

FIRST DIVISION

January 30, 2012

No. 1-11-2526

NOTICE: This order was filed under Supreme Court Rule 23 and may not be cited as precedent by any party except in the limited circumstances allowed under Rule 23(e)(1).

IN THE
APPELLATE COURT OF ILLINOIS
FIRST DISTRICT

STEWART TITLE GUARANTY COMPANY,)	Appeal from the
)	Circuit Court of
Plaintiff-Appellant,)	Cook County.
)	
v.)	No. 08 CH 40378
)	
CVOF 71, LLC, as Assignee of Wachovia)	Honorable
Bank, N.A., Master Servicer and Special)	Rita M. Novak,
Servicer for Wells Fargo Bank, N.A., as)	Judge Presiding.
Trustee for Credit Suisse First Boston)	
Mortgage Securities Corporation, the Assignee)	
of Column Financial, Inc.,)	
)	
Defendant-Appellee.)	

JUSTICE HALL delivered the judgment of the court.

Presiding Justice Hoffman and Justice Karnezis concurred in the judgment.

ORDER

¶ 1 **Held:** The circuit court's order requiring the plaintiff to produce documents and its attorney for deposition was proper: the documents were discoverable under the "at issue" exception to the attorney-client and work-product privileges. Even though the circuit court's production order was affirmed,

the record on appeal supported a finding that the appeal from the contempt order was taken in good faith. Therefore, this court vacates the finding of contempt and the sanction.

¶ 2 The plaintiff, Stewart Title Guaranty Company (Stewart) filed a complaint for declaratory judgment seeking a declaration that it owed no duty to defend or indemnify the defendant, CVOF, LLC (Wachovia),¹ against mechanics lien claimants asserting priority of their liens over Wachovia's mortgage rights. The circuit court granted Wachovia's motion to compel, in part, and ordered Stewart to produce certain documents and its coverage attorney for deposition. The circuit court granted Stewart's motion for a contempt finding and imposed a \$1-per-day sanction.

¶ 3 Pursuant to Illinois Supreme Court Rule 304(b)(5) (eff. Feb. 26, 2010), Stewart appeals the contempt finding. This court granted Wachovia's motion to place this case on an accelerated docket. See Illinois Supreme Court Rule 311(b) (eff. Feb. 26, 2010).

¶ 4 On appeal, Stewart raises the following issues for review: (1) whether the circuit court erred when it granted Wachovia's motion to compel Stewart to produce documents and communications based on exceptions to the attorney-client and work product privileges; (2) whether the circuit court erred when it denied Stewart's motion to squash the production of the privileged documents and communications; and (3) whether the circuit court erred when it held Stewart in contempt for failing to comply with the court's discovery orders. A summary of the pertinent facts is set forth below.

¹ For clarity purposes, we will refer to "CVOF, LLC," as "Wachovia," as the parties have done.

¶ 5

I. FACTS

¶ 6 In 2005, H&S Hotel Property, LLC sought to purchase and renovate Hotel 71 (the property or project). In March 2005, it received a loan in the amount of \$100,785,289. The loan amount was secured by a first mortgage on the property. H&S executed a loan agreement and promissory note, which were subsequently assigned to Wachovia. Wachovia distributed \$64,000,000 from the loan proceeds to fund the purchase price. The remaining funds were placed in various escrow accounts controlled by Wachovia for the payment of various obligations, one of which was the renovation reserve account. On April 1, 2005, Stewart issued a title insurance policy. Pertinent to this case, the policy protected the priority of Wachovia's mortgage over statutory lien claims for work contracted for or commenced on the property prior to the date of the title policy.

¶ 7 Wachovia was responsible for the administration and distribution of the loan proceeds. Under the terms of the loan agreement, prior to distribution of any funds, Wachovia was required to obtain the following: executed lien waivers from contractors, subcontractors and suppliers; contractors' affidavits of payment of debts and claims; a title search and a letter from Stewart stating that there had been no change in the title adverse to the lender and that the search of the public records had revealed no recorded instrument negatively affecting the property; a report as to the anticipated cost to complete the project; and evidence that the renovation escrow account would be sufficient to complete the conversion work. Wachovia hired IVI Architects, Engineers & Construction Consultants (IVI) to manage and provide oversight for the project.

