An Examination of Reinsurers’ Associations in Underlying Claims: The Iron Fist in the Velvet Glove?

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An Examination of Reinsurers’ Associations in Underlying Claims: The Iron Fist in the Velvet Glove?

LOUIS TORCH*

I. INTRODUCTION

The onslaught of environmental and asbestos claims coupled with the aftermath of the terrorist attacks of September 11, 2001, and their deleterious effects on the commercial property reinsurance industry, has left insurers and reinsurers reeling.¹ This article submits that the iron fist in the velvet glove has replaced the once gentlemanly handshake that cemented contractual relations between cedent and reinsurer. The case law reveals that both cedent and reinsurer share the blame for this markedly adversarial shift. As the cases in this article demonstrate, cedents bear responsibility for shortcomings in their underwriting and claims handling, and reinsurers have often earnestly sought to avoid settlements even when clearly at fault.

The laws that govern the relationship between reinsurers and the cedents who they reinsure must keep pace with the evolutionary changes that take place between these parties. For example, have the courts’ analyses of doctrines such as “attorney-client privilege,” “work-product,” “common interest,” and “follow the fortunes” and its progeny, kept pace with the increased adversarial tenor between these two mutually dependent parties? This begs the question whether a reinsurer genuinely shares a common

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¹ The vast majority of newly filed asbestos litigation claims, which constitute a huge expense for insurers, are by people who have not exhibited medical symptoms; hence, they are aptly titled “unimpaired claims.” In fact, Equitas is appealing a California court decision which ruled that Equitas and other U.S. and London insurers were obligated to pay upwards of US $188 million for possible future asbestos claims not yet filed. Richard Banks, Hatch is Closed, but Michigan’s Doors Open: The Push for Asbestosis Reform, 1444 Insurance Day 11 (Sept. 18, 2003); see also Thomas Cunningham, London Market Documentation Requirements for Asbestos Claims: Reinsurance Contract Implications, 9 2001 Reinsurance Law Report (newsletter of Sidley Austin Brown & Wood, L.L.P.) 1, 10 (Winter 2001) (available at http://www.sidley.com/db30/cgi-bin/pubs/RLR.pdf) (discussing new documentation and claim procedure requirements in handling asbestos claims); Neil H. Wyland & Jonathan I. Katz, As the Dust Settles: Emerging Issues in the Wake of September 11, 9 2001 Reinsurance Law Report (newsletter of Sidley Austin Brown & Wood, L.L.P.) 1, 2 (Winter 2001) (available at http://www.sidley.com/db30/cgi-bin/pubs/RLR.pdf) (noting that the September 11 terrorist attacks will be the largest insured loss in insurance history).
goal with its cedent. Perhaps it is more accurate to say, first and foremost, a reinsurer strives to avoid a settlement with its cedent rather than to cooperate with the cedent in denying the underlying claim.

In some contexts, past payment methodologies by reinsurers have fallen by the wayside. For example, Scott Moser, a recently appointed executive at Equitas, the specialty fund vehicle that Lloyd’s established to administer and reinsure pre-1993 London syndicate liabilities, has changed its approach towards resolving asbestos claims. At one press report, Moser stated:

[T]here previously was a belief that if asbestos claims were settled with ‘swift small payment’ the problem would disappear and costly court battles could be avoided. But because of the significant increase in the number of claims in the past few years, that theory has been abandoned.2

Thus, the frequency and costs associated with reinsurance claims have forced cedents, reinsurers and the judiciary to reexamine centuries-old doctrines that often proved ill equipped to deal with this new battleground. Excess and umbrella carriers have invoked contract provisions such as the right to associate in the area of direct insurance to ensure that the parties were obligated to pay the underlying claim. Today, reinsurers have made use of this contract provision to gain access to information to support their arguments for avoiding reinsurance settlements. This article examines how reinsurers use different contract provisions and doctrines either 1) to align themselves with their cedents to defeat or minimize the costs of underlying claims, or 2) as a shield and sword against the cedent to prevent indemnifying the cedent for its losses.

