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The New Importance of Interpleader Actions

By Ronald W. Collett

There was a time when interpleader actions were used only to relieve a stake-holder of the risk of paying one claim against a fund to the detriment of another claimant also having an interest in the same fund. Should the stake-holder pay the first claimant, later learning of another claimant with a greater interest, the stake-holder was out of pocket in the amount of the mistaken payment.

Insurance carriers have often been the stake-holders facing multiple claims against a finite fund - the applicable policy limits. As is often the case, there may be three or more persons sustaining injuries in an accident, whether a motor vehicle accident, a structural failure, or some other catastrophic event. Not all the injured claimants will recover from injuries at the same time or decide to hire attorneys at the same time (if at all). And, more often than not it seems there is always one claimant demanding payment of the policy limits even before the extent of other claims has been determined. How long can the initial claim be put on hold pending an evaluation of the other claims? What if it is obvious from the outset that the value of all claims, to one degree or another, will exceed the policy limits? How does the insurer give equal consideration to the interests of its insured if the payment

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RES JUDICATA: When Does it Preclude a Public Employee From Suing a Public Employer?

By Michele Molinario

In certain cases, a public employee may be entitled to assert his/her due process rights and challenge a public employer's decision to terminate his/her employment. When this occurs, a termination appeal [administrative] hearing is held. Following the hearing, the employee may file a lawsuit against the public employer on various grounds ranging from wrongful termination to violation of constitutional rights. Public employers should be aware that the termination appeal hearing is an important proceeding and should be approached strategically with future civil litigation in mind. Consider the following scenario:

> A police officer was employed by the City of Anywhere. The police officer was terminated after an internal investigation revealed that she posted scandalous photographs of herself on her personal Facebook page. The police officer was wearing her department-issued departmental equipment in the photographs. During the termination appeal hearing, the police officer

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In This Issue

To Protect or Not to Protect? The Benefits of Using Defense Counsel to Assist With Initial Company Investigations

By Matthew S. McLaughlin

Imagine an incident occurring on company property that requires an immediate investigation to determine whether the company is potentially liable. This type of situation happens all the time. For example, two patrons get into a fight in a bar and one is seriously injured. Although it is likely just a fight between two highly intoxicated individuals, by the time the case gets into an attorney's hands, the patron who was seriously injured now alleges he was viciously attacked while the bar employees sat back, watched and did nothing. Sound familiar?

To discover what actually happened, the company will need to conduct an investigation, which would include taking statements from the employees who were witnesses to the incident. How the company proceeds with the investigation could mean the difference between protecting the information gathered and helping the other side build a case. Without proper safeguards, the statements taken from the employees could potentially be discoverable in a subsequent lawsuit.

Early statements from employees are critical to an investigation because the information gathered will allow the company to make early decisions regarding how to proceed with a potential defense. Facts witnessed by employees will certainly be discoverable in a subsequent lawsuit, and the employees will surely be deposed. It is important, however, to protect the statements given by the employees to the company during the investigation because the company may ask questions and gather information not considered by opposing counsel. It would be a shame to conduct a great investigation and then have to "gift wrap" and give it to an opposing attorney who is not as diligent or prepared. For this reason, the company needs to be very careful at this early stage of the investigation, and retaining an attorney to take the employees' statements is a proper and necessary safeguard.

Under Arizona law, statements made by employees during a company investigation are potentially protected under either the attorney-client privilege or work product privilege, or both. This may seem simple enough at first, but whether statements are protected or must eventually be produced depends on which privilege applies. As discussed below, the safest way to proceed with a company investigation is to ensure that the statements are protected by the attorney-client privilege.

A. Attorney/Client Privilege

A.R.S. § 12-2234 states:

> **(A)** In a civil action an attorney shall not, without the consent of his client, be examined as to any communication made by the client to him, or his advice given thereon in the course of professional employment. An attorney's paralegal, assistant, secretary, stenographer or clerk shall not, without the consent of his employer, be examined concerning any fact the knowledge of which was acquired in such capacity.
>
> **(B)** For purposes of subsection (A), any communication is privileged between an attorney for a corporation, governmental entity, partnership, business, association or other similar entity or an employer and any employee, agent or member of the entity or employer regarding acts or omissions of or information obtained from the employee, agent or member if the communication is either:
>
> 1. For the purpose of providing legal advice to the entity or employer or to the employee, agent or member.
>
> 2. For the purpose of obtaining information in order to provide legal advice to the entity or employer or to the employee, agent or member. Ariz. Rev. Stat. Ann. § 12-2234.

Under a literal reading of this statute, statements of employees to counsel retained by the company would seem to be protected if taken for the purpose of providing legal advice to the company (ie: regarding the company's potential liability). It seems clear that any employee statements taken by counsel investigating the incident should be protected as attorney-client communication because the statements were taken both for the purpose of providing legal advice to the company and to obtain the information necessary to provide such advice.

