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NEWSLETTER

Coverage Litigation Focus: The Discoverability of an Insurer's Loss Reserves

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The discoverability of an insurer's loss reserves, or the money an insurer sets aside to cover potential liabilities, frequently arises in coverage litigation. As one court has noted, "Everybody in coverage litigation with an insurance company would like to secure reserve information to use against it." *J.C. Assoc. v. Fid. & Guar. Ins. Co.*, No. Civ. A. 01-2437 RJLJM, 2003 WL 1889015 (D.D.C. Apr. 15, 2003). Many states require insurers to set loss reserves, *see, e.g.*, Cal. Ins. Code § 923.5 (West 2005); N.Y. Ins. Law § 1303 (McKinney 2006), and such reserves serve accounting and business purposes. The information, however, may also reflect an insurer's legal assessment and valuation of a claim. The varying purposes, methodologies and degrees of analysis embodied in loss reserve information are all factors that bear on the discoverability of reserves. Because of the number of variables courts may consider and the case-specific nature of discovery disputes, case law regarding the discoverability of reserves is mixed. This article highlights the major issues raised by insurers' attempts to protect reserves on the grounds of privilege and relevance.

Two leading cases have held, to varying degrees, that loss reserve information may be protected by the work product privilege. *See generally Simon v. G.D. Searle & Co.*, 816 F.2d 397 (8th Cir. 1987) (work product doctrine may protect individual reserve figures but not aggregate reserve information); *Rhone-Poulenc Rorer Inc. v. Home Indem. Co.*, 139 F.R.D. 609 (E.D. Pa. 1991) (reserves protected by work product doctrine and may reflect privileged attorney-client communications). In *Simon*, a self-insured manufacturer faced approximately forty products liability actions and refused to disclose risk management documents that included aggregate reserves information. *Simon*, 816 F.2d at 398-99. The court held that "individual case reserves reveal the mental impressions, thoughts and conclusions of an attorney in evaluating a legal claim" and are protected opinion work product. *Id.* at 401. The manufacturer, however, based the aggregate reserves figures on a formula that compiled individual case reserves and accounted for other variables. *Id.* at 402. The court concluded that these aggregate figures diluted the mental impressions related to specific cases and held that the aggregate figures were not protected by the work product doctrine, except to the extent individual case reserves were disclosed. Id. at 401-02.

The United States District Court for the Eastern District of Pennsylvania interpreted the work product doctrine more broadly to provide protection for individual and aggregate reserve figures. *Rhone-Poulenc*, 139 F.R.D. at 613-15. In *Rhone-Poulenc*, the court stated that individual case reserves established on legal input involve the

legal assessment of a claim in anticipation of litigation and are protected by the work product doctrine. *Id.* at 614; *see also Independent Petrochem. Corp. v. Aetna Cas. & Sur. Co.*, 117 F.R.D. 283, 288 (D.D.C. 1986) (reserves are work product when based on legal input and may reflect attorney-client communication). The *Rhone-Poulenc* court extended this protection to risk management documents that contained aggregate reserve information because this material still contained mental impressions documented in anticipation of litigation. *Rhone-Poulenc*, 139 F.R.D. at 615. The application of work product protection may be extended to documents that reveal the analysis or methodology an insurer uses to set reserves. *See In re Pfizer*, 1994 WL 263610, at *1-2 (S.D.N.Y. June 6, 1994) (the methodology for setting individual reserves is protected as work product but methodology for aggregate reserves not work product).

The application of the work product doctrine, however, requires some case-specific evaluation and does not necessarily depend on a general rule for reserves. *See, e.g., Certain Underwriters at Lloyds, London v. Fid. & Cas. Ins. Co. of New York*, No. 89 C 876, 1998 WL 142409 (N.D. Ill. Mar. 24, 1998) (reserves protected in this case because based on attorney's evaluation of underlying case and created after date used to establish anticipation of litigation for discovery purposes). Some courts have therefore concluded, on a case-specific basis, that the insurer failed to meet its burden to show that work product applies. *See U.S. Fire Ins. Co. v. Bunge N. Am., Inc.*, 2007 WL 1531846 (D. Kan. May 25, 2007) ("blanket claim" of work product insufficient to meet insurer's burden); *Nat'l Union Fire Ins. Co. v. Cont'l Ill. Group,* 1988 WL 79515 (N.D. Ill. Jul. 22, 1988) (reserves not protected work product where insurer did not meet burden of showing that reserves reflected attorney's thought processes). At least one court, however, has held that reserves do not contain confidential communications and are established in the ordinary course of business without examining how or why the insurer established the reserves at issue. *Loyal Order of Moose, Lodge 1392 v. Int'l Fid. Ins. Co.*, 797 P.2d 622, 628 n.14 (Alaska 1990).

