

# Recent Legislative and Judicial Trends Affecting the U.S. Casualty Industry

Update #2

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## What Is Privileged Information between Ceding Companies and Their Reinsurers?

In November 2005, Guy Carpenter & Company, Inc. (“Guy Carpenter”) issued a report, *Recent Legislative and Judicial Trends Affecting the U.S. Casualty Industry*, prepared by Lord, Bissell & Brook LLP, attorneys at law, in conjunction with Guy Carpenter. We followed with an update to describe the current issues surrounding the discoverability of loss reserves between an insurer and an insured. This second update, prepared by Guy Carpenter, details another significant issue: the determination of what constitutes privileged information between ceding companies and their reinsurers.

## Reinsurer Access to a Ceding Company's Privileged Documents

It has long been considered a necessary and integral part of the reinsurance relationship that reinsurers have the ability to audit and review all of a ceding company's books and records. However, if insurers provide their reinsurers with unfettered access to privileged documents or information, they run the risk of a court subsequently ruling that they have waived the privilege. Generally, "privileged" documents are those pertaining to communications between attorney and client and/or written materials prepared in anticipation of or in connection with litigation.

The consequences of such a ruling would be that 1) in a coverage litigation, the claimant will have access to the insurer's attorney-client communications and strategy, and 2) the insured and insurer defending a lawsuit may find that the insured has waived its privilege after the reinsurer views such documents in the insurers' files.

Disputes about whether an insurer can lose the privilege attached to such documents centers on the access to records clause in the reinsurance treaty and the "common interest" doctrine.

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### Access to Records

Most reinsurance agreements contain very broad clauses allowing reinsurers access to all of the ceding company's files and records. Typically, such clauses have been silent on the subject of privileged documents. Do courts read a waiver of privilege into the access to records clause? There are a number of cases holding that access to records clauses do not operate as blanket waivers. In *North River Insurance Company v. Philadelphia Reinsurance Corporation*, 797 F. Supp. 363 (D.N.J. 1992), the reinsurer requested documents that contained privileged discussions with the cedent and its attorney, but the federal court held that a "reinsurer is not entitled under a cooperation clause to learn of any and all legal advice obtained by the reinsured with a 'reasonable expectation of confidentiality.'"<sup>1</sup>

And what of litigations between the cedent and the reinsurer themselves?

The most recent case deciding this issue is *Gulf Insurance Company v. Transatlantic Reinsurance Company*, 13 A.d. 3d 278, 788 N.Y.S.2d 44 (1st Dep't 2004). Gulf sued the nonpaying reinsurers on its vehicle residual value treaty, and those reinsurers alleged that the disputed settlements were in bad faith and *ex gratia*. The reinsurers asked the court to compel production of Gulf's privileged documents, arguing that the information they sought was relevant to whether the settlement was driven by factors extraneous to the merits of the litigation and whether the policy was outside the treaties' scope of coverage. The lower court allowed the reinsurers to view the privileged documents. The appellate court reversed the decision, stating that access to records clauses, no matter how broadly worded, could not be interpreted to waive a privilege – otherwise, such privileges would be meaningless. (The court noted that reinsurers were still entitled to challenge whether the documents were actually privileged.)

The court in *North River Insurance Co. v. Columbia Casualty Co.*, No. 90 civ. 2518, U.S. 1995 Dist. LEXIS 53 (S.D.N.Y. Jan. 5, 1995) held that because a cedent submits a claim under its reinsurance contract, that in and of itself does not allow the privilege to be waived.

<sup>1</sup> See also *United States Fire Insurance Co. v. Phoenix Assurance Co. of New York*, No. 7712/91 (N.Y. Sup. Ct. Aug. 18, 1992).