II. THE MECHANICS OF A REINSURER’S INVOLVEMENT: COMING TO THE DANCE

A. Notice

A ceding company’s notice of an impending claim to its reinsurer becomes the springboard for the reinsurer’s right to associate in the defense of that claim. As discussed in greater detail below, the timing of the notice by the ceding company to its reinsurer can influence the relationship between the parties. Timely notice may yield cooperation between a cedent and its reinsurer. Accordingly, untimely notice may trigger a combative

2. Cunningham, supra n. 1, at 10.
relationship between a cedent and its reinsurer, should the reinsurer exer-
cise its right to associate in the defense of any underlying claim. Most
modern reinsurance contracts, particularly quota share, excess of loss and
facultative contracts typically include a notice requirement that may take
several forms.3

A typical notice clause may require that “prompt notice shall be
given by the [ceding insurer] to the Underwriting Managers on behalf of
the Reinsurers of any occurrence or accident which appears likely to in-
volve this reinsurance.”4 In addition to informing the reinsurer of a claim
or loss, the notice provision, more importantly, allows the reinsurer to set
adequate reserves and decide whether to associate in the defense of a
claim. The provision further aids in helping the reinsurer determine
whether to renew reinsurance coverage and how to set the appropriate price
for future coverage.5 Nevertheless, the advent of asbestos and environ-
mental liabilities have increased the tension between ceding companies and
their reinsurers. This tension is due, in part, to long-tail exposures that
make it more difficult for ceding companies to accurately assess the date of
loss and breadth of the claim. This predicament ultimately clouds which
reinsurer the ceding company should notify and when to give notice.6

Oftentimes, the financial stakes are so huge that the handshake, which
traditionally finalized agreements between cedents and reinsurers, has
come under increased scrutiny by reinsurers. Reinsurers have increasingly
sought to deny reinsurance claims. A reinsurer’s right to associate in the
defense of an underlying claim is an important albeit rarely exercised right.
This right to associate can profoundly impact a reinsurer’s financial obliga-
tions to the cedent.7 Late notice and disputes over the timing of notice
have become pivotal arguments raised by reinsurers in denying cedents’
claims.8 Ever mindful of the symbiotic relationship between the cedent
and the reinsurer, and the concomitant trust placed in the cedent, the Sec-
ond Circuit stressed the importance of notice provisions when it noted:

3. See e.g. C. E. Golding, The Law and Practice of Reinsurance 235, 248, 260 (5th ed., Witherby’s
Publg. 1987) (providing examples of varying notice requirements); Graydon S. Staring, Law of Rein-
surance § 17:1 (West 2004) (available at WL, REINSUR database) (discussing different notice re-
quirements).
Unigard III] (considering whether cedent provided proper notice when it informed its reinsurers that it
had entered into the Wellington Agreement).
5. Unigard III, 4 F.3d at 1065; Barry R. Ostrager & Mary Kay Vyskocil, Modern Reinsurance Law
7. Staring, supra n. 3, at § 17:1[4].
8. Foster, supra n. 6, at 773.
Indeed, reinsurers are so dependent upon ceding insurers for information that application of a cannon construing the reinsurance contract against the reinsurer would be highly anomalous . . . Prompt notice provisions in reinsurance are designed to: (i) apprise the reinsurer of potential liabilities to enable it to set reserves; (ii) enable the reinsurer to associate in the defense and control underlying claims; and (iii) assist the reinsurer in determining whether and at what price to renew reinsurance coverage.9

For the reasons set forth above, courts typically give reinsurers great latitude to inspect its cedent’s records relating to any claims under the reinsurance policy. Under general principles of contract law and the associated doctrines confined to the reinsured-reinsurer relationship, any failure by the cedent to make such records available for inspection may relieve the reinsurer of its obligation to indemnify its reinsured.10

The court in Unigard Security Insurance Co., Inc. v. North River Insurance Co. noted that

a provision that requires notice when it “appears likely to involve th[e] reinsurance,” does not require a “probability—much less a certainty—that the policy at issue will be involved. . . . All that is required is a ‘reasonable possibility’ of such happening, based on an objective assessment of the information available.”11

Even though most jurisprudence involves direct insurance, several reinsurance cases provide guidance in gauging emerging trends.

B. Prejudice as a Requirement for Untimely Notice

Two views prevail as to whether prejudice is presumed for untimely notice. At issue is whether a breach of the notice clause bars recovery ab-

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9. Unigard III, 4 F.3d at 1065 (citations and footnote omitted); see also Delta Holdings v. Nat. Distillers, 945 F.2d 1226, 1229 (2d Cir. 1991) (discussing the concerns that insurance and reinsurance markets have for determining risks to set premiums).