¶ 8 In February 2007, IVI certified a draw request of \$4,032, 318 for services and materials supplied for the project. Wachovia refused to fund the draw request. Thereafter, numerous

No. 1-11-2526

mechanic's lien claims were filed against the property. On July 17, 2007, Wachovia filed a foreclosure action against H&S, which then filed for bankruptcy. On January 14, 2008, the bankruptcy court approved Wachovia 's credit bid for the property, which consisted of \$100 million and another \$10,702,105 in cash payments to be escrowed to pay other obligations including \$6,852,479 in mechanics lien claims.

¶ 9 On February 14, 2008, Wachovia tendered a claim for loss under the title insurance policy to Stewart. The tender disclosed several mechanics lien claims. Eleanor Sharpe, a Stewart field customer representative, advised Wachovia that an investigation into the release of the lien claims was underway. However, as there had been no attempt to enforce the liens, no loss had occurred and that the liens recorded after the issuance of the policy were not covered.

¶ 10 In May 2008, Wachovia retained the law firm of Stein, Ray & Harris, LLP (Stein) to represent it in resolving the mechanics lien claims. Stein informed Stewart that the mechanics lien claimants were asserting a priority of their liens over Wachovia's interest in the property. Stewart then advised Stein that it was hiring the law firm of Dykema Gossett, LLC² (Dykema) to determine whether the lien claimants were challenging the priority of Wachovia's mortgage over the liens. On June 11, 2008, Stewart agreed to defend Wachovia in the bankruptcy and mechanics lien matters under a reservation of rights and retained Dykema to represent Wachovia. In her July 29, 2008, letter to Stein, Charity Makela, Stewart's regional claims counsel, advised that Stewart agreed to defend Wachovia against the mechanics lien claims in the pending bankruptcy action and, if the liens were valid and superior to the interest of Wachovia,

²Formerly Schwartz Cooper, Chartered.

No. 1-11-2526

Stewart would indemnify Wachovia pursuant to the terms of the policy. In response to Stein's assertion that the reservation of rights created a conflict of interest between Stewart and Wachovia, the parties agreed that Dykema would represent Wachovia in the H&S bankruptcy action and the mechanic's lien litigation, and Stein would transfer its relevant files to Dykema.

¶ 11 On October 9, 2008, Dykema recommended to Stewart that certain of the mechanics lien claims be settled. Subsequently, Stewart retained attorney Kevin Bruning to investigate and analyze the lien claims on behalf of Stewart. Throughout October, Dykema continued to seek authority from Stewart to settle these lien claims prior to the bankruptcy court's deadline for filing objections, since objecting to all the claims could result in increased attorney fees and costs. On October 23 and 27, 2008, Ms. Makela responded to Dykema's request to settle nine of the claims, stating that Stewart was not withholding authority to settle any of the claims and that there was no objection to commencing negotiations.

¶ 12 On October 27, 2008, Stewart filed the instant complaint for declaratory judgment. An amended complaint was filed on June 11, 2009. Stewart sought a declaration that it did not owe a duty to defend or indemnify Wachovia based on policy exclusions. Stewart also alleged that Wachovia concealed material facts from Stewart, and as a result of the concealment, Stewart was prevented from making a knowing and intentional waiver of its reservation of rights.

¶ 13 In its amended counterclaim, Wachovia sought a declaration that Stewart owed a duty to defend and indemnify it for damages it incurred as a result of lack of priority of its mortgage over the mechanic's lien claims. Wachovia alleged that under the Illinois estoppel and equitable doctrines, Stewart was estopped from raising policy defenses against it. Wachovia further

No. 1-11-2526

alleged that Stewart had breached the contract of insurance by failing to pay its defense costs and the losses resulting from the mechanics lien claims. Finally, Wachovia sought sanctions against Stewart under section 155 of the Illinois Insurance Code (215 ILCS 5/155 (West 2008)) based on Stewart's delay in responding to the tender of defense, its late reservation of rights, and its unreasonable delay, which prevented the settlement of the claims against Wachovia. Wachovia's motion for partial summary judgment on certain counts of its amended counterclaim were denied by the circuit court.

¶ 14 On February 18, 2011, Wachovia served attorney Bruning with a subpoena for deposition. *Inter alia*, Wachovia sought to depose attorney Bruning on the following topics: (1) Stewart's retention of Mr. Bruning as coverage counsel regarding Wachovia's claim; (2) Mr. Bruning's investigation for Stewart of Wachovia's claim; (3) Mr. Bruning's communications with Stewart about Wachovia's claim; (4) when Mr. Bruning began researching and drafting Stewart's Complaint for Declaratory Judgment; and (5) Mr. Bruning's investigation of the circumstances leading up to the filing of each mechanics lien pertaining to Wachovia's claim.