Insurers also may claim lack of relevance as a basis for withholding reserves information. A determination of relevance necessarily requires that a "court thoroughly consider[] the specific way the particular insurance company in a particular case determines reserves for a particular claims" and "the nature of the underlying litigation and the purpose for which the information is sought." *State ex rel. Erie Ins. Prop. & Cas. Co. v. Mazzone*, 625 S.E.2d 355, 359-60 (W. Va. 2005). To the extent an insurer sets a reserve to comply with regulations or by personnel who know little about the interpretation of the policies at issue, reserve information is not relevant to the existence of coverage. *See, e.g., Silva v. Basin Western, Inc.*, 47 P.3d 1184, 1190 (Colo. 2002) ("Statutory requirements [and] limitations in the evaluation . . . limit the usefulness of reserves . . . as valuations of claims."); *J.C. Assoc.*, 2003 WL 1889015, at *2 ("a reserve figure is not an admission unless it is in fact an assessment of liability rather than the product of state law or regulation or driven by tax or other financial considerations"); *Leksi v. Fed. Ins. Co.*, 129 F.R.D. 99, 106 (D.N.J. 1989) (reserve set by personnel unfamiliar with policy at issue only "tenuously relevant" to existence of coverage); *In re Couch*, 80 B.R. 512, 517 (S.D. Cal. 1987) (reserves requirements grounded in regulation and cannot be equated with admission of liability because setting reserve only partially in insurer's control). Likewise, where reserve information is calculated based on average losses over time or past experience, the insurer may persuasively argue that the information has little relevance to the facts or issues raised in an individual claim.

See Mazzone, 625 S.E.2d at 359.

As a general matter, many courts agree that reserve information has "tenuous relevance, if any relevance at all" to coverage issues. *See, e.g., Independent Petrochem.*, 117 F.R.D. at 288. In this vein, courts have recognized that whether the information is relevant necessarily depends on the specific issue at hand. For example, when the issue is one of notice to the insurer, some courts have concluded that the date on which the insurer set a reserve is relevant. *See, e.g., Gen'l Elec. v. DIRECTV*, 184 F.R.D. 32, 35 (D. Conn. 1998); *Savoy v. Richard A. Carrier Trucking, Inc.*, 176 F.R.D. 10, 12 (D. Mass. 1997). That the date on which the insurer acted, however, may be relevant to the particular coverage issue should not serve a basis to open the door to other reserve-related information. Indeed, in *Savoy*, the court recognized as much and, although it required the insurer to disclose the date the reserve was set, the court granted a protective order as to the amount of the reserve. *Savoy*, 176 F.R.D. at 12.

Also, where the issue is the insurer's purported bad faith, some cases have held that reserve information may be subject to disclosure. According to one court, this is because the timing and establishment of a reserve—even if done in the ordinary course of business—may provide some evidence of the insurer's investigation and evaluation of the claim, which might be relevant to whether the insurer acted improperly. *Athridge v. Aetna Casualty & Surety Co.*, 184 F.R.D. 181, 192-93 (D.D.C. 1998); *see also Bunge N. Am.*, 2007 WL 1531846, at *9-11 (insurer required to disclose reserves where insured demonstrated that timing and establishment of reserves were relevant to allegations that insurer acted in bad faith in its claims handling); *N. River Ins. Co. v. Greater N.Y. Mut. Ins. Co.*, 872 F. Supp. 1411, 1412 (E.D. Pa. 1995) (reserve must bear some relation to insured's potential liability and is therefore relevant to bad faith failure to settle claim). Some courts further have held that information regarding reserves constitutes circumstantial evidence of an insurer's "state of mind," which potentially may be relevant to the allegations of misconduct asserted against the insurer. *See Bernstein v. Travelers Ins. Co.*, 447 F. Supp. 2d 1100, 1107-08 (N.D. Cal. 2006) (allowing discovery of reserves where insurer's state of mind and internal assessment of claim purportedly was critical to bad faith claim); *Groben v. Travelers Indem. Co.*, 266 N.Y.S.2d 616, 619 (N.Y. Sup. Ct. 1965) (stating that reserves are relevant to establishing insurer's state of mind and actions with regard to bad faith allegations).

It cannot be assumed, however, that reserve information is relevant in the context of a bad faith claim. For example, at least one court has rejected the notion that evidence that an insurer increased its reserves over time would help prove the insurer acted in bad faith with regard to any indemnification obligation. Rather, according to the court, such evidence would "merely [show] . . . that the cost of defending the [underlying litigation] increased over time." *Fid. & Deposit Co. of Maryland v. McCulloch*, 168 F.R.D. 516, 525 (E.D. Pa. 1996). Similarly, other courts have recognized that where reserves are set pursuant to a statutory or regulatory mandate, the insured may not support a bad faith denial claim by pointing to reserve evidence to suggest that the insurer in fact believed there was coverage. *See, e.g., Executive Risk Indem., Inc. v. Cigna Corp.*, No. 1495, 2006 WL 2439733 (Pa. Com. Pl. Aug. 18, 2006).

To protect reserves information, an insurer should be prepared to demonstrate how and why it created

reserves, if this information can establish that reserves reflect an attorney's thought processes and evaluation or were calculated in anticipation of litigation. Likewise, an insurer should not depend on general assertions of lack of relevance but should be able to refute the connection, if possible, to the specific issues raised in coverage or bad faith litigation.