11. Unigard III, 4 F.3d at 1065 (interpreting its ruling in Christiania Gen. Ins. Corp. of N.Y. v. Great Am. Ins. Co., 879 F.2d 268, 276 (2d Cir. 1992), to require notice within a reasonable time). A brief procedural history untangles this confusing course of litigation. In the first case, brought before the United States District Court for the Southern District of New York, Unigard Sec. Ins. Co., Inc. v. N. River Ins. Co., 762 F. Supp. 566 (S.D.N.Y. 1991), the court ruled against reinsurer, North River’s late notice defense to indemnifying third-layer excess insurer, Unigard, for losses it paid on asbestos claims because North River had not been prejudiced by Unigard’s late notice. North River then appealed, see Unigard Sec. Ins. Co., Inc. v. N. River Ins. Co., 949 F.2d 630 (2d Cir. 1991), and the Second Circuit then certified the question to the New York Court of Appeals. The discussion that follows in part II(B) provides a summary of the litigation that followed.
sent a showing that the insurer (or reinsurer, in this case) has been prejudiced. Prejudice is presumed under the traditional view whereas a modern view has emerged which requires a showing of prejudice. Further, courts may view this issue differently in the direct insurance context as opposed to the reinsurance arena. Unigard III shows an interesting distinction between how direct insurance and reinsurance regard prejudice. For jurisdictions that do not require a showing of prejudice in the context of direct insurance, the opposite holds true in the reinsurance context.

The pivotal Unigard III case represents the emerging trend in those jurisdictions that require a showing of prejudice in the reinsurance context. Applying New York law, the court considered whether the cedent, North River, was obligated to notify its reinsurer, Unigard Security Insurance Company, that it had signed an intercompany agreement formed between producers of asbestos and insurers to resolve mounting claims from the deleterious effects of asbestos (the Wellington Agreement). Finalized in 1985, the parties had crafted terms and conditions and agreed that all disputes would be settled via alternative dispute resolution. The Wellington Agreement also stipulated how losses and limits would be paid. The Asbestos Claims Facility (a third party administrator) handled the administration of the claims. Unigard claimed that it was unaware that cedent, North River, had joined the Wellington Agreement, and therefore, it should not be liable for related claims. Unigard lost at the trial court level and on appeal the Second Circuit recognized that notice was an important issue and held that the cedent should have given notice that it had joined the Wellington Agreement. Nevertheless, the court found that the cedent did not act in bad faith, and Unigard, the reinsurer, failed to meet the prejudice standard required for the reinsurer to prevail.

In reaching its decision, Unigard III certified the following question to the New York Court of Appeals: “Must a reinsurer prove prejudice before it can successfully invoke the defense of late notice of loss by the reinsured?” The New York Court of Appeals answered in the affirmative and held that the defense of late notice required a showing of lack of notice.

12. Staring, supra n. 3, at § 17:1[4].
13. Ostrager, supra n. 5, at § 8.03[a].
plus harm.\textsuperscript{15} As discussed in greater detail below, regarding the judiciary’s views on differences between insurers and reinsurers with respect to notice provisions, the New York Court of Appeals commented:

A reinsurer is not responsible for providing a defense, for investigating the claim or for attempting to get control of the claim in order to effect an early settlement. Unlike a primary insurer, it may not be held liable for a breach of these duties. Settlements, as well as the investigation and defense of claims are the sole responsibility of the primary insurer; and settlements made by the primary insurer are, by express terms of the reinsurance certificate, binding on the reinsurer. Thus, failure to give the required prompt notice is of substantially less significance for a reinsurer than for a primary insurer.\textsuperscript{16}

Drawing from the New York Court of Appeals’ opinion, in response to the Appellate Court’s certified question, \textit{Unigard III} gave an extensive reasoned opinion for distinguishing direct insurers and reinsurers with respect to the importance of giving notice. Central to the court’s rationale for requiring strict adherence to providing timely notice stems from the duty of good faith and fair dealing implied in all contracts. Perhaps, more importantly, the court pointed to the unique relationship ascribed to the cedent and reinsurer as being one of utmost good faith or \textit{uberimae fides}.\textsuperscript{17} Thus, in the context of providing notice, a cedent’s failure to provide timely and full disclosure would create an undue burden on reinsurers because the reinsurer would incur the administrative and actuarial claims handling responsibilities normally borne by the cedent. Accordingly, either reinsurance would become unavailable or premiums would escalate.\textsuperscript{18}

