to redactions of "reserve" information is not at issue in this appeal. This appeal is limited solely to the application of the attorney-client privilege and work product doctrine and the sanctions related to that issue.

On March 10, 2009, the Court of Appeals Division II accepted discretionary review of the superior court's orders and entered a stay of all superior court proceedings pending appeal. On October 21, 2010, the Court of Appeals reversed the superior court.

V. ARGUMENT

A. Argument Why Review Should Be Denied.

1. Criteria for discretionary review.

This court should deny discretionary review of the Court of Appeals' reversal of the superior court's order pursuant to RAP 13.4, which precludes discretionary review by the Supreme Court unless one of the enumerated bases in RAP 13.4(b) is present and established. While petitioner does not identify which of those bases here justifies review, based on petitioner's arguments, respondent assumes that petitioner seeks review under RAP 13.4(b) (1), (2), or (4), which state:

A petition for review will be accepted by the Supreme Court **only**:

(1) If the decision of the Court of Appeals is in conflict with a decision of the Supreme Court; or

(2) If the decision of the Court of Appeals is in conflict with another decision of the Court of Appeals; or

...

(4) If the petition involves an issue of substantial public interest that should be determined by the Supreme Court

The Court should conclude the Court's of Appeals decision is not in conflict with any applicable decisions of the Supreme Court or the Court of Appeals. Further, because the Court of Appeals correctly followed established Washington law, this appeal no longer involves an issue of substantial public interest requiring review by the Court.

2. The Court of Appeals' decision is not in conflict with any Supreme Court decision or other Court of Appeals decision.

In the present case, the superior court's ruling strips from Farmers' privileged, confidential information and communications the protections afforded by the attorney-client privilege and work product doctrine. Without the Court of Appeals' reversal, Farmers would be required to divulge this protected information, and would never be able to restore the confidential nature of this information.

The Washington Court of Appeals' decision reversing the superior court was consistent with *Barry v. USAA*, 98 Wn. App. 199, 989 P.2d 1172 (1999). The superior court had abused its discretion by ordering the disclosure of confidential and privileged information with no basis to invoke the fraud exception to the attorney-client privilege.

In support of its order, the superior court effectively held that no insurer is ever entitled to the protections afforded by the attorney-client privilege and the work product doctrine where that insurer is sued for violations of the Consumer Protection Act or for bad faith.

In the context of a claim arising from a residential fire, the insurer owes the insured a heightened duty – a fiduciary duty, which by its nature is not, and should not be, adversarial. Under such circumstances, the insured is entitled to discover the entire claims file kept by the insurer without exceptions for any claims of attorney-client privilege. ... In the present case, the defendant's claims of attorney-client privilege are without merit. The plaintiff is entitled to receive all documents which were withheld and/or redacted in reliance upon the attorney-client privilege.⁴

CP 512. Notably, the superior court did not evaluate whether the redacted information qualifies as attorney-client communications. Instead, the superior court ruled that Farmers is entitled to no such privilege at all. This order was directly contrary to Washington law.

In support of its ruling, the superior court referred to *Escalante v. Sentry Ins. Co.*, 49 Wn. App. 375, 743 P.2d 832 (1987)

⁴ The superior court also committed obvious error in concluding that in the first-party insurance claim context the insurer has a fiduciary duty to its insured. Washington law has found nothing more than a “quasi-fiduciary” duty in which the insurer is entitled to treat its interest equally with that of its insured. See, e.g., *Van Noy v. State Farm Mut. Auto. Ins. Co.*, 142 Wn.2d 784, 791, 16 P.3d 574 (2001) (“[the quasi-fiduciary relationship] requires an insurer to deal fairly with an insured, giving equal consideration in all matters to the insured's interests as well as its own.”); *Jones v. Allstate Ins. Co.*, 146 Wn.2d 291, 327, 45 P.3d 1068 (2002), *reconsideration denied* (“this court has made it clear that an insurer is not a true fiduciary even to its insured. Rather, an insurer's duty is one of good faith. ‘[A]n insurer must deal fairly with an insured, giving equal consideration *in all matters* to the insured's interests.’” (quoting *Van Noy*, supra)).

and purported to rely on *Barry v. USAA*, 98 Wn. App. 199, 989 P.2d 1172 (1999). These two cases involved discovery disputes arising in the context of UIM claims. The superior court acknowledged that these two cases relied on a trial court decision from another jurisdiction, which simply stated:

The time-worn claims of work product and attorney-client privilege cannot be invoked to the insurance company's benefit where the only issue in the case is whether the company breached its duty of good faith in processing the insured's claim.

Silva v. Fire Ins. Exch., 112 F.R.D. 699 (D. Mont. 1986). The *Barry* case quoted this section from *Silva* and then held further: "We have good reason to treat first-party bad faith claims involving the processing of UIM claims differently, however." From these three cases, the superior court erroneously held that an insurer's right to the protections afforded by the attorney-client privilege and the work product doctrine are limited to UIM claims.