Although Arizona caselaw makes sorting through this issue a little more confusing, it still supports upholding the attorney-client privilege in this situation. Under *Samaritan Found. v. Goodfarb*, 176 Ariz. 497, 507, 862 P.2d 870, 880 (1993), a factual communication by a corporate employee to corporate counsel is within the corporation's privilege only if it concerns the employee's own conduct within the scope of his or her employment, and if it is made to assist the lawyer in assessing or responding to the legal consequences of that conduct for the corporate client. This standard excludes from the privilege any communications from those who, but for their status as officers, agents or employees, are witnesses.

Samaritan appears to limit privileged communications to statements taken by counsel relating to acts committed by any employee that could give rise to the liability of the corporation. *Samaritan* specifically holds that statements from employees who are merely witnesses to an act are not protected just because they are employees.

This could potentially mean that statements from an employee who is merely a bystander or who witnesses the acts of another employee would not be protected. According to the *Arizona Rules Civil Handbook*, however, a subsequent legislative amendment to A.R.S. § 12-2234 makes all communications between corporate counsel and a corporate officer, employee or agent privileged if they were: (1) for the purpose of providing legal advice to either the corporation or to the employee, or (2) for the purpose of obtaining information in order to provide such legal advice.

This legislative amendment is further discussed in *Roman Catholic Diocese of Phoenix v. Superior Court ex rel. County of Maricopa*, 204 Ariz. 225, 228, 62 P.3d 970, 973 (App. 2003). The Court states that in response to *Samaritan*, the Arizona Legislature amended the civil attorney-client privilege statute to broaden the privilege for corporations in civil cases. Under the 1994 amendment, *any* communications between an attorney and an employee or agent of the corporation, made for the purpose of providing legal advice or obtaining information to provide legal advice are protected. *Id*.

In the scenario discussed above involving the bar patron fight, the employees' statements can likely be taken under the protection of the attorney-client privilege, based on § 12-2234 and *Roman Catholic Diocese*. Furthermore, any worker who was present that night potentially committed an act that could give rise to corporate liability, so even under *Samaritan*, the statements of the employees present that night should be protected.

Speaking Engagements

Lori Voepel, JS&H appellate counsel, will present "Year in Review: 2010 Key Appellate Civil Decisions" at the March 2011 luncheon seminar hosted by the Arizona Association of Defense Counsel (AADC). Lori will be joined by **Jaleh Najafi**, also with JS&H's appellate department.

Ed Hochuli will moderate "The Five Minute Drill" at the Council on Litigation Management's (CLM) Annual Conference on March 23, 2011 in New Orleans. **Ed** also presented "Negotiating With the Big Boys - Techniques For Successful Negotiations" at the 2011 National Retail and Restaurant Defense Association's (NRRDA) Annual Seminar on February 25, 2011 in Orlando and "The Average Joe Principle - Don't Settle for Being Average" to Walgreens on January 25, 2011 in Chicago.

Don Myles presented "Trying the Coverage Case to a Jury: A Mock Trial Experience" at the 2011 American Bar Association Tort Trial & Insurance Practice Section's (ABA TIPS) Annual Insurance Coverage Litigation Committee Meeting on February 24, 2011 in Phoenix. **Don** also presented "How Bad Faith is Being Set Up Today" at the DRI Insurance Coverage and Practice Symposium on November 18, 2010 in New York.

B. Work Product

To be protected under the work product privilege, the information gathered must have been prepared "in anticipation of litigation." In Arizona, no single test is imposed to determine whether material was prepared in anticipation of litigation, and thus protected from discovery. Rather, courts consider various factors including: (1) the nature of the event that prompted preparation of materials; (2) whether the requested materials contain legal analyses and opinions or purely

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Whistle While You Work: Distinctions Among Public Employees Under the Whistleblower Statute

By Barry H. Uhrman

As a general principle of employment law, a "whistleblower" is an employee who exposes alleged wrongdoing on the part of his employer and is subsequently discharged. There are various statutory protections for employees in Arizona who engage in "whistleblowing," that is, making a disclosure evidencing illegal or improper activities. Examining these various laws reveals an important question - are officers and employees of municipalities permitted to assert whistleblowing claims against their employers?

Arizona Employment Protection Act

Enacted in 1996, the Arizona Employment Protection Act ("AEPA")[1] abolished common law wrongful discharge claims, codifying most of them as statutory discrimination claims with exclusive non-tort remedies. Tort claims are cognizable under the AEPA in limited instances where an employer's conduct was retaliatory or in violation of a statute that otherwise provides no statutory remedy to the terminated employee.

The AEPA prohibits the termination of public and private sector employees in retaliation for exercising their legal rights to notify a public body or political subdivision about a violation of Arizona law. It is not necessary for an employee to prove that a violation actually happened, only that the employee expressed that a violation of Arizona law could or did occur.

For an employee to succeed in a wrongful termination lawsuit against his employer, the whistleblowing activity must further an important public policy interest embodied in the law, not merely the employee's own personal interests. For purposes of whistleblowing claims, "public policy" must strike at the heart of the citizen's social rights, duties and responsibilities.

