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EXPERT ANALYSIS

Reinsurance: What Every Policyholder Should Know

By Catherine Serafin, Esq.
Lowenstein Sandler LLP

Reinsurance is insurance for insurance companies.[1] Many policyholders do not realize that, when they submit a claim to their insurance company, the insurance company, in turn, submits a claim to its reinsurer and takes a position about coverage for the policyholder's claim. This process is important to policyholders for a number of reasons, including discovering whether the insurance company is taking inconsistent positions with its policyholder and its reinsurer, and learning the insurance company's assessment of the value of the claim.

Policyholders, however, often do not know what is going on behind the scenes. Policyholders should educate themselves on this process, and press for information, in order to maximize their coverage.

TYPES OF REINSURANCE AND WHAT IS COVERED

When an insurance company (the "cedent" or "ceding company") buys reinsurance, it generally can buy one of two types: treaty reinsurance or facultative reinsurance. Treaty reinsurance (not to be confused with the "reinsurance treaty") covers more than one insurance policy sold by the cedent, such as all policies sold to a particular class of business. Facultative reinsurance generally is negotiated for a particular risk and covers a single insurance contract.[2]

Reinsurance is a way for insurance companies to spread the risk of loss.[3] If the insurance company pays a claim submitted by one of its policyholders, the insurance company can, in turn, submit a claim to its reinsurer(s) and be reimbursed for all or part of that loss. The ceding company can negotiate reinsurance coverage for, among other things, any defense costs paid with respect to its policyholder's claim, its own claim administration or processing costs (such as claim investigation costs, and fees and expenses if the insurance company hires outside counsel to assist with the claim), and any settlement or judgment paid on behalf of its policyholder.[4] Insurance companies even can buy reinsurance covering them if they are found to have acted in bad faith with respect to a claim.[5]

HOW TO GET REINSURANCE DETAILS FOR YOUR CLAIM

If your claim is in litigation, the scope of discovery under the Federal Rules of Civil Procedure is quite broad. Rule 26(b)(1) allows parties to "obtain discovery regarding any nonprivileged matter that is relevant to any party's claim or defense." The requested information need only be "reasonably calculated to lead to the discovery of admissible evidence."

Reinsurance agreements are inherently relevant in insurance actions.[6] Courts routinely hold that an insurer's communications with reinsurers are discoverable.[7] Communications between two unrelated entities — the cedent and its reinsurer — are the type of evidence that policyholders should seek in discovery if the claim is in litigation.[8]

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For example, policyholders should send requests for the production of documents asking for production of reinsurance treaties applicable to the claim, as well as all communications among the insurance company, its reinsurers and any intermediary, such as a reinsurance broker. Policyholders also should consider sending third-party subpoenas directly to reinsurers and the reinsurance broker.

Asking deposition questions of claim representatives can be fruitful, because claim representatives often prepare reports that are passed on to reinsurers regarding the insurance company's assessment of coverage for the claim, or have direct interaction with reinsurer representatives during reinsurer audits of the insurance company.

Insurance companies generally resist such discovery on privilege, work product and confidentiality grounds. However, because insurance companies communicate information about strengths and weaknesses of a policyholder's claims to reinsurers as a matter of routine business practice, courts have allowed reinsurance discovery, noting that such communications frequently contain admissions by insurers that support a policyholder's claims for coverage, and rebut the insurers' defenses to coverage.[9]

Further, many courts find that there is no privilege with respect to these routine business communications. For instance, a federal court in Nevada recently found that an insurance company "and its reinsurers are in the business of insurance and must continue to make business judgments and decisions when litigation is foreseeable, threatened or pending," and concluded that an insurance company's business decisions are not privileged.[10] Any confidentiality concerns can be resolved through the use of a protective order in the case.