Significantly, however, no case has ever applied the *Silva* rule stripping an insurer's claim file of the attorney-client privilege and work product protection outside of the UIM context. The only Washington cases to address the *Silva* case are *Barry* and *Escalante*. In each of these cases, the Washington Courts of Appeals declined to apply the *Silva* case in the context of a UIM claim. The reason why the courts declined to follow *Silva* – and, thus, why Farmers

correctly chose to redact privileged information in its claim file in this case – is key to understanding the basis of respondent’s original appeal.

The superior court failed to recognize that the *Barry* and *Escalante* cases were distinguishing UIM claims from situations where “[an] attorney is engaged and paid by the carrier to defend the insured and therefore operates on behalf of two clients”—in other words, in liability defense situations. *Barry*, 98 Wn. App. at 204 (citing *Baker v. CNA Ins. Co.*, 123 F.R.D. 322, 326 (D. Mont. 1988)). The *Barry* case further holds that insurers in a UIM setting should be afforded the protections of the attorney-client privilege, “[b]ecause the provision of UIM coverage is by nature adversarial [and] an inevitable conflict exists between the UIM carrier and the UIM insured.” *Id.* at 205 (citing *Fisher v. Allstate Ins. Co.*, 136 Wn.2d 240, 249, 961 P.2d 350 (1998)). The *Barry* case distinguished UIM claims – not from **all first-party** coverage disputes – but from situations where an attorney is engaged and paid by the carrier to defend the insured.

The friction between this adversarial relationship and the traditional fiduciary relationship of an insured and an insurer is difficult to resolve. The difficulty is complicated by those cases where an attorney represents an insured in an action against the tortfeasor and then must represent the carrier when the insured makes a UIM claim. Such was not the case here,

however. **Considering the fact that [the insurer's] attorney was only involved in [the insured's] UIM claim, it follows that communications between [the insurer] and its attorney concerning the UIM claim are privileged for the purposes of [the insured's] bad faith insurance suit.**

Id. at 205 (emphasis added). Thus, *Barry* stands for the proposition that an insurer is entitled to the protections afforded by the attorney-client privilege – not only in UIM claims – but in any first party coverage disputes where the insurer's attorney is retained solely to represent the carrier only with respect to claims being made by its insured. That is precisely the situation here.

Thus, the single sentence from *Silva*, which *Barry* and *Escalante* quoted in *dicta*, and on which the superior court relied, has extremely limited precedential value. Further, the two-page *Silva* ruling neither refers to nor relies on any law or case in support of its conclusion. Instead, the *Silva* court fabricates its rule out of whole cloth.

The Court of Appeals properly recognized and applied the correct rule of law from *Barry* and *Escalante*.

We reject Cedell's argument that an insurance company does not have any right to attorney-client privilege in a bad faith claim. *Escalante* did not hold that an insurance company has no right to assert attorney-client privilege in a bad faith action. ... An insurance company does not lose attorney-client privilege protection simply because its litigation opponent raises an issue where advice of counsel may be relevant.

See Court of Appeals Decision, Ex. A., at 7-8 (citations omitted).

The Court of Appeals ruling is consistent with well established Washington law. Washington courts have consistently held that insurers are entitled to the protections afforded by the attorney-client privilege and work product doctrine. See, e.g., *Escalante*, 49 Wn. App. 375, reversed on other grounds, *Ellwein v. Hartford Accident & Indem. Co.*, 142 Wn.2d 766, 15 P.3d 640 (2001); *Barry*, 98 Wn. App. 199; *Lexington Ins. Co. v. Swanson*, 240 F.R.D. 662 (W. D. Wash. 2007). Nothing contained in *Escalante* or *Barry* explicitly or implicitly limits the protections afforded by the attorney-client privilege to UIM claims alone.⁵

The superior court's ruling here – that Farmers was not entitled to the protections afforded from the attorney-client privilege – was directly contrary to Washington law and created an unprecedented exception to one of the most fundamental privileges recognized in our judicial system. See generally, *In re Disciplinary Proceeding Against Schafer*, 149 Wn.2d 148, 66 P.3d 1036 (2003) (“While we laud the principles protecting the sanctity of attorney-

⁵ Other jurisdictions recognize the same protections. See, e.g., *Hartford Financial Services Group, Inc. v. Lake County Park and Recreation Board*, 717 N.E.2d 1232 (1999) (Indiana law); *Ferrara v. DiMercurio, Inc. v. St. Paul Mercury Ins. Co.*, 173 F.R.D. 7 (1997) (Massachusetts law); *Ring v. Commercial Union Ins. Co.*, 159 F.R.D. 653 (1995) (Montana law); *Haines v. Liggett Group, Inc.*, 975 F.2d 81, 95-96 (3d Cir. 1992))

client confidences and secrets, we are cognizant that there are occasions when revealing a client's statements may be justified. These occasions are extremely limited, however, consistent with the profession's goals of establishing and maintaining trust in the judicial process.”). The Court of Appeals' decision reversing the superior court's orders was appropriate, proper, and consistent with long-established Washington case law.