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Common Interest

Quite apart from an argument based on waiver via the access to records clause, reinsurers have argued that there is a “common interest” between the cedent and reinsurer, which entitles them to share privileged documents without adverse consequences. The common interest doctrine, which historically arises in the context of multiple parties represented by one attorney, has been extended to situations where the parties’ interests are also so aligned, as in the defense of an insured by an attorney chosen by the insurer. Courts have held that the parties must have an “identical, not merely similar, legal interest in the subject matter of a communication between an attorney and a client.”<sup>2</sup>

The *Allendale* case is interesting because, after holding that the documents were not privileged as a threshold matter and that the common interest doctrine only applied to disclosure of privileged documents, the court felt the need to state that in any event, a reinsurer and insurer had no common interest relating to litigation as that term was defined under the law. The *Allendale* court cited *In re Liquidations of Reserve Ins. Co.*, 122 Ill.2d 555, 120 Ill.Dec. 508, 524 N.E.2d 538 (1988), where the Illinois Supreme Court observed: “the interest involved in a reinsurance agreement is different from that involved in a direct insurance agreement. Reinsurance is not a contract to insure those who face the risk of loss by fire or death or accident or any other hazards classified under the [Illinois Insurance Code].”<sup>3</sup>

In *North River Insurance Company v. Philadelphia Reinsurance Corporation*, 797 F.Supp. 363, (D.N.J. 1992), the court also refused to apply the common interest doctrine and stated that if the reinsured has been forthright in making available to its reinsurer all factual knowledge or documentation in its possession relevant to underlying claim or handling of that claim, it has satisfied its obligations under the cooperation clause in reinsurance certificate.<sup>4</sup>

In yet another case finding a lack of common interest between cedent and reinsurer, *Reliance v. Lintex Corporation*, (not reported in F.Supp 2001) WL 604080 (S.D.N.Y. June 1, 2001), the cedent (Reliance) tried to argue that the attorney-client privilege applied to correspondence to the reinsurer concerning legal analysis of the case, because primary insurers and reinsurers share a “unity of interest.” However, the plaintiff failed to establish that Reliance and its reinsurance underwriter share a common legal interest that warrants the extension of the attorney-client privilege to the document in question. While their commercial interests coincide, to some extent, no evidence was proffered that establishes that Reliance and its reinsurer share the same counsel or coordinate legal strategy in any way<sup>5</sup>: “[T]he interests of the ceding insurer and the reinsurer may be antagonistic in some respects and compatible in others.”<sup>6</sup>

To get a sense of what the parameters of common interest are, *Aetna Cas. & Sur v. Certain Underwriters at Lloyds*, 176 Misc. 2d. 605, 676 N.Y.S. 2d 727 (N.Y. Sup. Ct. 1998) was for once a reversal of the usual situation. A group of London reinsurers moved for the return of documents they had inadvertently produced during discovery in a reinsured’s suit that sought to allocate to the reinsurers a portion of its settlement of a chemical company’s environmental liability claim. Apparently, the reinsurers claimed that minutes taken by counsel of the meetings of an industry-wide group of leading London reinsurance underwriters concerning potentially huge losses on environmental liability claims against United States reinsureds

<sup>2</sup> *Allendale Mutual Insurance Company v. Bull Data Systems*, 152 F.R.D. 132 (N.D. Ill. 1993).

<sup>3</sup> 120 Ill.Dec. at 511, 524 N.E.2d at 541.

<sup>4</sup> See also *Massachusetts Bay Insurance Co. v. Stamm*, 700 N.Y.S. 707, 708 (1st Dep’t 2000).

<sup>5</sup> See *North River Insurance Co. v. Columbia Casualty Co.*, No. 90 Civ. 2518, 1995 WL 5792 at \*5 (S.D.N.Y. Jan. 5, 1995).

<sup>6</sup> *Id.* at \*4.

were privileged because of the common interest of *all* London reinsurers. The New York court held that the “common interest” privilege did not attach to the documents, which were, where the “common interests” were nearly exclusively commercial ones focusing on maintaining the financial viability of the entire London market, little if any legal advice was sought, and no specific litigation was expected.