Reinsurance information and communi-cations may prove relevant to many issues in the case. For example, they may reveal the insurance company's construction of the policy terms at issue. That information is relevant to show how the policy should be interpreted, the insurance company's practical construction of the provisions at issue, whether the insured's expectations of coverage were reasonable, and the validity of certain claims or affirmative defenses, such as unclean hands, bad faith and estoppel.[11] Reinsurance documents also can be used to examine insurance company witnesses, as well as to impeach them with any prior inconsistent statements.

Following the production of reinsurance communications, policyholders and courts often discover that insurers take contradictory positions. For instance, a federal court in Oregon recently precluded an insurer from taking a position against its policyholder that was "inherently inconsistent with its earlier position" in seeking reinsurance coverage from its reinsurers.[12] The court previously had granted a motion to compel reinsurance discovery, and so the policyholder was able to present "considerable evidence demonstrating" the inconsistency of the insurer's positions.[13]

The reinsurance evidence revealed that the insurer had demanded reinsurance coverage for its potential payout to its policyholder, despite denying liability to its policyholder. Discovery further revealed that the insurer had in fact already recovered "substantial amounts" from its reinsurers for the same liability.[14] The court found that the contradictory positions taken by the insurance company in that case could be used as admissions, and also would support certain of the policyholder's affirmative defenses.[15]

If the claim is not in litigation, the policyholder still can take steps to determine whether there is reinsurance for the claim. For instance, a policyholder could ask a mediator to inquire about the matter and, if there is an arbitration allowing discovery, a convincing case can be made to arbitrators regarding the relevance of the information. Sometimes, if reinsurance is the "sticking point" in settlement discussions, policyholders might ask that reinsurance companies have a seat at the table.

CONCLUSION

Reinsurance communications and information, although not readily available to policyholders, can help policyholders properly value their claim, and prove the case for coverage at trial. Directed discovery early in a case, and motion practice, if necessary, is key to getting the information needed. Insurance companies generally do not voluntarily produce reinsurance information, so policyholders should be prepared to press the issue. Having the complete picture of which entities bear financial risk with respect to the claim is an immeasurable aid to settling, as well as litigating, the claim.

NOTES

[1] *See Lipton v. Superior Court (Lawyers. Mut. Ins. Co., real party in interest),* 48 Cal. App. 4th 1599, 1617 (Cal. Ct. App., 2d Dist. 1996); *Lyon v. Bankers Life & Cas. Co.,* No. CIV. 09-5070, 2011 WL 124629, at *18 (D.S.D. Jan. 14, 2011).

[2] 4-40 NEW APPLEMAN INSURANCE LAW PRACTICE GUIDE § 40.04(1). This is an overgeneralization designed to give the reader only a basic familiarity of the main types of reinsurance. There are a number of different types of treaty reinsurance, such as proportional and non-proportional, and reinsurance treaties may cover only portions of the cedent's liability. *See id.,* § 40.04(2). Also, reinsurance generally is purchased in layers, and there is much variation in treaty terms. Once a policyholder learns what type and which treaty(ies) of reinsurance cover the claim at issue, further research should be done so that the policyholder understands exactly what is covered.

[3] *See Transport Ins. Co. v. TIG Ins. Co.*, 202 Cal. App. 4th 984, 989 (Cal. Ct. App., 1st Dist. 2012) ("Reinsurance provides insurers with the ability to spread the risk they have assumed, thereby preventing any one insurer from suffering a catastrophic loss.") (quoting 1A COUCH ON INSURANCE 3d (2010 revised ed.), Reinsurance, § 9.1).

[4] 4-40 New Appleman Insurance Law Practice Guide §§ 40.04(2), 40.13.

[5] *Hartford Fire Ins. Co. v. Lloyd's Syndicate,* No. 3:97-CV-00009 (AVC), 1997 WL 33491787 (D. Conn. July 2, 1997); 4-40 NEW APPLEMAN INSURANCE LAW PRACTICE GUIDE § 40.14.

[6] *See, e.g., Lyon,* 2011 WL 124629, at *17-18.