\section*{C. Notice as a Condition Precedent and the Requirement for a Showing of Prejudice}

The underlying issue is whether, given the presence of a notice clause, notice is a condition precedent to a reinsured’s right to enforce a contract.\textsuperscript{19} Whereas reinsurers must generally show prejudice for late notice, direct

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\textsuperscript{16} Unigard Sec. Ins. Co., Inc., 594 N.E.2d at 574 (footnote omitted).
\textsuperscript{17} Unigard III, 4 F.3d at 1066, 1069 (discussing the conflicting opinions regarding characterizing contemporary reinsurance contracts as one of utmost good faith but holding that the proper standard to determine bad faith is gross negligence or recklessness).
\textsuperscript{18} See id. at 1054 (discussing the reinsurance industries reliance on good faith information sharing to determine premiums).
\textsuperscript{19} Staring, supra n. 3, at § 17:1[1].
\end{flushleft}
insurers need not follow suit. Nevertheless, lessons learned suggest that direct insurers must notify their reinsurers if the reinsurers will be encumbered. Courts have employed different standards of notice for reinsurers and direct insurers.

Courts generally employ a rational process when considering reinsurance issues, and specifically, late notice. First, when addressing reinsurance issues, courts typically turn to the relevant state’s law in the arena of direct insurance. Traditionally, courts would determine whether the reinsurance contract explicitly stipulated that notice was a condition precedent to recovery. Any failure to provide such notice trumped recovery by the reinsured. Alternately, absent a contractual provision that made notice a condition precedent, courts have considered whether the cedent’s late notice prejudiced the reinsurer. Recent jurisprudence, however, reveals that courts generally disfavor viewing notice as a condition precedent and instead focus on the second prong – whether the reinsurer was prejudiced.

The underlying driver for determining whether a direct insurer would suffer prejudice stems from the direct insurer’s requisite claims handling responsibilities. For example, untimely notice from an insured party to the direct insurer could lead to the direct insurer’s inability to forge a competent defense to the claims raised by the insured. This time lag can cause deleterious effects on crucial evidence, possibly amounting to fraud. Conversely, many courts view the presumption of prejudice inapplicable in the context of reinsurance because reinsurers, unlike direct insurers, do not have a duty to investigate and defend claims.

The genesis of jurisprudence considering whether notice is a condition precedent to a cedent’s recovery emerged in Keehn v. Excess Insurance Co. of America, an older leading case following Illinois’ direct insurance jurisprudence. The trial court held that notwithstanding the absence of an explicit provision stating that notice constituted a condition precedent; the insured’s late notice prejudiced the reinsurer. The breach severed the reinsurer’s right and opportunity to associate in defense of the claim as set

20. Foster, supra n. 6, at 774.
21. Id.
22. Id.
23. Id.
25. Ostrager, supra n. 5, at § 8.03[b].
26. 129 F.2d 503 (7th Cir. 1942).
27. Id. at 505.
forth in the claims cooperation clause. On appeal, the Seventh Circuit Court of Appeals noted, “[t]he right was provided by the terms of the contract and we are of the view that the deprivation of such right would constitute prejudice without any actual proof that the results of the litigation would have been different.”

One court rejected any distinction between direct insurance and reinsurance under Massachusetts and Texas law, when it held that prompt notice is a condition precedent. Further, that court opined that “such distinction would be strained at best, in that the notice provisions in both contracts serve the same purpose: to afford a company which may be ultimately liable on a claim the opportunity to participate in the defense of that claim.”

A line of older cases requires that in the absence of an explicit clause which makes notice a condition precedent to a ceding insurer’s ability to recover, reinsurers must show prejudice before avoiding payment. Security Mutual Casualty Co. v. Century Casualty Co., an oft-cited case touting this approach, reinforces the need to draft precise language clearly requiring notice as a condition precedent:

We do not believe this language plainly states a condition precedent. It is significant, in a contract as carefully drawn as an insurance contract, that none of the usual words indicating a condition precedent are present. Perhaps more significant is the inclusion of language expressly designating compliance with another contract clause a condition precedent. The arbitration clause states, ‘(A)s a condition precedent to any right of action hereunder, the parties to this agreement shall submit the matter in dispute to arbitration.’ Certainly the omission of similar language from the notice clause is some indication it was not considered a condition precedent.