There are jurisdictions that do find a common interest in the insurer/reinsurer relationship. In *Minnesota School Boards Association Insurance Trust v. Employers Insurance Co. of Wausau*, 183 F.R.D. 627 (N.D.Ill.1999), an Illinois federal court held that the insurer’s disclosure of work product to its reinsurers did not waive the privilege, even if one of them was actually a reinsurance broker. The insurer successfully argued that that waiver only occurs if the disclosure of work product to a third party “is inconsistent with the maintenance of secrecy from the disclosing party’s adversary.”<sup>7</sup> The insurer also pointed out the common interest in evaluating and minimizing the exposure arising from the underlying lawsuit and that the disclosure was made with the expectation of confidentiality. Other courts have held the same.<sup>8</sup>

To give one the flavor of the sharp difference of opinion between the jurisdictions, the *Hartford Steam Boiler* court stated: “The legal and economic interests of IIC and HSB in the EIL insurance claims and lawsuits are inextricably linked by the reinsurance treaty. The fact that HSB is not a party defendant in those lawsuits is of little significance because HSB will automatically share in any liability suffered by IIC. As indicated, HSB even shares in paying attorney fees and other costs incurred by IIC in the defense of those lawsuits. Furthermore, Article V of the treaty provides that IIC must cooperate with HSB so that the latter can determine whether and to what extent it should provide defense efforts in addition to the required 7.5% financial contribution. Such cooperation would naturally include communications between IIC attorneys and HSB and other communications subject to the privilege.”<sup>9</sup>

In those jurisdictions favorable to the extension of the common interest doctrine, reinsurers will press ceding companies for access to all records, even privileged documents, and the ceding company may find some comfort in knowing that a court will protect the privilege.

So what are parties’ options, faced with this division of case law on both the subject of the access to records clause and the common interest doctrine? Some cedents have tried to protect themselves by including “non-waiver” provisions either in the reinsurance contract or a separate pre-audit agreement. It is not clear how effective such precautions would be if the jurisdiction is one in which the parties do not satisfy the common interest requirements. There are enough negative cases to heighten ceding companies’ concerns that once given away, the privilege will be gone forever. Where it is clear in the jurisdiction that the common interest doctrine can be claimed, it may bolster reinsurers’ arguments that they should be entitled to such documents without fear of waiving any privilege associated with them. However, there is often no certainty what the eventual choice of law will be for individual reinsurance agreements.

<sup>7</sup> *United States v. American Tel. & Tel. Co.*, 642 F.2d 1285, 1299 (D.C.Cir.1980).

<sup>8</sup> See *United States Fire Ins. Co. v. General Reinsurance Corp.*, 1989 WL 82415 at \*3 (S.D.N.Y.1989); *Hartford Steam Boiler Inspection and Ins. Co. v. Stauffer Chem. Co.*, 1991 WL 230742 at \*2 (Conn.Super.Ct.1991); *Great American Surplus Lines Ins. Co. v. Ace Oil Co.*, 120 F.R.D. 533, 537-38 (E.D.Cal.1988); *American States Ins. Co. v. Glover*, 1992 WL 78786 at \*6 (6th Cir.1992).

<sup>9</sup> *Hartford Steam at 2*.

Even a confidentiality clause or agreement, which can be found in many reinsurance contracts, will not protect the ceding company from the possibility that sharing documents with its reinsurer could destroy the privilege.

A cautionary note is that each jurisdiction's rules on privilege may impact this discussion. For example, in *Great American Surplus Lines Ins. Co. v. Ace Oil Co.*, the court's reliance upon California law was key. California law differs markedly from federal law in that, under California law, only a client may waive the attorney-client privilege, thereby eliminating any possibility of waiver through inadvertent production by the attorney (or in this case, by the reinsurer). Thus, when the reinsurer disclosed the disputed documents, it did not hold the attorney-client privilege and could not have waived the attorney-client privilege held by the cedent.

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