3. The Court of Appeals ruling regarding the civil fraud exception is equally consistent with Washington law.

Under *Escalante*, Washington law protects confidential communications between an insurer and its counsel unless an insured can establish that the factual circumstances justify application of the fraud exception. *Escalante*, 49 Wn. App. at 394. Generally, the exception is invoked only when the insured presents a prima facie showing of bad faith tantamount to civil fraud. *Id.* To strip a communication of the attorney-client privilege, the insured must show that (1) the insurer was engaged in or planning a fraud at the time the privileged communication was made, and (2) the communication was made in furtherance of that activity. *Id.*; *Barry*, 98 Wn. App. at 205 (citing *Haines*, 975 F.2d at 95-96).

To invoke an *in camera* review, the insured must make a “factual showing adequate to support a good faith belief by a

reasonable person that wrongful conduct sufficient to invoke the ... fraud exception ... has occurred.” *Escalante*, 49 Wn. App. at 394. The trial court based its required “good faith belief” that Farmers committed fraud merely on the alleged “inconsistency” between Farmers’ valuation of the damaged property in the context of a disputed, suspicious claim, and the short time limit placed on the offer to settle.

Under *Barry*, the “good faith belief” is not satisfied by mere allegations or even evidence of bad faith or CPA violations. *Barry*, 98 Wn. App. at 206-07. In *Barry*, the insured sought an *in camera* review of the insurer’s claim file and argued that there was a factual basis to support a good faith belief that the insurer had committed fraud, alleging that the insurer had significantly delayed responding to and settling her claim. The Court of Appeals ruled that such allegations or evidence were insufficient to support a good faith belief that the insurer had committed fraud.

Here, the superior court committed the same error and the Court of Appeals properly reversed its order.

Moreover, even if a factual basis to support a good faith belief that an insurer committed fraud existed, the Court of Appeals properly held that this was still insufficient to invade the privilege. In order to strip a communication of the attorney-client privilege, the

court must “subject[] the documents to an *in camera* inspection to determine whether there is a foundation in fact for the charge of civil fraud.” *Escalante*, 49 Wn. App. at 394; *Barry*, 98 Wn. App. at 206 (citing *Seattle Northwest Securities Corp. v. SDG Holding Co.*, 61 Wn. App. 725, 740, 812 P.2d 488 (1991)). Here, the superior court conducted the *in camera* review, but then failed to determine whether any redacted portions of the claim file supported a foundation in fact for the charge of civil fraud. Indeed, the superior court’s letter ruling failed to provide any analysis whatsoever – or even any allegation, supported or otherwise – of any fraudulent conduct on the part of Farmers. Instead, the letter ruling finds only that Farmers is not entitled to the protection at all.

Accordingly, the Court of Appeals properly reversed the superior court decision.

4. The Court of Appeals decision no longer involves an issue of substantial public interest, given that the Court of Appeals’ decision is consistent with long-established Washington law.

Petitioner argues that Review should be accepted, because the issues present here are of substantial public interest. While Farmers agrees that the trial court’s decision to eviscerate the attorney-client privilege involved an issue of substantial public interest, the Court of Appeals decision does not. The decision by the Court of Appeals

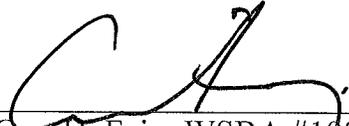
simply followed long-established Washington law on the attorney-client privilege and work product doctrine.

VI. CONCLUSION

The Court should deny petitioner's Petition for Review of the Court of Appeals decision, dated October 21, 2010.

RESPECTFULLY SUBMITTED this 21st day of December, 2010.

NICOLL BLACK & FEIG

By: 

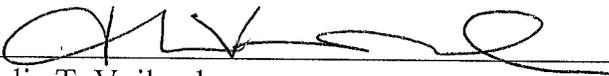
Curt H. Feig, WSBA #19890
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Of Attorneys for Respondent/Defendant
Farmers Insurance Company of Washington

CERTIFICATE OF SERVICE

The undersigned certifies under penalty of perjury under the laws of the State of Washington, that on December 21, 2010, I caused service of the foregoing pleading on each and every attorney of record herein:

Stephen L. Olson (via e-mail (by agreement) and U.S. mail)
Olson Zabriskie & Campbell, Inc.
104 West Marcy Avenue
Montesano, WA 98563

DATED this 21st day of December, 2010, in Seattle, Washington.



Julie T. Voiland