[7] *Id.* at *18 ("There can be no question [insurers] communicated (pre-or-post-issuance or both) with their reinsurers about the policies. Regardless of the legal nature of the reinsurance arrangements, those communications are relevant.") (*citing Nat'l Union Fire Ins. Co. v. Cont'l Ill. Corp.,* 116 F.R.D. 78, 83 (N.D. Ill. 1987)); *see also Allendale Mut. Ins. Co. v. Bull Data Sys.,* 152 F.R.D. 132, 139-42 (N.D. Ill. 1993); *Stonewall Ins. Co. v. Nat'l Gypsum Co.,* No. 86 CIV. 9671, 1988 WL 96159 (S.D.N.Y. Sept. 6, 1988); *Owens-Corning Fiberglass Corp. v. Allstate Ins. Co.,* 660 N.E.2d 765, 768 (Ohio Ct. Com. Pl. 1993); *Progressive Cas. Ins. Co. v. FDIC, as Receiver for Silver State Bank,* No. 2:12-cv-665-KJD-PAL, 2013 WL 5947783, at *9-10 (D. Nev. Nov. 1, 2013); *Progressive Cas. Ins. Co. v. FDIC as receiver of Vantus Bank,* No. C 12-4041-MWB, 2014 WL 4947721 (N.D. Iowa Oct. 3, 2014); *Progressive Cas. Ins. Co. v. Delaney*, No. 2:11-cv-0678-LRH-PAL (D. Nev. Dec. 11, 2013) (Dkt. 83).

[8] *See Lipton,* 48 Cal. App. 4th at 1617; *Ins. Co. of State of Pa. v. City of San Diego,* No. 02-cv-693, 2008 WL 926560, at *1 (S.D. Cal. Apr. 4, 2008). *See also Olin Corp. v. Cont'l Cas. Co.,* No. 2:10-cv-00623, 2011 WL 3847140 (D. Nev. 2011) (finding that communications with reinsurers "may contain information relevant to whether [a party] has a right to recover under the policy").

[9] *See, e.g., U.S. Fire Ins. Co. v. Bunge N. Am.,* 244 F.R.D. 638, 645 (D. Kan. 2007); *Regence Group v. TIG Specialty Ins. Group,* No. 3:07-cv-01337, at *3-4 (D. Or. May 1, 2009), *aff'd on mot. for reconsideration,* 2010 WL 476646 (D. Or. Feb. 4, 2010); *Bull Data,* 152 F.R.D. at 139; *Nat'l Union Fire Ins. Co. v. Stauffer Chem. Co.,* 558 A.2d 1091, 1096-97 (Del. 1989).

[10] *Silver State,* 2013 WL 5947783, at *10; *see also Vantus Bank,* 2014 WL 4947721. Many courts have found that there is no "reinsurance" privilege. *Reliance Ins. Co. v. Am. Lintex Corp.,* No. 00 CIV 5568, 2001 WL 604080, at *4 (S.D.N.Y. June 1, 2001). *See also Bunge N. Am.,* 244 F.R.D. at 645 (stating that "[t]here is no basis for a blanket protection of [reinsurance] documents from discovery"); *Bull Data*, 152 F.R.D. at 136-37.

[11] *Stonewall*, 1988 WL 96159 (insurer's communications with reinsurers may "evidence the insurer's understanding of the underlying claims and may contain admissions that these claims are covered").

[12] *Regence Group v. TIG Specialty Ins. Group,* 903 F. Supp. 2d 1152 (D. Or. 2012).

[13] *Id.*

[14] *Id.*

[15] *See id. (citing Estate of Ashman v. Comm'r of Internal Rev.,* 231 F.3d 541, 543 (9th Cir. 2000) (stating that "[a]n inconsistent position taken with an insurance carrier ... on the one hand and in a court on the other can result in judicial estoppel")).

Catherine Serafin is a partner with **Lowenstein Sandler LLP** in Washington. She has been representing policyholders in coverage disputes since the 1980s. The views expressed in this article are hers, and are not the views of the firm or any of its clients. The author gratefully acknowledges Courtney Alvarez, an associate in the firm's Washington office, for her assistance in the preparation of this article.