DISCOVERY BY A REINSURER OF DOCUMENTS

FROM CEDENTS AND THEIR INSUREDS

by

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I. Introduction

Most Mealey's readers are familiar with the issue, if not the mixed case law, of a claimant's right to discover documents in the possession of reinsurers.[1] Less well known, and less litigated, is the issue of a reinsurer's right to obtain documents about underlying claims from a cedent or its insured. Ordinarily, a reinsurer has a broad right to review the files of its cedent through an access to records clause. However, objections have been used to deny reinsurers access to documents in the possession of the cedent and its insured.

Presumably, most discovery disputes between cedents and reinsurers take place in an confidential arbitration context and for this reason, there are relatively few cases on point. Nonetheless, this article examines existing case law concerning relevance, attorney-client and work product objections to a reinsurer's attempt to gain access to documents in the possession of the cedent or its insured plus certain exceptions to these privileges.

II. Relevance

A series of discovery disputes between Arkwright Mutual, as the cedent, and National Union, as the reinsurer, over the same claim examined the issue of relevance of the reinsurer's discovery requests. It is not clear from the cases why an access to records clause did not play a role in the court's deliberations. Perhaps the reinsurance contract at issue was a facultative certificate which omitted some of the more common treaty clauses.

Arkwright Mutual Ins. Co. v. National Union Fire Ins. Co. of Pittsburgh, 1993 WL 14448 (S.D.N.Y.) ("Arkwright I") involved a fire that allegedly spread PCB's throughout a facility due to the fact that the paint used in the building contained PCB's. National Union denied the claim on the basis of insufficient evidence that the contamination was not pre-existing. Litigation ensued and National Union made broad discovery requests seeking to prove alternative theories of causation. Initially, the court noted that the scope of some of National Union's discovery requests were so broad that they did nothing to advance any plausible alternative theory of causation and were objectionable as a result. More specifically, the court ruled that there was no scientific basis for inquiry into "precursor chemicals" in the building which might have formed

PCB's when burned. The court denied discovery of every substance in the burned facility but allowed discovery of limited documents related to the area where the fire started and how it spread plus use of PCB's in the manufacturing process. The court allowed discovery concerning use and disposal of hazardous waste at the facility that burned but not at other facilities. Employee accident reports were ruled discoverable but only those involving explosion or spill of PCB's. In addition, the insured was ordered to produce its records of any emissions of PCB's from neighboring plants.

The next round of the discovery battle was Arkwright Mutual Ins. Co. v. National Union Ins. Co. of Pittsburgh, 1993 WL 437767 (S.D.N.Y.) ("Arkwright II"). Arkwright argued that discovery of the drafting history of the policy in question was irrelevant because National Union was obligated to follow the fortunes of Arkwright. The court rejected this argument, noting the diametrically opposed views held by the parties of the same policy language, and ruled that policy development history was reasonably calculated to lead to admissible evidence. The court also allowed discovery of Arkwright's underwriting capacity and the manner in which the property in question became part of the program due to a defense of recission for failure to maintain a retention and an issue of National Union's right to participate in adjustment of the loss. For competitive reasons, the court limited National Union's request for underwriting guidelines and procedures for adjusting and paying claims to the type of risk and loss at issue.

The third round was Arkwright Mutual Ins. Co. v. National Union Ins. Co. of Pittsburgh, 1994 WL 510043 (S.D.N.Y.) ("Arkwright III"). In this case, National Union sought the entire underwriting file for the policy in question but Arkwright objected to producing any portion other than that related to the facility where the loss occurred. Given the competitive issues addressed in the prior case, the court upheld Arkwright's objection.

III. Attorney-Client Privilege

Trustmark Ins. Co. v. General & Cologne Life Re of America, 2000 WL 1898518 (N.D.Ill.) involved an alleged joint venture between Trustmark, the cedent, and General & Cologne Re, the reinsurer to purchase a book of business. When General & Cologne Re canceled its participation the joint venture, litigation ensued. General & Cologne Re sought minutes of meetings and documents exchanged within a task force formed by Trustmark which included an independent contractor, two in-house attorneys and several other employees. General & Cologne Re argued that the attorney-client privilege had been waived because the task force included individuals who did not qualify for the "control group" within which the communications must be kept confidential. The court found that the independent contractor was within the control group:

[The independent contractor] was properly party of Trustmark's "control group", because he was an agent of Trustmark who served as an advisor to top management and was consulted for the purpose of determining what legal action the corporation would pursue. . . . [N]o management decision regarding Cologne's assertions about Trustmark's claims-handling practices would be made without [the independent contractor's] advice and recommendation.[2]

