Reinsurance Agreements and Initial Disclosures

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A recent decision by a North Carolina federal court adds to a list of cases requiring insurance company defendants in coverage actions to produce reinsurance agreements as part of their initial disclosures under Federal Rule of Civil Procedure 26. Although the list may be growing, many of these decisions adopt an overly simplistic, one-size-fits-all approach that fails to recognize the complexities of reinsurance and the wide variety of reinsurance covers that may or may not apply to a policyholder's claim under an insurance policy. Courts would be better served to take a case-by-case approach to determine whether disclosure of reinsurance agreements advances the policy objectives underlying Rule 26's disclosure requirement – i.e., "to enable counsel for both sides to make the same realistic appraisal of the case, so that settlement and litigation strategy are based on knowledge and not speculation."[1] While there may be unique or particular circumstances in which disclosure might serve those objectives, in the majority of coverage cases, reinsurance is completely irrelevant.

In *United States Tobacco Cooperative v. Certain Underwriters at Lloyd's*,[2] United States Tobacco Company (USTC) brought suit against 13 Lloyd's syndicates (Syndicates) seeking coverage with respect to damages tobacco growers suffered from Hurricane Matthew. USTC filed a motion to compel arguing that the Syndicates' initial Rule 26 disclosures were deficient for a number of reasons, including the Syndicates' failure to produce any reinsurance agreements. The Syndicates argued that its reinsurance agreements were not relevant. The court held that Rule 26(a)(1)(A)(iv) required disclosure of reinsurance agreements, explaining that "the only relevant question here is whether a reinsurer may be liable to pay part of a judgment against the [Syndicates]." The court did not rely on any prior decisions but did cite to the Advisory Committee Notes to the 1970 amendments to Rule 26 and concluded that production of reinsurance agreements served the purpose of the disclosure requirements.

While the *United States Tobacco Cooperative* court did not offer any further analysis beyond reference to the Rule itself and the Notes to the Advisory Committee, courts in prior cases have conducted a more thorough review of the disclosure issue. In 2016, the court in *Certain Underwriters at Lloyd's v. Amtrak*[3]likewise ordered production of reinsurance agreements. While the court acknowledged the difference between insurance policies and reinsurance contracts, it construed "insurance" and "reinsurance" as functional equivalents under Rule 26(a)(1)(A)(iv). The court rejected Lloyd's arguments explaining why the reinsurance agreements, which Lloyd's claimed might exceed 1,000 in number, would have no impact on potential settlement. The court concluded that "the availability of reinsurance might very well affect an *insured's* willingness to settle, especially where a direct insurer's solvency may be an issue." More recently, in *Estate of Brown v. Lambert*,[4] a California federal court required a self-insured city to produce reinsurance contracts issued pursuant to California's joint powers authority statute. The city had failed to disclose, until after a trial resulting in a $6 million verdict, that its ultimate liability was limited to a $3 million retention above which reinsurance contracts provided up to $50 million in coverage. Although these facts presented a unique scenario in which the reinsurance contracts were arguably relevant to the parties' "realistic appraisal" of the case, the court stated that "relevance is not an appropriate inquiry here."

The courts' rigid application of Rule 26(a)(1)(A)(iv) requiring initial disclosure of reinsurance agreements ignores the important differences between insurance and reinsurance, the wide variety of reinsurance coverages that may apply and the difficulty insurers face in determining at an early stage of litigation whether reinsurance may even be implicated at all. Specifically, the court rulings ignore key factors such as the following:

- reinsurance is very different from insurance for purposes of case appraisal, settlement and trial preparation – while policy limits may be a factor in settlement discussions, reinsurance limits don't affect settlement;
- while insurers often control settlement decisions for claims against their insureds, reinsurers typically do not control settlement of claims against insurers;
- while some insureds may have limited financial resources, there is rarely a question about an insurance company's solvency;
- reinsurance treaties typically provide broad coverage and do not apply on a policy-specific basis;
- reinsurance is often written on an excess of loss basis and in layers – without a clear understanding of the scope of potential damages and bases therefore, it may be difficult, if not impossible, to determine whether any particular reinsurance agreement may apply (e.g., is an insurer required to produce its catastrophe treaties?); and
- reinsurance also may apply on a different basis than the insurance policy applies to underlying claims (e.g., based on definitions of business covered or loss occurrence).

The approach of some courts to initial disclosures stands in contrast to how courts have addressed discovery of other reinsurance-related information, including communications between insurers and their reinsurers, in the context of insurance coverage litigation. In that context, courts examine relevance and routinely decline to require production of such documents because they are irrelevant. Courts would be better served to take a similar case-by-case approach to disclosure of reinsurance agreements under Rule 26(a)(1)(A)(iv).[5] While there may be unique circumstances where reinsurance is relevant to counsel's appraisal of the case and potential settlement – like the *Lambert* case where the reinsurance functioned more like insurance than traditional reinsurance – in the overwhelming majority of cases, reinsurance agreements will have no bearing on the policyholder's claims against its insurer.

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[1] Fed. R. Civ. P. 26(a) advisory committee's notes to 1970 amendment.

[2] No. 5:19-CV-430, 2021 U.S. Dist. LEXIS 69206 (E.D.N.C. April 9, 2021).

[3] No. 14-CV-4717, 2016 U.S. Dist. LEXIS 64088 (E.D.N.Y. May 16, 2016).

[4] No. 15-CV-1583, 2020 U.S. Dist. LEXIS 117235 (S.D. Cal. July 2, 2020).

[5] *See, e.g., Cummins, Inc. v. ACE Am. Ins. Co.*, No. 1:09-cv-738, 2011 U.S. Dist. LEXIS 4568 at *29-31 (S.D. Ind. Jan. 14, 2011) (declining to order production of reinsurance contracts where plaintiff did not dispute insurer defendant's ability to satisfy judgment and contracts were not relevant to coverage or bad faith issues).