¶ 15 On March 7, 2008, Stewart filed a second privilege log, supplementing an earlier privilege log filed in 2009, and filed a motion to quash the subpoena, asserting attorney-client and work-product privileges. Wachovia filed a motion to compel attorney Bruning's deposition and the production of the documents on Stewart's privilege log, asserting that the documents were not privileged, and even if they were, Stewart waived the privilege by placing attorney Bruning's advice at issue or under the common interest doctrine.

¶ 16 After hearing argument on the motions and an *in camera* review of the documents, the

No. 1-11-2526

circuit court granted both the motion to compel in part and the motion to quash in part. The court found some of the documents were not privileged. In the case of the privileged documents, the at issue and the common interest exceptions to the attorney-client privilege applied. The court ordered Stewart to produce 106 documents and attorney Bruning for deposition. Stewart refused to produce the documents or attorney Bruning and requested that the court make a contempt finding so the issue could be appealed. In a separate order, the court granted Stewart's motion and imposed a \$1-per-day sanction but stayed the contempt finding and the imposition of the sanction pending appeal. The court also denied Wachovia's request for sanctions for Stewart's violation of discovery rules. This appeal followed.

¶ 17

II. ANALYSIS

¶ 18 In support of the issues it raises on appeal, Stewart contends that the documents the circuit court ordered it to produce are protected from discovery by the attorney-client and work-product privileges. Stewart further contends that because the contempt order was utilized in good faith to test the correctness of the discovery order, the contempt finding and monetary sanction should be vacated.

¶ 19

A. Standard of Review

¶ 20 While in general, contempt orders are reviewed for an abuse of discretion, a court lacks the discretion to compel disclosure of information. *Illinois Emcasco Insurance Co. v. Nationwide Mutual Insurance Co.*, 393 Ill. App. 3d 782, 785 (2009). Therefore, our review is *de novo*. See *Illinois Emcasco Insurance Co.*, 393 Ill. App. 3d at 785-86 (applicability of attorney-client privilege is reviewed *de novo*).

¶ 21

B. Discussion

¶ 22

1. *Attorney-Client Privilege*

¶ 23 Illinois Supreme Court Rule 201(b)(2) provides that privileged communications between a party and his attorney are protected against disclosure through any discovery procedure. See Ill. S. Ct. R. 202(b)(2) (eff. July 1, 2002). In *Waste Management, Inc. v. International Surplus Lines Insurance Co.*, 144 Ill. 2d 178 (1991), our supreme court addressed the purpose behind the attorney-client privilege and its limitations, stating as follows:

" The purpose of the attorney-client privilege is to encourage and promote full and frank consultation between a client and legal advisor by removing the fear of compelled disclosure of information.' [Citation.] However, the privilege is not without conditions, and we are mindful that it is the privilege, not the duty to disclose, that is the exception. [Citation.] Therefore, the privilege ought to be strictly confined within its narrowest possible limits. Further, the attorney-client privilege is limited solely to those communications which the claimant either expressly made confidential or which he could reasonably believe under the circumstances would be understood by the attorney as such. [Citations.] Finally, we note that in Illinois, we adhere to a strong policy of encouraging disclosure, with an eye toward ascertaining that truth which is essential to the proper disposition of a lawsuit. [Citation.]" *Waste Management, Inc.*, 144 Ill. 2d at 190.

¶ 24 Our courts have held that a party waives the attorney-client privilege where the attorney's advice is at issue. See *Fischel & Kahn, Ltd. v. Van Straaten Gallery, Inc.*, 189 Ill. 2d 579 (2000). The at issue exception permits discovery where the sought-after material is either the basis of the

No. 1-11-2526

lawsuit or the defense thereof. *Waste Management, Inc.*, 144 Ill. 2d at 199-200; see *Shapo v. Tires 'N Trucks, Inc.*, 336 Ill. App. 3d 387, 394 (2002) (the at issue exception applies to both the attorney-client privilege and the work-product privilege). The privilege may also be waived where the parties share a common interest in the material sought to be discovered. See *Waste Management, Inc.*, 144 Ill. 2d at 195.