The court found, however, that the attorney client privilege had been waived by inclusion in the task force of two individuals who provided the equivalent of technical information concerning

the business transaction. The court ruled that there was no evidence that they "occupied an advisory role in an area that such a decision would not normally be made without their advice or opinion, or that they otherwise contributed to decision making on a legal (as opposed to business) issue."[3]

In Arkwright III, *supra*, the reinsurer sought communications with the law firm which represented both the cedent and the insured against a company allegedly guilty of fraudulent billing with respect to clean up services. The reinsurer claimed that sharing the documents with the insured waived the privilege. The court ruled that there was no privilege waiver since the insured was a co-plaintiff with the insurer.[4]

Murray, the contractor who allegedly caused the fire which resulted in the explosion asserted attorney-client privilege as to documents provided by its fire investigator, UBA, to the contractor's counsel in Arkwright Mutual Ins. Co. v. National Union Ins. Co. of Pittsburgh, 1994 WL 5899 (6th Cir.) ("Arkwright IV").. These documents were prepared after meeting with Murray and counsel. The appellate court found that the lower court did not abuse its discretion in ruling that certain documents (*e.g.*, invoice, expense sheet, excerpt from welding textbook) did not contain confidential communications. Neither did the lower court abuse its discretion in reviewing other documents *in camera* to determine their nature. Given the fact that UBA was not the client of Murray's counsel, the court ruled:

To find any of these documents to be privileged, therefore, the district court must find (1) that the document reflects privileged communications made by Murray to Murray's counsel, and that the communications did not lose their privileged status because of their disclosure to UBA; or (2) that the document reflects confidential communications made by Murray to UBA for the purpose of ultimately receiving legal advice, and that UBA was acting as the agent of Murray's counsel (citation omitted); or (3) that the document contains a confidential communication made by UBA as Murray's agent, for the purpose of receiving legal advice.[5]

IV. Work Product Privilege

A receiver of an insolvent cedent tried to protect certain audit reports against discovery by a reinsurer in Curiale as Liquidator of Ideal Mutual Ins. Co. v. Phoenix General Ins. Co. of Greece; 1991 WL 230606 (S.D.N.Y.). In 1981, Ideal commissioned an audit by Norman Reitman of its managing general agent, Global Aviation, and in 1983 considered an action against Global. In late 1984, Ideal was placed in receivership and shortly thereafter, the receiver again commissioned an audit of Global Aviation by Norman Reitman. In mid-1986, the receiver hired Caronia to audit Global's claim files and late that year retained a law firm to litigate against Global. While suit was never filed against Global, the receiver asserted a work product privilege as to both the Reitman and Caronia audit. The court found that the Reitman audit was not privileged because it "was undertaken principally, if not exclusively, to permit the Superintendent to carry out his statutory duty to marshal and plan for the disposal of the company's assets."[6] However, the court found that the Caronia audit did qualify for the work product privilege:

[T]hat audit was commenced at a time when litigation against Global was under active consideration and, most importantly, the instructions to Caronia indicate that the prospect of litigation played a more significant role both in motivating the audit and in shaping the instructions that were given to Caronia as to the procedures to be used in carrying it out.[7]

The Trustmark court, *supra*, found a waiver of attorney-client privilege due to inclusion of non-control group individuals as recipients of the documents in question. Nonetheless, the court also found that the documents qualified for a work product privilege: "Thus, even if Trustmark showed these documents to members who were not properly part of its 'control group,' as long as those members were adversaries to Cologne, the work product privilege would not be waived."[8]

The reinsurer, National Union, sought certain documents from the contractor, Murray, who allegedly caused the explosion and its fire investigator in Arkwright IV, *supra*.. Murray sought to withhold these documents under the work product privilege. The court found that these documents were prepared in anticipation of litigation since the investigator was retained shortly after a serious loss and in tandem with a law firm which was retained to defend Murray. However, the work product privilege applies to documents prepared by or for a party to the present litigation. Since neither Murray nor its fire investigator was a party to the instant litigation, the court ruled that the privilege did not apply to the documents in question.[9]

In Arkwright III, *supra*, the insured retained an accounting firm, Matson Driscoll, to do normal accounting work with respect to a claim but as evidence of fraud by a contractor mounted, Matson Driscoll was retained by the insured's law firm to focus on the contractor. In addition, a law firm was retained to investigate and pursue subrogation opportunities. The reinsurer sought Matson Driscoll's audit materials and the documents of the subrogation law firm. The court ruled that the audit materials became work product after Matson Driscoll was retained by the law firm, since litigation was then likely. Likewise, the court ruled that documents prepared for the cedent by the subrogation law firm were prepared in anticipation of litigation and constituted work product. [10]