Additional Statutory Provisions for Public Employees in Arizona

Public employees in Arizona are not only protected by the AEPA, but are also covered by a separate whistleblower statute. Enacted by the legislature in 1985, Arizona's Whistleblower Statute[2] prohibits retaliation against a public employee who reasonably believes and discloses to a public body a violation of any law or mismanagement, a gross waste of monies or an abuse of authority.[3]

The Whistleblower Statute is very precise in its requirements. The disclosure has to be made in writing and must contain the following information: 1) the date of the disclosure; 2) the name of the employee making the disclosure; 3) the nature of the alleged violation of law, mismanagement, gross waste of monies or abuse of authority; and 4) if possible, the date or range of dates on which the alleged violation of law, mismanagement, gross waste of monies or abuse of authority occurred.[4]

Definition of "Employee" Under Arizona's Whistleblower Statute

Are all public employees in Arizona covered by the Whistleblower Statute? The statute defines the term "employee" as follows:

> "Employee" means an officer or employee of this state or any of its departments, commissions, agencies or boards. Employee includes employees and officers of community college districts, school districts and counties of this state *but does not include officers or employees of a municipal corporation established for the purpose of reclamation and distribution of water and the generation of electricity*.[5]

While the statutory definition of an "employee" explicitly includes state and county employees and employees of community college districts and school districts, does the statute *actually* include *all* municipal employees within this definition? Had the legislature intended to exempt employees of *all* municipal corporations from protection under Arizona's Whistleblower Statute, it could have done so by simply stating "municipal corporation." Why would the legislature add such an incommodious clause to the meaning of "employee?"

Following the enactment of the Whistleblower Statute, these questions remained. Are officers and employees of municipalities permitted to assert whistleblowing claims against their employers? Did the Arizona Legislature intend to protect employees of municipal corporations that were *not* established for the purpose of reclamation and distribution of water and the generation of electricity?

Clarifying Legislative Intent - *Wagner v. City of Globe*

Relevant Arizona case law supports the conclusion that Arizona's Whistleblower Statute does not include municipal employees, irrespective of whether the municipalities were established for the purpose of reclamation and distribution of water and the generation of electricity. In *Wagner v. City of Globe*,[6] a City of Globe police officer brought a common law wrongful termination tort claim against the City. The officer alleged that he was fired in retaliation for exposing the fact that a prisoner was being detained beyond his sentence expiration date. In evaluating the officer's claim, the Arizona Supreme Court recognized his conduct was best characterized as whistleblowing behavior, as he took affirmative steps to investigate and rectify the illegal detention and called it to the attention of the police chief and city magistrate. This whistleblowing activity fit within the common law wrongful termination "against public policy" exception to the at-will employment rule.[7]

To bolster its conclusion that the officer's termination violated the public policy of Arizona, the Arizona Supreme Court cited the Whistleblower Statute as an example of public policy generally endeavoring to protect whistleblowers:

> Indeed, our legislature has recognized that whistleblowing activity is worthy of protection. In 1985, the legislature enacted A.R.S. § 38-532, which protects *state and county employees* from retaliation for their whistleblowing activity. While A.R.S. § 38-532 is not applicable to this case, it evinces a legislative expression of public policy fully consonant with our decision.[8]

While citing A.R.S. §38-532 with approval as generally reflecting a public policy of protecting whistleblowers, the court also recognized that the statute only applies to state and county employees. Nevertheless, it held that the officer's whistleblowing activity was in furtherance of public policy and that he therefore stated a valid claim for wrongful termination.[9]

The Arizona Court of Appeals Weighs In

For over twenty years, neither the Arizona Supreme Court nor the Arizona Court of Appeals issued an opinion clarifying whether the definition of "employee" in the Whistleblower Statute applies to any or all municipal employees. In 2008, however, the Court of Appeals issued a memorandum decision examining the scope of this statutory definition.

In *Sasser v. City of Phoenix*,[10] a city employee sued the City of Phoenix under the Whistleblower Statute, claiming he was fired for exposing improprieties of Phoenix Police Department polygraph examiners. The trial court granted summary judgment on this claim, concluding that the statute did not apply to municipal employees. The Arizona Court of Appeals affirmed the dismissal, stating in pertinent part:

> *On its face, § 38-531(1) does not include municipal employees*. Because it was uncontroverted that Sasser was employed by the City, the superior court correctly concluded Sasser was not authorized to bring a § 38-532 claim against the City. Accordingly, the superior court correctly granted summary judgment in favor of the City on the retaliation claim.[11]

The Arizona Court of Appeals concluded that, as a City of Phoenix employee, he was not an eligible "employee" to bring a whistleblowing claim under Arizona's Whistleblower Statute.[12] Unfortunately, this was a memorandum decision, without precedential value.

The United States District Court Reaches the Same Conclusion - Municipal Employees Are Not Covered by Arizona's Whistleblower Statute

Recently, the United States District Court (Arizona) addressed the same issue and reached the same conclusion. Jan Smith-Florez, a retired Court of Appeals judge, was terminated from her position of City Attorney for the City of Nogales in 2008. She filed a lawsuit against the City of Nogales, City Council members, and City officials, asserting, among other claims, that she was terminated in violation of Arizona's Whistleblower Statute and the AEPA for reporting a violation of Arizona's Open Meeting Laws.

