The Legal Intelligencer
THE OLDEST LAW JOURNAL IN THE UNITED STATES 1843-2016
PHILADELPHIA, TUESDAY, JANUARY 26, 2016
An ALM Publication

Discovery of Reinsurance and Reserve Information

BY TIMOTHY W. STALKER

Coverage litigation between insurance carriers and their policyholders is now commonplace in Pennsylvania, as it is in most other states. Oftentimes, when a dispute arises, counsel for the policyholder will file a complaint alleging breach of contract and "bad faith" by the carrier in its handling of the claim. In many instances, in an attempt to support his position, the policyholder will serve "blunderbuss" discovery requests upon the insurance carrier, in an effort to obtain information that contradicts that the position taken by the carrier vis-a-vis the policyholder.

The purpose of this paper is to provide a broad overview of the evolving cases of law in Pennsylvania regarding the discovery or reinsurance and reserve information in the context of coverage or "bad faith" litigation between a policyholder and its insurance carrier.

'Bad Faith' Claim Handling

A "bad faith" claim handling is a generic term that is used in Pennsylvania and other states to describe the alleged failure of the insurance carrier to handle a policyholder's claim in compliance with pertinent policy provisions or applicable statutory or fair claim handling regulations.

Pennsylvania's insurance bad faith statue (42 Pa.C.S.A. Section 8371) provides in pertinent part: in an action arising under an insurance policy, if the court finds that the insurer has acted in bad faith toward the insured, the court may take all of the following actions: (1) Award interest on the amount of the claim from the date the claim was made by the insured in an amount equal to the prime rate of interest plus 3 percent; (2) Award punitive damages against the insurer; (3) Assess court costs and attorney fees against the insurer, as held in Williams v. Progressive Northern Insurance Company, (M.D. Pa. Dec. 4, 2015).

Mere negligence or bad judgment is insufficient for a finding of bad faith, at least under the bad faith statute, as in Polselli v. Nationwide Mutual Fire Insurance, 23 F.3d 747, 751 (3d Cir. 1994); Terletsky v. Prudential Property and Casualty Insurance, (Pa. Super. 1994), appeal denied (Pa. 1995). If an insurer had a reasonable basis for denying benefits, even if incorrect, it should have no liability for bad faith, as in Condio v. Erie Insurance Exchange, 899 A.2d 1136 (Pa. Super. 2006) (reversing summary judgment in favor of insured on bad faith claim because evidence did not support finding as matter of law that insurer acted without reasonable basis), appeal denied, 912 A.2d 838 (Pa. 2006); Hartman v. Motorists' Mutual Insurance Company, 2006 U.S. Dist. LEXIS 1719 (W.D. Pa. 2006) (despite finding coverage, court held insurer did not act in bad faith because its interpretation of the pollution exclusion clause was reasonable).

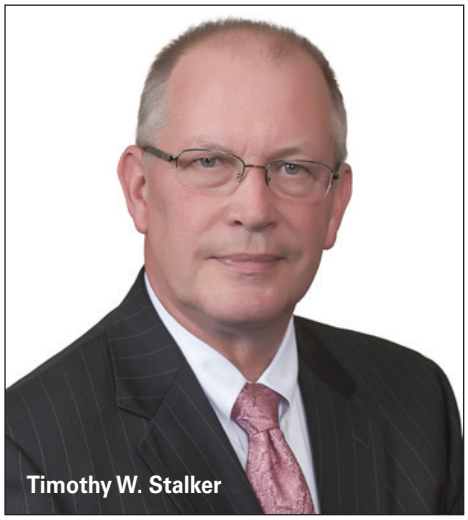
Bad faith on the part of an insurer is any frivolous or unfounded refusal to pay proceeds of a policy; it is not necessary that such refusal be fraudulent. For purposes of an action against an insurer for failure to pay a claim, such conduct imports a dishonest purpose and means a breach of a known duty (i.e., good faith and fair dealing), through some motive of self-interest or ill will; mere negligence or bad judgment is not bad faith, as in Post v. St. Paul Travelers Insurance Company, (3d Cir. 2012). The standard to establish bad faith for the policyholder, is clear and convincing evidence, as in Amica Mutual Insurance v. Fogel, (3d Cir. 2011).

Discovery Requests

Two ways that policyholders attempt to establish dishonest or improper conduct on the part of an insurance carrier is through the production of reinsurance information and case reserves. In Pennsylvania, insurance companies have had mixed success in resisting these requests.

1. Reinsurance Generally

In general terms, reinsurance is insurance of insurance companies. It is a mechanism whereby


Timothy W. Stalker

insurers spread their financial risk for loss. Reinsurance comes in many forms, however, the two main types of reinsurance agreements are:

(a) Facultative reinsurance, which is coverage for a specific risk such as the Ben Franklin Bridge or the Wells Fargo Center; and

(b) Treaty reinsurance, which is coverage for a book of business underwritten by the insurer, such as commercial general liability or personal line.

Each type of reinsurance has specific reporting and reserving guidelines. Reinsurers also expect insurers (cedants) to accurately and timely report their claims to the reinsurance agreements.

2. Production of Reinsurance Information

Rhone-Poulenc Rouer v. Home Indemnity Company, (E.D. Pa. 1991) is one of earlier cases in Pennsylvania regarding the production (or lack thereof) of reinsurance information. This matter involved aids-related coverage litigation. The plaintiff, Rhone, sought through discovery defendant, Home Insurance's reinsurance documents and reports for the policies at issue. The plaintiff also sought reserve information on the subject policies.

With respect to reinsurance information, the defendant argued:

That insurers should be unimpeded in their effort to obtain internal financial security and should not be fearful that the reinsurance process will be used against them in coverage litigation; that the discovery of reinsurance files opens the door to a variety of too many other interpretations and that whatever possibility of relevance there may be is too remote, and not required by the needs of the particular use.

