Discoverability of Communications with Reinsurers in Bad Faith Cases

by

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I. Introduction

When insureds allege bad faith on the part of their insurers, they often seek broad discovery in an attempt to prove their cases. Aside from discovery of reinsurance agreements, which generally is allowed, these efforts can include communications between a ceding insurer and its reinsurer(s) in the hopes of finding a smoking gun. Unsurprisingly, the cases are split on this issue but perhaps the more significant point to be learned from an examination of the selected case law reviewed below is that the outcome of the an effort to obtain such communications can depend on the focus of the request as well as a nuanced response.

II. Cases Allowing Discovery of Communications with Reinsurers

A recent case in this category is *ContraVest Inc. v. Mt. Hawley Ins. Co.*, 2017 U.S. Dist. LEXIS 48638 (D. S.C.) in which a contractor sued its insurer for breach of contract and bad faith for failure to defend in a construction dispute. The contractor sought correspondence, memoranda, file notes and reports related to the insurer's reinsurance contracts and reserve estimates. The related motion was initially heard by a magistrate judge who reviewed case law to the effect that reinsurance is a spreading of risk that is irrelevant to the dispute in question but granted the motion ruling:

> The court sees no reason to simply assume that information exchanged with a reinsurer will not reveal the insurer's view of the underlying claim. Of course, this is only one possible outcome. If an insurer provides information clarifying the content of the disputed reinsurance information, discovery may be inappropriate, but defendant has not done so here. Absent such a showing, the court finds no reason to preclude discovery of the requested information in this case.[1]

On appeal, the district court affirmed.[2]

A leading case on point related to Hurricane Katrina claims is *Imperial Trading Co. v. Travelers Prop. Cas. Co. of Am.*, 2009 U.S. Dist. LEXIS 41372 (E.D. La.). Insureds sued their insurer, Travelers, for breach of contact and bad faith and sought "reinsurance information" which the court interpreted as communications between Travelers and it reinsurers. After surveying relevant case law, the court commented:

> As this brief summary of the law suggests, communications between Travelers and its reinsurers regarding plaintiff's insurance claims contain information that is relevant to Travelers' good faith to the extent that Travelers explained its reasons for granting or denying portions of plaintiffs' claims or otherwise described or explained it's handling of plaintiffs' claims.[3]

However, the court went on to make a more specific ruling on point:

> While relevance is by nature a context-sensitive determination, there is no question in this case that communications between Travelers and its reinsurers about plaintiffs' insurance claims are likely to contain information that is relevant to the issue of Travelers' bad faith. . . . Of course, as this discussion makes clear, not every communication between Travelers and its reinsurers will be relevant to plaintiffs' bad faith claim. Travelers will be required to produce only those documents or electronic communications that: (1) were transmitted between Travelers and one or more of its reinsurers; (2) were created on or after the date of Hurricane Katrina; and (3) contain information regarding plaintiffs' insurance claim and/or information regarding Travelers' handling of those claims.[4]

The *Imperial Trading* decision was followed in *Leevac Shipbuilding L.L.C v. Westchester Surplus Lines Ins. Co.*, 2015 U.S. Dist. 5070 (W.D. La.).

United States Fire Ins. Co. v. Bunge N. Am., Inc., 244 F.R.D. 638 (D. Kan. 2007) involved a dispute by an insured against its insurers over environmental liability at several sites. The insured sought communications between the cedent and its reinsurers arguing that such communications could be relevant to the cedent's late notice defense and the insured's bad faith action, could contain admissions with respect to coverage and liability and could shine a light on the existence and terms of lost policies. The court agreed that such communications were relevant holding:

> The Insurers may well have discussed various positions or issues with their reinsurers. The timing and content of those communications could readily lead to the discovery of admissible evidence regarding the Insurers' handling and investigation of [the insured's] claims or [the insured's] notice to the Insurers. Such communications could also relate to the allegedly lost policies.[5]

Nat'l Union Fire Ins. Co. v. Donaldson Co., 2014 U.S. Dist. LEXIS 85621 (D. Min.) involved a dispute over the coverage provided by a batch clause and a bad faith counterclaim by the insured that sought a broad range of communications between the cedent and its reinsurers. The insured argued that such communications might reveal the cedent's plans for application of the batch clause. The magistrate judge allowed the discovery sought by the insured and the district court affirmed:

> Given the split of authority on this issue, the Court cannot conclude that it was contrary to law or clearly erroneous for the Magistrate Judge to order production of [the cedent's] communications with reinsurers, and will defer to the Magistrate Judge's discretion. Furthermore, the Court is persuaded that [cedent's] statements to their reinsurers might shed light on what [the cedent] knew and when with regard to their plans for handling the [underlying] litigation, which is sufficiently relevant to [the insured's] claims for breach of duty of good faith and fair dealing to be discoverable.[6]