In granting the City's Motion for Judgment on the Pleadings[13] on May 18, 2010, the Honorable Frank R. Zapata concluded that Arizona's Whistleblower Statute specifically excludes officers or employees of a municipality. Judge Zapata rejected the argument that municipal corporations falling outside the statute's narrow "purpose" (of reclamation and distribution of water and the generation of electricity) were meant to be covered by the statute. Rather, he emphasized that the statute only expressly included state and county employees and employees of community college districts and school districts within its definition of protected employees; it

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Court of Appeals Upholds Insurer's Denial of Tavern's Claim Under Assault and Battery Exclusion

By Michael E. Hensley

JSH litigation attorney Michael Hensley and appellate attorney Nicholas Acedo obtained an Arizona Court of Appeals victory for their insurance company client in a case involving breach of contract and bad faith claims. The case involved the carrier's denial of coverage under the policy's assault and battery exclusion for claims of personal injuries arising from an assault committed by a bar patron upon other bar patrons. In *Tucker/Bohren v. Scottsdale Indemnity Company*, the Court rejected the argument that: (1) the assault and battery exclusion was ambiguous, and (2) the insured had a "reasonable expectation" of coverage despite the unambiguous language in the assault and battery exclusion.

The lawsuit arose out of an incident at a bar where one of the patrons assaulted the Plaintiffs, causing severe personal injuries. Plaintiffs sued the bar, alleging that bar employees served the patron alcohol while he was intoxicated, then allowed him to stay on the premises while intoxicated. The bar submitted the lawsuit to Scottsdale Indemnity, which denied a defense and coverage for both Plaintiffs' claims based upon the assault and battery exclusion contained in the bar's policy. The bar entered a *Damron/Morris* agreement with the Plaintiffs, assigning its rights against Scottsdale Indemnity for an agreement not to execute on a default judgment against the bar. Plaintiffs subsequently sued Scottsdale Indemnity for breach of contract and bad faith.

The trial court entered summary judgment for Scottsdale Indemnity. It found that the bad faith claim was barred by the statute of limitations, and further, that Scottsdale Indemnity did not breach the contract of insurance where there was no coverage due to the assault and battery exclusion. On appeal, the Arizona Court of Appeals upheld the trial court's entry of summary judgment. The Court's written decision discusses Arizona law on the issue of ambiguous policy language and the reasonable expectation of coverage doctrine, which provides good practice pointers for insurance companies to use when evaluating claims under assault and battery exclusions.[1]

The Court explained that the language of an insurance policy is ambiguous if it is subject to "conflicting reasonable interpretations." Here, the Court found the assault and battery exclusion was not ambiguous and that it limited coverage under the entire policy, including the liquor liability coverage. The Court also held that no ambiguity was created by the fact that the insured was "unaware of the exclusion" and "still did not understand the exclusion" after reading it. This is a key part of the holding, as insureds often claim they have never read or do not understand the policy language.

Addressing the assault and battery exclusion specifically, the Court rejected the insured's arguments that the assault and battery exclusion did not exclude claims for: (1) failure to institute and enforce policies for removing intoxicated patrons; (2) selling alcohol to intoxicated persons; and (3) allowing a disorderly person to remain on the premises. Noting that all of the claimed injuries resulted from the assault and battery, the Court reasoned that the language of the exclusion specifically excluded coverage "for all injuries" resulting from an assault and battery, as well as from selling, serving and furnishing of alcohol that resulted in assault and battery.

The Court also rejected the assertion that the insured had a "reasonable expectation" of coverage for the injuries caused by assault and battery despite the unambiguous language of the assault and battery exclusion. First, the Court explained that under the "reasonable expectation doctrine," an insured may be relieved of unambiguous terms of a policy **if the insurer had "reason to believe" the insured would not have agreed to the policy if it knew the policy contained a particular term**. The Court then outlined several considerations for determining whether the insurer had a "reasonable belief" that the insured would not have agreed to the policy. These include: (1) the parties' prior negotiations; (2) the circumstances of the transaction; (3) whether the term is "bizarre or oppressive;" (4) whether the term eviscerates the non-standard terms; and (5) if the term dominates the purpose of the transaction. The Court also stated that the reasonable expectation doctrine only applies in very "limited circumstances" and "requires more than the insured's fervent hope" that coverage exists. These

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[1] For a copy of the memorandum decision, contact Mike Hensley or Nick Acedo at JSH.

Appellate Highlights

Lear v. Fields
AZ Court of Appeals (Div. 2)
A.R.S. § 12-2203, which incorporates the Daubert factors for determining the admissibility of expert testimony in Arizona, is unconstitutional because it usurps the Supreme Court's rulemaking authority by repealing a rule of evidence, and therefore violates the separation of powers.