The court held "there has been no finding of ambiguity in defendant's policies and therefore, discovery into extrinsic evidence such as reinsurance documents or information should not and will not be permitted."

TIG Insurance Company v. Tyco International, (M.D. Pa. Nov. 12, 2010) involved a dispute between Tyco, Grinnell the Brooklyn Hospital Center, and TIG Insurance Company. The lawsuit involved whether Grinnell's policy with TIG covered the settlement of an underlying action. In its discovery requests, Grinnell sought claims and underwriting manuals, reinsurance agreements and reserve information from TIG.

The court denied Grinnell's discovery requests regarding reinsurance agreements between TIG and its reinsurers, finding: Its [TIG's] arrangements with other insurers may or may not provide insight into the meaning of the terms of the policy between TIG and Grinnell. Moreover, and more importantly, what TIG and its reinsurers may agree a term means as between them is not, ipso facto, probative of what the term means in the subject policy.

The foregoing decision should be compared to PECO Energy v. Insurance Company of North America, (Pa. Super Ct. 2004). This case involved environmental coverage litigation between PECO and its insurance carriers. The Superior Court rejected the insurers' public policy and attorney-client privilege arguments and ordered the production of reinsurance information involving the insurers' handling of PECO's claim.

3. Production of Reserve information

A second area in which disputes sometimes arise over documents is when reinsurers seek access to the reports of the cedent's counsel in the underlying coverage actions either pursuant to the access to records provision contained in reinsurance agreements or during discovery in an arbitration.

In Rhone, the court also considered and denied the production of reserves. The court noted that reserves were "information of very tenuous relevance, if any relevance at all, as well as constituting work-product material." Noting Hickman v. Taylor, 329 U.S. 495 at 512, 67 S. Ct. at 394, the court held: Although these risk management documents being sought by plaintiffs may not have in themselves been prepared in anticipation of litigation, they may be protected from discovery to the extent that they disclose the individual case reserves calculated by defendants' attorneys. The individual case reserve figures reveal the mental impressions, thoughts and conclusions of an attorney in evaluating a legal claim. By their very nature they are prepared in anticipation of litigation, and consequently, they are protected from discovery as opinion work product.

The court also denied the production of reserve information in TIG, ruling:

"Grinnell seeks reserve information on the basis that it may show how TIG interprets the policy. Reserve amounts are generally required by state law to cover potential liability. The fact that in setting the reserve amount, a company such as TIG allows for an interpretation of its policy which has not been determined and with which it does not agree is of little value in determining the meaning of a policy term or terms. It is simply too speculative to provide good cause to discover it."

Recently, in Sharp v. Travelers Personal Security Insurance, (Pa. County Ct. 2014) the court granted in part the insured's motion to compel discovery. In Sharp, the plaintiff filed a complaint, asserting claims for breach of contract, violations of the Motor Vehicle Financial Responsibility Law, 75 Pa. C.S. 1797(b)(1) and violations of the Unfair Trade and Consumer Protection Law (UTPCPL) against Travelers, her UIM carrier. The lawsuit was filed after the plaintiff received notification from Travelers that benefits would be cut off after Jan. 15, 2010, due to the plaintiff's alleged non-compliance with the scheduling of a medical examination. The plaintiff served 101 interrogatories and 75 discovery requests on Travelers; Travelers filed 25 objections to the interrogatories and 49 objections to the requests for production. On Nov. 15, 2013, Sharp and Travelers filed for de novo appeals of the Special Master's ruling.

With respect to reserve information, the court ruled that:

"since Sharp has not presented a first party bad faith claim against Travelers based upon its handling of Sharp's medical expense benefits and UIM claims, Travelers' loss reserves information for those claims remains protected from discovery as opinion work products."

In Smith v. Progressive Specialty Insurance, (W.D. Pa. Nov. 4, 2015), the plaintiff brought an action against her automobile insurance carrier, Progressive Insurance Company (Progressive), alleging breach of contract and bad faith regarding her UIM claim.

The plaintiff served discovery requests on the insurer, and the insurer provided the insured with non-privileged portions of UIM claim notes along with a privilege log. The plaintiff then filed a motion to compel in which she argued that the redactions related to the insurer's valuation of her UIM claim and reserves were relevant to her bad-faith claim. Progressive opposed the motion to compel, arguing that the claim notes and reserves are protected from discovery as opinion work product, or alternatively, the information requested should be produced to the court for an in-camera inspection.

The court noted that there is "competing treatment of whether reserve information is discoverable in a bad-faith lawsuit," but ordered the insurer to produce any previously redacted reserve information in the claim file. Progressive was also ordered to produce to the court all entries it had previously redacted in the UIM claim notes based upon the work-product doctrine in order for the court to conduct an in-camera review. Finally, the court ordered Progressive to produce information it had previously redacted pursuant to its so-called "confidential and proprietary" privilege, finding that disclosure of this information appeared adequately protected by the parties' confidentiality agreement.

In handing litigation involving allegations of breach of contract or "bad faith" claim handling, insurance carriers should anticipate that the policyholder will attempt to obtain reinsurance and claim reserve information in an effort to bolster his or her claims against the carrier. As the above cases illustrate, there is some inconsistency in Pennsylvania regarding the production of this information. Nevertheless, the best approach for an insurance carrier is to handle its policyholder's claims consistent with its reserves, its internal guidelines and reports to reinsurers. •

Special to the Law Weekly Timothy W. Stalker is a partner in Weber Gallagher's Reinsurance Practice Group. He has spent more than 30 years in the insurance and reinsurance industry, where he has counseled both domestic and foreign insurers and reinsurers.