III. Cases Not Allowing Discovery of Communications with Reinsurers

A leading case in this category is *Great Lakes Dredge & Dock Co. v. Commercial Union Assur. Co.,* 159 F.R.D. 502 (N.D. Ill). The insured was claiming breach of contract and bad faith and sought all documents relating to reinsurance arguing: (a) that the presence of reinsurance in the face of a coverage denial suggests bad faith; and (b) any absence of reinsurance suggests bad faith. The court denied the discovery ruling:

> That hay could be made from either outcome is probably the best demonstration that the probative value of this information is little. . . . The court concludes that the relevance of "all documents" related to reinsurance is too attenuated to be discoverable under the relevant evidence standard of Rule 26.[7]

First Horizon Nat'l Corp. v. Houston Cas. Co., 2016 U.S. Dist. LEXIS (W.D. Tenn) is a coverage case in which the insured sued for breach of contract and bad faith. The insured sought

a broad range of communications with reinsurers on the basis that such communications might shed light on the cedent's understanding of certain policy provisions. However, the reinsurers submitted affidavits saying that such communications related to spread of risk (*i.e.* placement and underwriting information) and not to the substantive issues in the litigation. The court denied the discovery:

> Reinsurance-related communications are . . . not relevant to a claim of bad faith. . . . [The reinsurers] maintained at the hearing that the reinsurance is treaty insurance [*sic*] wording under which the reinsurer agrees to accept an entire block of business from the insured. This makes the reinsurance-related communications even less relevant to the claims asserted by the Plaintiffs.[8]

Heights at Isaquah Ridge Owners Ass'n v. Steadfast Ins. Co., 2007 U.S. Dist. LEXIS 95213 (W.D. Wa.) is a case in which the assignee of rights under an insurance policy brought an action against the cedent for breach of contract and bad faith. The assignee sought a broad range of reinsurance related documents but the court found a lack of relevance to the bad faith claim:

> Reinsurance involves an insurance company's effort to spread the burden of indemnification. It is a decision based on business decisions and not questions of policy interpretation. This is particularly so when the reinsurance is treaty insurance [*sic*] as it is here. Under a reinsurance treaty, the reinsurer agrees to accept an entire block of business from the insured. There is no connection between the claims asserted against [the cedent], and [cedent's] reinsurance block of its insurance policies, that would make that reinsurance relevant to the claims asserted here.[9]

The insurer brought a coverage declaratory judgment action against the insured in *Harleysville Lake States Ins. Co. v. Lancor Equities, Ltd*, 2014 U.S. Dist. LEXIS 154685. The insured counterclaimed for a monetary award under Illinois Insurance Code § 115 which allows a court to award damages due to a vexatious and unreasonable lawsuit. The insured sought discovery of all documents relating to the cedent's reinsurance coverage, both facultative and treaty, for first-party property claims for a certain block of years. The court denied the motion ruling:

> [This motion] is plainly too broad. [The insured's] motion and reply do nothing to justify such a broad fishing expedition. . . . The court will not compel [the

> cedent] to go beyond disclosing the reinsurance agreement or agreements and into a scope of production likely to generate disputes about privilege and work product in response to a request that goes well beyond the claims and defenses in this case.[10]

IV. Commentary

To increase their chances of being successful in obtaining reinsurance information, claimant's counsel need to focus their request on information relevant to the claim or coverage issue in question. There is very seldom any relevant information in placement or underwriting files, particularly for reinsurance treaties.[11] By casting too broad a net, claimant's motions stand too great a chance of being denied for overbreadth.

Cedents can consider a number of ways to reach a successful conclusion. First, they should consider whether the motion is worth opposing. There may be nothing in any portion of their communications with reinsurers that is relevant to the issues in dispute. Alternatively, they might oppose the motion with affidavits of lack of relevant information was done in *First Horizon, supra*

In addition, cedents can educate the court on the difference between facultative and treaty reinsurance as was done in *Heights at Isaquah Ridge, supra.* Facultative reinsurance focuses on the characteristics of a known risk while treaty reinsurance focuses on unknown, prospective risks, making the latter type of reinsurance even less likely to contain relevant information in reinsurance placement and underwriting files.

Finally, cedents can argue for an order which narrowly focuses discovery on the matters in dispute such as that in *Imperial Trading Co, supra*.

ENDNOTES

1 2016U.S. Dist. LEXIS 185608 *9.
2 2017 U.S. Dist. LEXIS 48638 *30.
3 2009 U.S. Dist. LEXIS 41372 *8-*9.
4 *Id.* at *11.
5 244 F.R.D. 638 (D. Kan. 2007) at 643.
6 2014 U.S. Dist. LEXIS 85621 *16.
7 159 F.R.D. 502 at 504 (internal citations omitted).

[8] 2016 U.S. Dist. LEXIS *44 - *45 (internal citations omitted).

[9] 2007 U.S. Dist. LEXIS 95213 (W.D.Wa) *12 (internal citations omitted).

[10] 2014 U.S. Dist. LEXIS 154685 *26.

[11] This is coming from a former general counsel of a large, direct writing reinsurance company that operated in lower layer coverage *i.e.* the type of reinsurer *most likely* to have relevant information in their placement or underwriting materials.