DeSela v. Prescott Unified School Dist.
AZ Supreme Court
Notwithstanding Arizona's prohibition on assignment of personal injury claims, a parent may assign to a minor the right to recover her own medical expenses and thereby toll the statute of limitations for filing suit, so long as the assignment occurs within the one year limitations period.

Morris v. Giovan
AZ Court of Appeals
28 U.S.C. § 1367(d) does not toll the statute of limitations for supplemental state law claims where the federal court dismisses the action for lack of subject matter jurisdiction.

Lee v. State
AZ Court of Appeals
Any genuine issues of material fact involving compliance with Arizona's notice of claim statute must be decided by a jury, but the trial court should bifurcate discovery and trials rather than delaying the notice of claim issues until trial on the merits.

Thompson v. Pima County
AZ Court of Appeals
In Arizona's notice of claim statute, "facts sufficient" refers to the quantum of facts the plaintiff must include in the notice, whereas "accrual" refers to when the plaintiff first becomes aware of his or her cause of action against the defendant.

The Planning Group of Scottsdale v. Lake Mathews Mineral Properties, Ltd
AZ Supreme Court
A state court may exercise personal jurisdiction over a non-resident defendant who possesses purposeful, minimum contacts with the forum state, so long as the exercise of personal jurisdiction over the defendant is otherwise reasonable.

Leflet v. Redwood Fire and Casualty Insurance Company
AZ Court of Appeals
An insured and an insurer may not join in a *Morris* agreement that avoids the primary insurer's obligation to pay policy limits and passes liability in excess of those limits onto other insurers.

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of the first claim may leave insufficient policy limits available to pay the second, third and fourth claims?

Prior to *McReynolds v. American Commerce Insurance Company*, 568 Ariz. Adv. Rep. 15, 235 P.3d 278 (App. 2010), the insurer's dilemma of how to treat multiple claims with values in excess of the policy limits had no easy or clear-cut answer. The wrong decision could easily lead to a bad faith action in which the policy limits could suddenly become infinite. Since *McReynolds*, there is at least one solution for the problem of what to do when the value of multiple claims exceeds the policy limits.

In *McReynolds*, the plaintiff sustained severe injuries in a motor vehicle accident with American Commerce Insurance Company (ACIC)'s insured (Raineri). The policy limits of the ACIC policy were 25/50. Plaintiff McReynolds, who had been treated for injuries sustained in the accident, faced a healthcare lien in excess of $43,000. When Plaintiff's attorney demanded payment of the policy limits, ACIC tendered payment to Plaintiff and the healthcare lien holder. Plaintiff rejected this payment, claiming co-payment to the lien holder was a material change from the settlement offer.

Plaintiff subsequently filed an offer of judgment for the $25,000 policy limits. Upon advice of counsel, ACIC filed an interpleader action naming as defendants McReynolds, the healthcare provider and the Arizona Healthcare Cost Containment System (AHCCCS). The interpleader action was dismissed when the healthcare provider released its lien and AHCCCS defaulted. Nonetheless, Plaintiff McReynolds' lawsuit against ACIC's insured Raineri went to trial with Plaintiff obtaining a judgment against Raineri for $469,110.17. Raineri then assigned bad faith rights to Plaintiff McReynolds in exchange for a covenant not to execute.

McReynolds then filed a Complaint against ACIC alleging it had acted in bad faith and violated its duty of good faith and fair dealing by failing to give equal consideration to Raineri's interests. McReynolds claimed that ACIC failed to properly mange the policy limits by paying nothing, which left the insured exposed to both the personal injury claim and the healthcare lien. The Court found that the case was indeed about failure to properly manage the policy limits, but it held that by continuing to provide a defense to Raineri after the timely filing of the interpleader action, ACIC fulfilled its duty to give equal consideration to its insured.

Announcements

JS&H is pleased to announce that **Matthew McClellan** and **Steven Serbalik** have joined the firm as associates.

Georgia Staton has been appointed a lawyer representative to the Ninth Circuit Judicial Conference.

Bill Schrank was elected to the Board of Directors for the Trucking Industry Defense Association (TIDA).

David Cohen was reappointed to the Arizona Health Care Association's (AHCA) Public Policy Committee.

Mark Zukowski was accepted to the American Arbitration Association's (AAA) Roster of Mediators.

Eileen GilBride, **David Cohen, Michael Ludwig** and **Michael Hensley** were each named one of *Arizona's Finest Lawyers* (AFL).

Although *McReynolds* involved a single claimant, the healthcare lien was a competing claim against the single limit. Accordingly, the Court's reasoning also applies to multiple claimants competing against insufficient policy limits. When one of several claimants demands payment of the policy limits, files suit and declines to consider the injuries and claims of others to the limits, an interpleader action will protect the insurer from bad faith claims if the recalcitrant claimant proceeds to trial and obtains a judgment against the insured for an amount in excess of the applicable limits.