Perhaps precise contract drafting requires the magic buzzwords “as a condition precedent” in order for reinsurers to foist a late notice argument on its reinsured. This author submits that reinsurance contracts do not carry the same precision as that of a direct insurance contract – especially in reinsurance treaties and to a lesser extent in facultative arrangements.


30. Foster, supra n. 6, at 776.


32. Id.
Thus, hypertechnical arguments that a reinsurer did not intend to require notice as a condition precedent by failing to include the magic words are misplaced. Additionally, these arguments are further disproved by the fact that prompt notice plays such a key role in a reinsurer’s right to associate in setting reserves and so forth.

E. Recent Case Law

Recent case law has continued to shape the contours of late notice. In 1990, *Insurance Co. of the State of Pennsylvania v. Associated International Insurance Co.* noted that, “under California law, contractual provisions are not deemed to be conditions precedent unless stated ‘in conspicuous, unambiguous, and unequivocal language.’” 33 The court also noted that under California law, there is no presumption of prejudice, rather under California case law, the only prejudice sufficient to allow an insurer to avoid liability based on late notice is found in those cases where the insurer actually demonstrated that there was a substantial likelihood that it could have either defeated the underlying claim against its insured, or settled the case for a smaller sum than that for which its insured ultimately settled the claim.34

Whereas, in ruling favorably for the reinsurer, instead of relying solely on the presence of condition precedent contractual language, the lower court tied its holding to the presence of a right to associate clause in the reinsurance contract. The Ninth Circuit reversed and ruled in favor of the cedent and in so doing held “a reinsurer, must show actual and substantial prejudice to maintain a late notice defense against . . . its reinsured.”35

One commentator has noted that the Ninth Circuit provided two significant comments despite the opinion’s unfavorable tenor towards reinsurers. First, the court holds insurance companies to a higher standard of review than lay insureds when complying with notice clauses. Second, the court embraced an objective standard for measuring when a ceding company must notify the reinsurer. Under an objective standard, the cedent

33. 922 F.2d 516, 524 (9th Cir. 1990) (citing to *Thompson v. Occidental Life Ins. Co. of Cal.*, 513 P.2d 353, 357 (Cal. 1973)).
34. *Id.*; see *N.W. Title Sec. Co. v. Flack*, 85 Cal. Rptr. 693, 698 (Cal. App. 1st Dist. 1970) (insurer did not demonstrate prejudice); see also *Trustees of Univ. of Pa. v. Lexington Ins. Co.*, 815 F.2d 890, 899 (3d Cir. 1987) (“prejudice requires a showing that the lateness of notice probably altered the result”).
36. Foster, *supra* n. 6, at 779.
“has the obligation, implied by law, to perform its duty under the reinsurance contract ‘with care, skill, reasonable expedition and faithfulness.’”

F. Notice and the Right to Associate

The Christiania General Insurance Corp. v. Great American Insurance Co. court poignantly stated:

If the only purpose of notice was to enable a reinsurer to decide whether to associate, the notice clause would be redundant because notice is a necessary concomitant of the reinsurer’s right to associate. Notice is designed to do more than enable the reinsurer to decide whether it should associate in the defense of a particular suit.

Nevertheless, according to the court in Unigard III, simply losing the right to associate in the defense of claims is not enough. Clearly the court relied heavily on the New York Court of Appeals’ reasoning:

Unigard asserts, however, that a reinsurer’s “right to associate” with the ceding insurance company makes it necessary for the reinsurer to have prompt notification of any claim likely to involve the reinsurance. The “right to associate” involves the right to consult with and advise the reinsured in its handling of a claim. Unigard argues that this right gives it an interest similar to that of a primary insurer and that it, therefore, must have early notice so that it may itself investigate the claim and foreclose the possibility of fraud. We agree that there are cases in which the reinsurer’s right to associate may be impaired by late notice from the reinsured. Nonetheless, because of the critical distinctions between a primary insurer’s right to control the investigation and defense of a claim and a reinsurer’s “right of association” with the ceding companies, we cannot agree with Unigard’s contention that the risk of such impairment is sufficiently grave to warrant applying a presumption of prejudice. Accordingly, there is no sound reason to depart from the general contract law principle that a breach will excuse performance only if it is material or demonstrably prejudicial. Indeed, it has been noted that reinsurers seldom have occasion to exercise their right to associate.