V. Exceptions to the Privileges

A. Substantial Need

Arkwright IV, *supra*, involved an explosion and fire on April 4, 1990 and by the time that the reinsurer, National Union, was notified on June 18, 1990, clean up activities by UBA and others had substantially altered the site of the loss. National Union sought documents from UBA under an exception to the work product rule due to the fact that National Union had a substantial need for the materials in preparation of their case and was unable, without undue hardship, to obtain the substantial equivalent of the materials elsewhere. The court upheld the ruling of the lower court that National Union had demonstrated a basis for the substantial need exception.[11]

In Arkwright III, *supra*, the reinsurer, National Union, sought to obtain audit reports on a contractor who alleged submitted fraudulent bills under the substantial need exception to the work product privilege. National Union argued that it needed this information to establish the size of the loss, whether *ex gratia* payments had been made, to determine whether the claims were adjusted in good faith and to understand the auditors analysis of data already in National Union's possession. The court ruled that National Union had not demonstrated a substantial need. It observed that National Union did not need the mechanics of the settlement to determine the reasonableness of the settlement and could retain its own accountants to analyze the raw data.[12]

B. Common Interest

The cedent, North River, sought reinsurance recoverables from Columbia Casualty in North River Ins. Co. v. Columbia Casualty Co., 1995 WL 5792 (S.D.N.Y.) ("North River I"). Columbia Casualty sought memoranda prepared by in-house counsel of North River and by a senior claims specialist for North River concerning his conversations with counsel. Columbia Casualty asserted an exception to attorney-client privilege on the basis that the cedent and the reinsurer had a common interest in the defense of the underlying claim. The court stated that the test for a common interest exception:

[I]s that the nature of the interest be identical, not similar, and be legal, not solely commercial. The fact that there may be an overlap of a commercial and a legal interest for a third party does not negate the effect of the legal interest in establishing a community of interest.[13]

Applying this test, the court found no common interest between North River and Columbia Casualty:

Clearly, they were not represented by the same counsel, and Columbia Casualty did not contribute to North River's legal expenses nor exercise any control over its conduct of the proceedings. Nor is there any evidence that the two coordinated litigation strategy in any way. While their commercial interests coincided to some extent, their legal interests sometimes diverged, as demonstrated by the instant litigation. In short, Columbia Casualty's only argument for finding a common interest is that the two parties stand in the relation of reinsurer to ceding insurer, and that is insufficient.[14]

In the same case, North River attempted to make the at issue doctrine run to its benefit. North River had revealed the documents in question to another reinsurer, CIGNA Re, as part of an unsuccessful settlement effort. North River argued that there was a common interest between North River and CIGNA Re that caused such documents to remain privileged with respect to Columbia Casualty, notwithstanding their disclosure to CIGNA Re. The court found that there was no common interest between CIGNA Re and North River and, in fact, that their interests were adverse.[15]

North River Ins. Co. v. Philadelphia Reins. Corp., 797 F.Supp. 363 (D.N.J.1992) was a suit by the cedent, North River, against its reinsurer, CIGNA Re, for expenses of litigation. CIGNA Re attempted to discover North River's communications with counsel under a common interest

exception to the attorney-client privilege. The court rejected CIGNA Re's analogy to the common interest between an insured and an insurer defending a liability claim and ruled for the cedent on a basis very similar to that in North River I, *supra*.[16]

The court in North River Ins. Co. v. Philadelphia Reins. Corp., *supra*, went to considerable effort to question the ruling of the court in a declaratory judgment action between an insurer and an insured in Waste Management, Inc. v. International Surplus Lines Ins. Co., 579 N.E.2d 322 (Ill. 1991). The insurer provided environmental liability coverage under a policy which did not require the insurer to provide a defense. When a suit between the insured and a claimant was settled, the insurer sought certain communications with the insured's attorney. The court ruled that the common interest exception to the attorney-client privilege rule applied:

Insureds and insurers share a special relationship; they are in privity of contract. In a limited sense, counsel for insureds did represent both insureds and insurers in both of the underlying litigations since insurers were ultimately liable for payment if the plaintiffs in the underlying action received either a favorable verdict or settlement.[17]

This rationale is readily transferable to the reinsurance context where the cedent controls the litigation but the reinsurer is contractually obligated to share expenses and follow the cedent's fortunes..