The caveat is that the insurer must act timely. This means that when an insurer becomes aware there are insufficient limits to satisfy all claims, and demands and lawsuits are filed by less than all potential claimants, the interpleader action must be filed promptly, absent some agreement with claimants who have filed suit to await all potential claims. The insurer must also keep its insured informed as to developments and should request the insured's input as to payment of less than all claims. ◆

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raised several constitutional defenses, such as violations of her rights under the First Amendment and Equal Protection Clause.

The City of Anywhere considered whether it should try to preclude the police officer's constitutional defenses and argue they were outside the scope of the administrative proceeding. The City of Anywhere decided to address the police officer's defenses and fully litigated these claims. Ultimately, the police officer lost and her termination was upheld by the hearing officer.

The officer did not appeal the final decision of the administrative law hearing officer to the Superior Court and later sued the City of Anywhere in federal court. The federal lawsuit consisted of Equal Protection and First Amendment claims - all of which were raised in the administrative hearing.

How should the public employer approach this lawsuit?

At the administrative hearing, the City of Anywhere had two choices: (1) litigate the police officer's First Amendment and Equal Protection claims, or (2) move to preclude such evidence. Because the City of Anywhere defended the claims, it should analyze whether a Motion to Dismiss the federal lawsuit is proper under the doctrine of *res judicata*.

What is *Res Judicata*?

Under the doctrine of *res judicata*, a judgment on the merits in a prior suit involving the same parties or their privies bars a second suit based on the same causes of action. *Lawlor v. National Screen Service Corp.*, 349 U.S. 322, 326 (1955). *Res judicata* binds a party standing in the same capacity in subsequent litigation not only to facts that were actually litigated in the prior suit, but also on those points that might have been litigated. *Allen v. McCurry*, 449 U.S. 90, 94 (1980); *see also Dommisse v. Napolitano*, 474 F.Supp.2d 1121, 1128 (D. Ariz. 2007). Thus, to the extent the lawsuit attempts to retry the issues and facts that were or could have been raised in the administrative proceeding, it is arguably barred by *res judicata*.

Does the Doctrine of *Res Judicata* Apply to Administrative Proceedings?

Yes. For purposes of *res judicata*, an administrative decision is a "final judgment" entitled to preclusive effect. *Olson v. Morris*, 188 F.3d 1083, 1086 (9th Cir. 1999).

Does *Res Judicata* Preclude a Subsequent Civil Suit?

In the scenario above, the parties in the subsequent civil suit are the same as those who were involved in the administrative proceeding. And, the police officer's lawsuit is based on the same alleged violations of her rights under the First Amendment and Equal Protection Clause (i.e. termination for posting scandalous Facebook photographs). *Res judicata* applies because the facts underlying most of the police officer's federal claims are virtually identical to those she litigated in the termination appeal proceedings. Also, because the constitutional defenses were fully litigated and the hearing officer's decision was final, the City of Anywhere may properly move to dismiss the federal lawsuit.

Practical Tips for the Public Employer:

- Take the administrative hearing seriously. Although administrative hearings are typically informal proceedings, they should not be treated lightly. It could save you time and money litigating any civil suit in the future.
- Make a record. Suggest to the hearing officer that the parties prepare written position statements. And, consider using a court reporter. A record is imperative to demonstrate that the facts underlying the subsequent civil suit were already litigated.
- Let go of your inclination to fight everything. Carefully consider the potential consequences of moving to exclude evidence or testimony at the administrative hearing. While a motion to exclude evidence might sound good at the time, consider whether it may defeat a *res judicata* argument in the future. ◆

COMPANY INVESTIGATIONS continued from Page 3

factual contents; (3) whether the material was requested or prepared by a party or its representative; (4) whether the materials were routinely prepared; and (5) when the materials were prepared. Ariz.R.Civ.P. 26(b)(1); *Brown v. Superior Court In & For Maricopa County*, 137 Ariz. 327, 670 P.2d 725 (1983).

Applying the above factors to the bar fight incident supports protecting as work product the statements of the employees obtained by the company after the incident. First, the nature of the event giving rise to the preparation of the materials (one patron injuring another in the bar) is something that is likely to result in a lawsuit against company. Second, although the statements will likely just contain factual information from the employees, they will be taken in anticipation of potential litigation and for the purpose of making a liability determination. Third, the statements will be taken by the company (party) or its representative. And finally, statements taken during an investigation in response to an alleged assault in the bar are not "routinely" prepared, and will be taken after litigation is anticipated.

Thus, all of the factors outlined in *Brown* support the statements falling under the work product privilege. That being said, even if the statements are considered work product, there are exceptions to the privilege that can make the work product discoverable.

Rule 26(b), Arizona Rules of Civil Procedure states:

> (3) *Trial preparation: Materials.* Subject to the provisions of subdivision (b)(4) of this rule, a party may obtain discovery of documents and tangible things otherwise discoverable under subdivision (b)(1) of this rule and prepared in anticipation of litigation or for trial by or for another party or by or for that other party's representative (including the other party's attorney, consultant, surety, indemnitor, insurer or agent) only upon a showing that the party seeking discovery has substantial need of the materials in the preparation of the party's case and that the party is unable without undue hardship to obtain the substantial equivalent of the materials by other means. In ordering discovery of such materials when the required showing has been made, the court shall protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation.