¶ 25 a. At Issue

¶ 26 The leading authority in Illinois on the at issue exception is *Fischel & Kahn, Ltd.* In that case, the plaintiff-law firm provided legal advice to the defendant-art gallery on limiting its liability to consignment artists in case of damage or destruction of the artists' work. When fire destroyed the gallery, the defendant was sued for damages by many of the artists. The defendant hired the law firm of Pope & John to represent it in the fire-related litigation. When the plaintiff sued the defendant for attorney fees, the defendant counterclaimed alleging malpractice on the part of the plaintiff. In response to the malpractice counterclaim, the plaintiff raised several affirmative defenses relating to damages the client had incurred and sought production of Pope & John's files.

¶ 27 On review, the supreme court held that the defendant waived the privilege as to its communications with the plaintiff because the counterclaim placed the plaintiff's advice to it at issue. *Fischel & Kahn, Ltd.*, 189 Ill. 2d at 585. The court then determined that the defendant had not waived the privilege with respect to communications between it and Pope & John, stating as follows:

"To allow Fischel & Kahn to invade the attorney-client privilege with respect to

subsequently retained counsel in this case simply by filing the affirmative defenses it did would render the privilege illusory with respect to the communications between van Straaten and Pope & John. Thus, we believe that the allegations raised in Fischel & Kahn's affirmative defenses were insufficient to put the cause of van Straaten's damages at issue, resulting in waiver of the attorney-client privilege in this case.

* * *

That van Straaten's damages are subject to dispute by the parties does not mean that van Straaten has waived its attorney-client privilege regarding communications between it and Pope & John that might touch on that question. If raising the issue of damages in a legal malpractice action automatically resulted in the waiver of the attorney-client privilege with respect to subsequently retained counsel, then the privilege would be unjustifiably curtailed. [Citation.]" *Fischel & Kahn, Ltd.*, 189 Ill. 2d at 586-87.

¶ 28 Stewart argues that in seeking a declaratory judgment, it did not place attorney Bruning's advice at issue. We disagree.

¶ 29 Stewart alleged that it did not discover until October 2008, Wachovia's concealment of material facts relevant to the mechanics lien claims. Wachovia's concealment caused Stewart to waive its reservation of rights, the preservation of which was necessary in order for Stewart to raise policy defenses. What Wachovia sought to discover was what Stewart learned from attorney Bruning on the issue of concealment that prompted Stewart to bring a declaratory judgment complaint at this late date in the proceedings. That information would impact the validity of Stewart's reassertion of its reservation of rights and whether its declaratory judgment

No. 1-11-2526

action could be considered timely. Otherwise, Stewart would be barred from raising policy defenses, the purpose of filing a declaratory judgment action or defending under a reservation of rights in insurance cases.

¶ 30 Stewart contends that the circuit court's order requiring it to produce attorney Bruning for deposition is contrary to the long-standing rule that counsel of record should not be deposed. See *Kilpatrick v. First Church of the Nazarene*, 182 Ill. App. 3d 461 (1989). However, in *Kilpatrick*, the reviewing court found that the information sought from the attorney was privileged and not discoverable. Moreover, the court found that requiring the attorney in that case to be deposed was a tactic by the opposing attorney and constituted harassment. *Kilpatrick*, 182 Ill. App. 3d at 468-69. In the present case, the information sought from attorney Bruning was discoverable due to the waiver of the privilege, and we find no evidence that requiring his deposition was merely for harassment purposes. Finally, Stewart's complaint that the circuit court's order prohibiting Wachovia from inquiring about attorney Bruning's "pure work product," created more problems than it solves, can be addressed by the circuit court if and when such "problems" arise.

¶ 31 We conclude that by alleging in its complaint for declaratory judgment that Wachovia concealed material facts resulting in Stewart's waiver of its reservation of rights, Stewart placed its communications with attorney Bruning and his advice at issue. The circuit court's determination, that the at issue exception applied and therefore, Stewart had waived the attorney-client privilege, was correct.

¶ 32 b. Common Interest Exception

¶ 33 As we have determined that Stewart waived the attorney-client privilege, we need not

address the common interest exception.

2. *Work-Product Privilege*

¶ 34 Rule 201(b)(2) provides that "[m]aterial prepared by or for a party in preparation for trial is subject to discovery only if it does not contain or disclose the theories, mental impressions, or litigation plans of the party's attorney." Ill. S. St. R. 201(b)(2) (eff. July 1, 2002). Since the overriding considerations in discovery are to ascertain the truth and expedite the resolution of the lawsuit, "ordinary work product, which is any relevant matter generated in preparation for trial which does not disclose 'conceptual data' [citation] is freely discoverable." *Waste Management, Inc.*, 144 Ill. 2d at 196.