C. Cooperation or Access to Records Clauses

The reinsurance contract in North River Ins. Co. v. Philadelphia Reins. Corp., *supra*, contained a clause requiring the cedent to make available for inspection each insurance policy and any of its records relating to the reinsurance or claims in connection therewith. The court characterized this as a co-operation clause. The reinsurer cited this as an exception to the attorney-client privilege. The court rejected the reinsurer's argument ruling:

Although a reinsured may contractually be bound to provide its reinsurer with all documents or information in its possession that may be relevant to the underlying claim adjustment and coverage determination, absent more explicit language, it does not through a cooperation clause give up wholesale its right to preserve the confidentiality of any consultation it may have with its attorney concerning the underlying claim and its coverage determination.[18]

D. Fiduciary Relationship

In North River I *supra*, the reinsurer sought documents protected by the attorney-client privilege on the basis that the cedent owed a fiduciary duty to the reinsurer. The court rejected this argument on the basis that there is no fiduciary relationship between a reinsurer and a cedent.[19] *See also* North River Ins. Co. v. Philadelphia Reins. Corp. *supra*, in which the court made a similar ruling on the grounds that there is no fiduciary relationship inherent in facultative reinsurance.[20]

In contrast is a case wherein an excess insurer was attempting to recover damages from the primary insurer for bad faith refusal to settle a claim. Zurich Ins. Co. v. State Farm Mutual Auto.

Ins. Co,, 524 N.Y.S.2d 202 (App.Div.1988). The court ruled that the primary insurer owed a fiduciary duty to the excess insurer and that under the circumstances, the primary insurer "may not use the attorney-client or work product privilege as a shield to prevent disclosure which is relevant to the insured's bad faith action.[21]

E. Subject Matter

The cedent had waived its attorney-client privilege with respect to two memos by showing them to another reinsurer in North River Ins. Co. v. Columbia Casualty Co., 1995 WL 408214 (S.D.N.Y.) *aff'd* 1995 WL 562176 (S.D.N.Y.) ("North River II"). Since North River filed suited against the other reinsurer eleven days after the memos were disclosed, the reinsurer in this action, Columbia Casualty, claimed an implied subject matter waiver for all documents related to the matters discussed in the two memos. The court stated that subject matter waiver takes place when the disclosure takes place in a litigation context but if disclosed outside the litigation context, the waiver does not extend beyond the documents disclosed. The court ruled that the disclosure was not in a litigation context but noted an exception to the subject matter rule:

When privileged communications are disclosed in an extrajudicial context, however, a subject matter waiver may still result if the discovering party demonstrates that a selective waiver of privilege has prejudiced it in its trial preparation or if the party asserting the privilege affirmatively used the communications in litigation.[22]

The court ruled that Columbia Casualty had not proved the predicate facts necessary to qualify for the exception.[23]

F. At Issue

In Arkwright III, the reinsurer, National Union, sought communications with Arkwright's counsel on the basis that the contents of those communications had been placed in issue in the litigation. The court disagreed:

I am unconvinced that the "at issue" doctrine justified waiver of the attorney-client privilege in the present case. . . . National Union has not demonstrated that the *content* of legal advice received by Arkwright in any of the contested documents is directly relevant to either Arkwright's claims or National Union's defenses. Arkwright has not placed its good faith adjustment of the underlying GE claim at issue simply by suing for indemnity; . . Arkwright has not made specific allegations that make an issue of its counsel's conduct. Finally, National Union has not shown that Arkwright intends to prove its damages or its good faith adjustment of the GE claim through disclosure of the contested documents.[24]

CIGNA Re, the reinsurer, attempted to discover the document of North River's counsel on the basis of the at issue exception in North River Ins. Co. v. Philadelphia Reins. Corp., *supra*. The court ruled that the documents were not discoverable:

North River represented to the Court at oral argument that it has no intention to prove its case in any way by reliance on any attorney-client communication, whether produced or withheld from

discovery. It thus cannot be said that North River is using the attorney-client privilege as a "sword and shield" through selective disclosure of privileged documents. . . . [CIGNA Re's] argument that North River's merely placing the broad question of coverage in issue somehow makes it fair game for CIGNA Re to discover confidential attorney-client communication is a misconstruction of the "in issue" doctrine.[25]

For a similar case and ruling, *see* North River I.[26]

Whether or not a letter of intent issued by the cedent, Trustmark, was binding was an issue in Trustmark Ins. Co. v. General & Cologne Life Re of America, *supra.* The reinsurer, General & Cologne, sought documents exchanged within a task force, which included attorneys, to support its position. The court ruled that the "at issue" exception did not apply to such documents:

Here, Trustmark has not placed, or affirmatively relied on, advice of counsel or counsel's work product to establish any element of its case in chief. Significantly, the truthful resolution of whether the letter of intent with Hartford Life was legally binding does not require the disclosure of privileged communications. Merely because Trustmark's counsel may have discussed this element of Trustmark's case, and embodied those discussion in privileged documents, does not mean that Cologne has a right to those communications. Such a rule would undermine the very protection offered by the attorney-client privilege or the work product doctrine.[27]

G. Fraud

In North River I *supra*, the reinsurer, Columbia Casualty, sought internal communications with counsel concerning an arbitration with an insured. Columbia Casualty alleged that North River, the cedent, acted in a negligent manner in handling the arbitration and then fraudulently concealed the negligence. Columbia Casualty argued that the communications fell into a fraud exception to the attorney-client privilege. The court found that this exception applies only "when there is probable cause to believe that the communications with counsel were intended in some way to facilitate or conceal [fraudulent activity]."[28] The court reviewed related documents for which the privilege had been waived and concluded that there was no evidence to support the allegation:

[T]hat North River and its attorneys were engaged in an ongoing scheme to fraudulently conceal North River's allegedly negligent conduct in the ADR proceedings. . . . [The related documents] constitute nothing more than the balancing of potential rights and liabilities that typically characterize attorney- client communications.[29]

VI. Conclusion

Most reinsurance contracts call for dispute resolution between the cedent and the reinsurer to be resolved by confidential arbitration. Nonetheless, there is a relatively small number of dense and fact-oriented cases dealing with the such discovery disputes - specifically relevance, the attorney-client and work product privileges and exceptions thereto. In only one of these cases did an access to records clause play a role in the opinion suggesting that: (1) the contracts at

issue did not contain such a clause; or (2) the parties did not consider the clause sufficient to waive or otherwise supercede a privilege.

For the most part, the idiosyncracies of the reinsurance marketplace were not a factor in the courts' decisions. There are, however, two areas in which future case law might diverge based on further explication of the reinsurance environment.

Two cases cited above find no fiduciary exception to the attorney-client and work product privileges since cedents in those jurisdictions are not fiduciaries with respect to their reinsurer. Initially, there is case law in other jurisdictions which would support a fiduciary relationship. Also, it is an open question whether the "utmost good faith" which is thought to characterize the reinsurance relationship also should qualify for the exception.

Secondly, the common interest exception might benefit from a more complete explication of the similarity between the relationship of a reinsurer and cedent as compared to that between an insurer and insured (where common interest with respect to third party claims is generally acknowledged). Important factors in this analysis could include the reinsurer's reliance on the cedent to underwrite and pay claims properly, the reinsurer's obligation to follow the cedent's fortune and the sharing of defense costs.

Endnotes

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[1] . *See e.g.*, Joseph M. Donley an Patricia Powers, *Discovery of Reinsurance Information Remains Unresolved in Most Jurisdictions*, VIII Mealey's Reins. Rpt. No. 11 at 17 (1997).

[2] . 2000 WL 1898518 *5.

[3] . *Id*. *6.

[4] . 1994 WL 510043 *9.

[5] . 1994 WL 58999 *5

[6] . 1991 WL 230606 *4.

[7] . *Id*.

[8] . 2000 WL 1898518 *4.

[9] . 1994 WL 58999 *4.

[10] . 1994 WL 51043 *7 - 8.

[11] . 1994 WL 58999 *4.

[12] . 1994 WL 510043 *10 - 11.

[13] . 1995 WL 5792 *3.

[14] . 1995 WL 5792 *5.

[15] . *Id*. *7 - 8.

[16] . 797 F. Supp. 363 at 367.

[17] . 579 N.E.2d 322 at 194 - 195.

[18] . 797 F.Supp. 363 (D.N.J.1992) at 368.

[19] . 1995 WL 5792 *6.

[20] . 797 F. Supp. 363 (D.N.J.1992) at 369 - 370.

[21] . 524 N.Y.S.2d 202 at 203.

[22] . 1995 WL 408214 *2.

[23] . *Id*.

[24] . 1994 WL 510043 *13.

[25] . 797 F.Supp. 363 at 370 - 371.

[26] . 1995 WL 5792 *6.

[27] . 2000 WL 1898518 *8.

[28] . 1995 WL 5792 *6.

[29] . *Id*. *7.