Ariz. R. Civ. P. 26(b).

Under this rule, work product shall be discoverable only upon a showing of substantial need, coupled with an inability to obtain the substantial equivalent of the materials without undue hardship. The following circumstances are well recognized bases for disclosure of witnesses' statements under the "substantial need" and "undue hardship" test of Rule 26(b)(3): (1) hostility of a witness; (2) inability of a witness to recall details about the event; (3) substantial contemporaneity of the statement with the occurrence at issue; (4) the statements are sought to impeach or determine the credibility of a witness, and (5) the statements contain admissions. *See Longs Drug Store v. Howe*, 134 Ariz. 424, 657 P.2d 412 (1983); *Klaiber v. Orzel*, 148 Ariz. 320, 714 P.2d 813 (1986); 4 J. Moore, *Federal Practice*, § 26.64 (1984); 8 C. Wright and A. Miller, *Federal Practice and Procedure*, § 2025 pp. 215-219 (1970).

In the bar fight situation, the employees would likely be considered "hostile" because they are employees of the party claiming the privilege. The timing of the depositions and whether the testimony of the employees conflicts with the statements or is incomplete due to failure to recall facts of the incident will determine whether the information contained in the statements can be obtained from depositions. The employees' memories at the time they are deposed will be important. If the testimony is inconsistent at the time of the depositions, the statements may be discoverable based on *Klaiber*. However, mere surmise that a party might find useful information has been held insufficient to justify production. *Klaiber*, 148 Ariz. at 324-325, 714 P.2d at 817-818. Thus, until depositions are taken and a determination can be made regarding the employees' recollections, it is difficult to assess whether a substantial need exists to defeat the privilege.

If the employees' depositions are not taken for several years, the plaintiff may have an argument that he cannot obtain the equivalent of statements taken within one month of the incident. This would likely result in a motion to compel and an *in camera* inspection by the judge following the depositions of the employees. If the employees consistently answer "I don't remember" during their depositions, the judge could find that the requisite substantial need and undue hardship have been shown, and order the production of the statements.

Instead of risking the potential production of the statements, the safest course of action is to have all employee statements taken by an attorney hired by the company to provide legal advice following the incident. The statements would then be protected by the attorney-client privilege based on A.R.S. § 12-2234, and they would be absolutely privileged.

The absolute attorney-client privilege eliminates any issues of substantial need and undue hardship. The attorney retained by the company to interview the employees should make it clear at the beginning of the interview that any statements made by the employees fall under the attorney-client communication protection provided by A.R.S. §12-2234. Defending even a potentially frivolous case is difficult enough without doing the other side's work for them. Safeguarding the investigation through the attorney-client privilege is a prudent first step in defending potential lawsuits against the company. ◆

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did not mention municipal employees as included within that definition. Judge Zapata also cited the decisions from the Arizona Supreme Court (*Wagner*) and Arizona Court of Appeals (*Sasser*) in determining that municipal employees simply are not covered by the Whistleblower Statute.

Judge Zapata also dismissed Smith-Florez's claim under the AEPA, which provides that "an employee has a claim against an employer for termination of employment" if "[t]he employer has terminated the employment relationship of an employee in violation of a statute of this state."[14] A municipal employee cannot establish a claim under the AEPA based termination in violation of Arizona's Whistleblower Statute, as she is not an eligible "employee" eligible under the statute. Thus, municipal employees are precluded from bringing a wrongful termination claims under the AEPA based on violations of Arizona's Whistleblower Statute.

Practical Advice for Municipalities

Public entities must understand their legal obligations and requirements with respect to state statutes and regulations, as well as any Constitutional implications for their employees. This is not to say that municipal employees have no protection for whistleblowing activity or cannot bring claims for retaliation. To the contrary, there are a host of federal laws containing anti-retaliation provisions. When faced with lawsuits under Arizona's Whistleblower Statute and the Arizona Employment Protection Act, however, the laws that protect state and county employees for their whistleblowing activity may not apply to municipal employees.

Employee handbooks and other written policies need to be continuously updated to comply with state and federal laws governing whistleblowing and retaliation. Most importantly, employers must ensure that all human resources personnel and supervisors are properly trained regarding statutory requirements to avoid costly litigation landmines. ◆

Jones, Skelton and Hochuli's Employment Law Practice Group will continue to keep you apprised of all future developments concerning employment law. Please feel free to contact Barry H. Uhrman [(602) 263-1706, buhrman@jshfirm.com] with any questions you may have regarding these important developments.

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[1] A.R.S. § 23-1501.

[2] A.R.S. § 38-532

[3] A.R.S. § 38-532(A).

[4] A.R.S. § 38-532(B).

[5] A.R.S. § 38-531(1) (emphasis added).

[6] *Wagner v. City of Globe*, 150 Ariz. 82, 722 P.2d 250 (1986).

[7] *Wagner*, 150 Ariz. at 88-89, 722 P.2d at 256-57.