37. Ins. Co. of State of Pa., 922 F.2d at 521 (citations omitted).
38. 979 F.2d at 277.
39. Unigard III, 4 F.3d at 1068-69.
In setting the standard for what constitutes prejudice, the court concluded that there must also be economic injury. Despite the fact that in Unigard III, the Court of Appeals concluded that “[n]otice was required because the signing of the Wellington Agreement substantially altered the terms of the reinsurance certificate,” the court went on to hold that Unigard’s inability to bear its burden in demonstrating that it suffered tangible economic injury due to North River’s failure to give timely notice that it signed the Wellington Agreement resulted in Unigard’s failure to prevail.

Also, in determining whether sufficient notice was provided, courts have grappled with the time when the cedent notified the reinsurer. For example, in Insurance Company of Ireland Ltd. v. Mead Reinsurance Corp., the court determined what constituted notice by first examining the wording of the notice clause. The clause stipulated that the cedent must provide notice when “any claim and any subsequent developments pertaining thereto which, in the opinion of the company, may involve the reinsurance hereunder.” The court acknowledged that the contract wording was subjective, wherein the insurer must reasonably believe or “opine” that the claim may trigger a reinsurer’s involvement. Still the court held that the subjective wording alone would not vest “unfettered discretion” in the insurer to determine when a claim is likely to invoke the reinsurers. Citing Travelers v. Buffalo Reinsurance Co., the court noted,

[s]uch a reading would effectively insulate the insurer from its contractual duty to provide timely notice, as it could simply allege a failure to perceive the likelihood of a claim involving the reinsurance.

G. The Claims Cooperation Clause and the Common Interest Doctrine

The general tenor of a claims cooperation clause in a reinsurance agreement typically obligates the parties to fully cooperate with each other in the defense of claims. More importantly, this clause gives the reinsurer, at its own expense, the right to associate in the defense of the underlying claim. Claims cooperation clauses may be combined with loss settlement
clauses or, may stand alone. Further, claims cooperation clauses, in many respects, accord equal footing with notice clauses given the fact that late notice may thwart a reinsurer’s opportunity to associate in the defense; therefore, a reinsurer may claim prejudice.

Issues of late notice and whether the reinsurer becomes prejudiced by late notice are closely aligned with the parties’ respective obligations under a claims cooperation clause. The most notable obligation being the obligation to completely cooperate in the defense of the underlying claims. This clause carries special significance given the deleterious effects on a reinsurer’s inability to participate in the defense of an underlying claim should the cedent fail to notify the reinsurer promptly. Thus, whereas notice and claims cooperation clauses bear many critical similarities, a claims cooperation clause can run counter to a “follow the forms” clause, “follow settlements” clause, or “loss settlements” clause.

A “follow the forms” clause should not be confused with a “follow the fortunes” clause or a “follow the settlements” clause. A “follow the fortunes” clause is broader than the “follow the forms” clause and prevents reinsurers from second-guessing good faith settlements and obtaining de novo review of judgments of the reinsurer’s liability to its policy holder. A “follow the fortunes” clause also goes beyond settlements, thereby protecting the underlying claim resolution. A typical clause reads as follows:

All claims involving this reinsurance, when settled by the Company, shall be binding on the Reinsurer, which shall be bound to pay its proportion of such settlements, and in addition thereto, in the ratio that the Reinsurer’s loss payment bears to the Company’s gross loss payment, its proportion of expenses . . . incurred by the Company in the investigation and settlement of claims or suits.

A “following fortunes” clause, unlike a “following settlement” clause describes the fundamental relationship between a reinsured and its reinsurer. In treaty insurance, the reinsurer relies on the insured’s utmost good faith in handling underlying claims. Conversely, a facultative agreement

50. Staring, supra n. 3, at § 17:2.
51. Id.
54. Staring, supra n. 3, at § 18:1.
offers the reinsurer a greater opportunity to analyze the underlying policy before assuming the risk. Typically worded “follow the fortunes” clauses “expound the congruence of coverage in detail and say nothing about settlements, while following settlement clauses, by contrast, deal with an obligation of the reinsurer to accept the reinsured’s judgments of particular claims.” Further, both “follow the settlements” clauses and “following settlements” clauses contractually obligate the reinsurer to accept and pay the reinsured’s settlements or judgments.