¶ 35 Stewart contends that the documents it was ordered to produce are work product and therefore protected from discovery by Wachovia. It correctly notes that the work-product doctrine provides a broader protection than the attorney-client privilege. *Shapo*, 336 Ill. App. 3d at 394. However, in Illinois, the work-product privilege, like the attorney-client privilege, may be waived as to a communication put at issue by the party holding the privilege. *Shapo*, 336 Ill. App. 3d at 394; see *Waste Management, Inc.*, 144 Ill. 2d at 199-200. By alleging Wachovia's concealment of material facts, Stewart placed its communications with and the advice from attorney Bruning at issue and waived the work-product privilege.

¶ 36 We note, that these privileges are available to bar disclosure of any communication or materials generated in preparation for the present declaratory judgment action. *Waste Management, Inc.*, 144 Ill. 2d at 201. However, the production of such materials or communications are not at issue in this case.

¶ 37

3. *Contempt Order*

¶ 38 Stewart requests that this court vacate the order of contempt and the monetary sanction. To facilitate the interlocutory appeal of a circuit court discovery order, a party may move the court for the entry of a contempt order. *Tomczak v. Ingalls Memorial Hospital*, 359 Ill. App. 3d 448, 457 (2005). Where a party appealed a contempt order in good faith and without contempt for the court's authority, this court vacated the order even though the underlying discovery order was determined to be proper. *Tomczak*, 359 Ill. App. 3d at 457. Wachovia contends that the taking of the appeal in this case was not taken in good faith but as a delaying tactic. However, the record supports Stewart's position that this appeal was taken in good faith and was by no means contemptuous of the circuit court's authority.

¶ 39 Finally, Wachovia contends that the circuit court erred when it denied in part its motion to compel and granted in part Stewart's motion to quash the production request and subpoena for attorney Bruning. Wachovia also argues that the monetary sanction of \$1-per-day was insufficient to assure compliance with the production order. Wachovia requests that, upon remand, we direct the circuit court to (1) order Stewart to produce all work product created either before or after October 27, 2008, (2) order that neither Stewart nor attorney Bruning be permitted to object to the topics identified on the court's August 18, 2011, order or on the basis of opinion work-product privilege, and (3) bar Stewart from raising a defense to Wachovia's affirmative defense of waiver.

¶ 40 Wachovia seeks review of the circuit court's discovery orders. Discovery orders are not appealable under Rule 301, and they are not directly appealable under Rule 304. *Lewis v.*

No. 1-11-2526

Family Planning Management, Inc., 306 Ill. App. 3d 918, 921 (1999); Ill. S. Ct. R. 301 (eff. Feb. 1, 1994); Ill. S. Ct. R. 304 (eff. Feb. 26, 2010). We are limited to reviewing the underlying discovery orders to determine whether the finding of contempt was proper. Such review does not serve to transform typical interlocutory discovery orders into final orders appealable under Rule 304(b)(5). See *Lewis*, 306 Ill. App. 3d at 924.

¶ 41 As to Wachovia's requested increase in the penalty for contempt, barring a party from raising a defense as a sanction is more akin to a sanction for violation of a discovery order rather than an appropriate punishment for contempt. See *People ex rel. General Motors Corp. v. Bua*, 37 Ill. 2d 180, 189 (1970) (although the order was cast in terms of a contempt proceeding, the appeal was dismissed since the striking of pleadings was not appropriate punishment for contempt). Since they are discovery orders, we lack jurisdiction to review the circuit court's rulings on the motion to compel, the motion to quash or on Wachovia's request to impose a harsher sanction for contempt.

¶ 42 The circuit court's August 18, 2011, order holding Stewart in contempt and imposing the \$1-per-day fine is vacated.

¶ 43 **III. CONCLUSION**

¶ 44 We conclude that Stewart waived the attorney-client and work-product privileges by placing attorney Bruning's advice at issue pursuant to the allegations of its declaratory judgment complaint. We therefore affirm the circuit court's orders granting in part and denying in part Stewart's motion to quash and Wachovia's motion to compel and ordering Stewart to produce the documents identified in the order and to produce attorney Bruning for deposition. We vacate the

No. 1-11-2526

August 18, 2011, order holding Stewart in contempt and imposing the \$1-per-day sanction.

¶ 45 Affirmed in part and vacated in part.