[8] *Id*. at 89, 722 P.2d at 257.

[9] *Wagner* was decided in 1986, long before enactment of the AEPA.

[10] No. 1 CA-CV 07-0090, 2008 WL 4108040 (Ariz. App. Jan. 10, 2008).

[11] *Sasser*, 2008 WL 4108040, at *2, 7 (emphasis added).

[12] Representing the City of Phoenix in *Sasser* were Georgia A. Staton and Eileen Dennis GilBride of Jones, Skelton & Hochuli.

[13] Representing the City of Nogales were Kathleen L. Wieneke and Barry H. Uhrman of Jones, Skelton & Hochuli.

[14] A.R.S. § 23-1501(3)(b).

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"limited circumstances" include when: (1) the insured does not receive full and adequate notice of the provision, and the provision is unusual, expected or emasculates apparent coverage; (2) a reasonably intelligent consumer cannot understand the policy language; or (3) some activity reasonably attributable to the insurer would either: (a) create an objective impression of coverage to a reasonable insured or (b) induce the insured to the reasonable belief that coverage exists, even though the policy clearly denies such coverage.

Under the facts of this case, the Court of Appeals determined that: (1) there was no evidence the insured would not have agreed to the policy with the exclusion; (2) the exclusion was not bizarre, oppressive or unusual, nor did it emasculate apparent coverage because assault and battery exclusions are common; and (3) the assault and battery exclusion did not eviscerate any non-standard terms. Most importantly, the Court rejected the Plaintiffs' allegations that the exclusion would eliminate coverage for the dominant purpose of liquor liability coverage, namely, to cover the tavern for injuries and damages arising from bar fights. The Court said "if all that was required to defeat the operation of a policy exclusion under the reasonable expectation doctrine was a provision attempting to qualify or limit the scope of the policy coverage, then every policy exclusion would be invalid as contrary to the insured's reasonable expectation of coverage."

The Court also rejected the argument that the insured did not have adequate notice of the clear and ambiguous language of the exclusion because: (1) the insurer gave a copy of the policy to the insured; and (2) the insured took efforts to make sure the exclusion was apparent by putting it on a full page, typed in bold face, with full capitalized headings. The fact that the insured never read it was of no consequence. The Court also found there was no activity reasonably attributable to Scottsdale Indemnity, including by the broker who sold the policy, that created an objective impression of coverage or induced the insured's reasonable belief it had coverage.

In sum, the Court found the insured did not have a "reasonable expectation of coverage" for claims of injury arising out of an assault and battery committed by a bar patron. An insured cannot obtain the benefits of the "reasonable expectation" doctrine merely by taking the stand and answering the subjective question, "did you reasonably expect that you would be covered?" This decision provides a very helpful analysis of the reasonable expectation of coverage doctrine, and it illustrates the importance of involving experienced defense and appellate counsel knowledgeable about the law on insurance contracts and bad faith.

About The Authors

Ronald W. Collett
Mr. Collett joined Jones, Skelton & Hochuli in 1984 and became a partner in 1987. He concentrates his practice on insurance law, bad faith, personal injury and products liability. Prior to joining the firm, he was an Assistant Attorney General in the Arizona Attorney General's office for four years and a Deputy Maricopa County Attorney for five years. Mr. Collett received his law degree from the University of the Pacific, McGeorge School of Law in 1974 and is admitted to practice in Arizona and the U.S. District Court, District of Arizona.

Michael E. Hensley
Mr. Hensley has been with Jones, Skelton & Hochuli since 1985 and a partner since 1992. He concentrates his practice on general civil litigation and insurance defense, including business and commercial litigation and life, health, disability and ERISA claims litigation. Mr. Hensley received his law degree from Arizona State University College of Law in 1986 and is admitted to practice in Arizona, the U.S. District Court, District of Arizona and the Ninth Circuit Court of Appeals.

Matthew S. McLaughlin
Mr. McLaughlin joined Jones, Skelton & Hochuli in 2010 and concentrates his practice on insurance coverage and bad faith, commercial litigation and personal injury defense. Mr. McLaughlin received his law degree from University of Missouri - Columbia School of Law and is admitted to practice in Arizona and Illinois.

Michele Molinario
Ms. Molinario joined Jones, Skelton & Hochuli as an associate in 2008 and concentrates her practice on governmental liability, labor/employment disputes, civil rights defense and general civil litigation. She received her law degree from Arizona State University College of Law in 2000 and is admitted to practice in all Arizona state and federal courts.

Barry H. Uhrman
Mr. Uhrman joined Jones, Skelton & Hochuli in 2007 and concentrates his practice on employment law, complex litigation and governmental liability. Mr. Uhrman received his law degree from Duke University School of Law and is admitted to practice in Arizona, the District Courts for Arizona and Ohio, and the U.S. Court of Appeals, Sixth and Ninth Circuits.

Jones, Skelton & Hochuli, P.L.C.
2901 North Central Avenue, Suite 800
Phoenix, AZ 85012

JS&H Reporter