One can readily see the conflict between a “follow the fortunes” clause (or variant thereof) and a claims cooperation clause (or other such clauses which grant a reinsurer control over settlements by inserting contract language which conveys such rights to the reinsurer). Further, combining the two clauses may create an ambiguity in the contract language. To illustrate, the “follow the fortunes” doctrine dictates that a reinsurer must follow its cedent’s underwriting fortunes and severely restricts the reinsurer to challenge the cedent’s good faith claims. Additionally, this doctrine “burdens the reinsurer with those risks which the direct insurer bears under the direct insurer’s policy covering the original insured.”

In Insurance Co. of Africa, a warehouse, which was reinsured in the London reinsurance market, was leased from the Liberian government and burned down. The warehouse was insured for $3,500,000 and 98.6% of that amount was reinsured. The reinsurance contract had a typical “follow the settlements” clause which provided inter alia: “Being a Reinsurance of and warranted same . . . terms and conditions as and to follow the settlements of the Insurance Company of Africa . . .” In addition to the settlements clause, a condition precedent in the policy stipulated that:

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55. Id.
59. Bellefonte Reinsurance, 903 F.2d at 912.
61. Id. at 312.
[U]nder this Insurance that all claims be notified immediately to the Underwriters subscribing to this Policy and the Reassured hereby undertake in arriving at the settlement of any claim, that they will co-operate with the Reassured Underwriters and that no settlement shall be made without the approval of the Underwriters subscribing to this Policy.62

At issue was whether a breach of the claims cooperation clause rendered the “follow settlements” clause inapplicable. Some discussion focused on whether the claims cooperation clause essentially emasculated the “follow settlements” clause.63 In its majority holding, the Court of Appeal’s Lord Justice Fox succinctly noted:

There is then, on the language of the two clauses, a plain inconsistency between them. The follow settlements clause requires the reinsurers to accept the honest settlements of the insurer arrived at in a businesslike way. The claims co-operation clause (or, more accurately, the second part of it) requires that the insurers shall not make settlements without the approval of the reinsurers. It is a possible view that the two provisions are so much in conflict that both should be disregarded. But I think that reading the two clauses together the proper course is to treat the follow settlements clause as applicable only to such settlements as are approved by the reinsurers. That does least violence to the language. I agree that from the point of view of the insurers that really removes the value of the follow settlements clause but I do not find it possible to give that clause an effect that disregards the clear wording of the claims co-operation clause.64

Interestingly, the Court of Appeal recognized that the two clauses contemplated a certain amount of reciprocity between the insured and reinsurer despite the apparent inconsistency and tension between the two clauses. Claims cooperation, by definition, requires cooperation by at least two parties. In the instant case, it was incumbent upon the reinsurers to cooperate with the insured in deriving a settlement. According to the Court of Appeal, the reinsurers’ actions drove a possible settlement to adjudication by withholding its approval and cooperation of the settlement. The reinsurers thereby ultimately increased the cost of settlement. Had the reinsurers simply accepted the insured’s claim, final settlement costs would

62. Id. at 318.
63. Id. at 323.
64. Id. at 334.
have been less. Of note, the majority observed that the ruling “effectively emasculates the following settlements clause . . . but it is . . . what the parties have agreed.” Nevertheless, the Court of Appeal did not absolve the reinsurers of all liability and required the reinsurers to prove the claim without the aid of the loss settlements clause.

Needless to say, careful contract drafting can become outcome determinate and serve to lessen adversarial conflicts between insurers and reinsurers solely by reducing contractual ambiguities and more closely defining each party’s respective obligations. Not unexpectedly, contract clauses have evolved in both English and American contracts.

The careful drafting of one revised loss settlements clause found in both English and American contracts has effectively thwarted broad interpretation. The clause states: “All loss settlements . . . including compromise settlements . . . shall be binding . . . providing such settlements are within the terms and conditions of the original policies . . . and . . . this Reinsurance.” Here the proviso clause ties reinsurer liability to that stated under the terms and conditions of the original policies. As noted above, a claims cooperation clause further restricts loss settlements by requiring the reinsurer’s agreement to settlements.

A more stringent restriction on a loss settlements clause may be imposed by a claims cooperation clause requiring the agreement of the reinsurers to settlements. As explained in the above analysis of Insurance Co. of Africa, where a loss settlement clause collides with a following settlements clause, precise contract drafting can prevent potential adjudications between the insurer and reinsurer. Conversely, imprecise drafting may yield increased transaction costs to all parties involved.

H. Audit and Inspection Clauses

Yet another tool in the reinsurer’s arsenal is the audit and inspection clause. A semblance of reciprocity exists wherein just as an insurer must have the opportunity to investigate an insured’s claim, a reinsurer should have the opportunity to avail itself of the right to audit a reinsured’s books, claims and underwriting files before settling a claim. As an added precaution reinsurers must insert such clauses in their facultative contracts to solidify their right to access their reinsured’s records. Such clauses, how-

65. Id. at 324.
66. Id. at 331.
67. Id. at 330; see also Staring, supra n. 3, at §§ 17:2[3], 18:6[5] (averring that the clause could still apply if the parties had approve in principal and then questioned amounts or other terms).
68. Staring, supra n. 3, at § 18:6[5].
69. Id. at § 15:8.
ever, do not make it open season for reinsurers to conduct “fishing expeditions.” As noted by the court in In re Arbitration of International Surplus Lines Insurance Co. v People’s Insurance Co. of China, the audit and inspection clause permitted “access to records at ‘reasonable times’ . . . not . . . access to all of its reinsured’s records at any time.” Further, North River Insurance (Philadelphia) held that the clause does not act as a waiver of the reinsured’s privileged communications with its counsel.

This merely reinforces the increased tensions between cedents and reinsurers and illustrates how far their relationship has evolved from the time when the two parties cemented agreements with a handshake. One commentator noted that despite contract clauses that grant a reinsurer inspection rights, cedents frequently refuse access to their records until such time as they have first been paid in full. Further, cedents often allege their reinsurer has acted in bad faith when it has not promptly paid requested claims. In reality, the reinsurer may simply be exercising due diligence in reviewing the underlying claim before acquiescing. Graydon Staring emphatically notes that “[t]he audit right is so important that . . . when it is denied or delayed, there should be no question of the right of the reinsurer to withhold payments until the audit or inspection is granted.”

III. DISCOVERY AND ATTORNEY-CLIENT PRIVILEGE

When challenging coverage with cedents, reinsurers typically seek production of privileged materials detailing the underlying dispute between the policyholders and cedents. Reinsurers often use the claims cooperation clause as a springboard for attempts to seek privileged communications – frequently relying on the common interest doctrine as support for their quest. Further, the question arises whether a cedent and its reinsurer share a common interest once they become embroiled in a legal dispute or when the reinsurer seeks privileged communications. Depending on the circumstances and breadth of discovery, cedents seek to avoid producing certain materials.

72. Staring, supra n. 3, at § 15:8.
73. Id.
74. Id.
75. Ostrager, supra n. 5, at § 15.02(a).
76. Id.
The touchstone for asserting the attorney-client privilege is obtaining legal advice. As discussed above, the onslaught of environmental liability has strained the insurer-reinsurer relationship and has threatened the free flow of information that must pass between insurer and reinsurer. One commentator has noted that the reinsurance industry must develop new communication methods in order to protect communications from legally mandated disclosures, without undermining the tenuous relationship between cedent and reinsurer.

Most discovery rulings stemming from cases based on reinsurer-reinsured relationships go unreported. Still, one may glean the general tenor of the judiciary’s treatment of the different types of discovery issues that surface. For example, attorney-client privilege may frustrate an insured’s attempt to attain communications between its primary insurer and reinsurer’s outside counsel. Above it all, however, inadvertent waiver looms large should a party fail to protect its work-product and attorney-client privilege.

A. Common Interest Doctrine

With respect to coverage disputes between cedents and reinsurers, reinsurers may use discovery motions to seek privileged material regarding the underlying contest between the cedent and the underlying insured. In support of their quest to obtain privileged material, reinsurers often argue that they share a common interest with the cedent concerning the underlying claim. Therefore, the “common interest doctrine” provides an avenue for obtaining privileged materials. As discusses herein, courts cast a
jaundiced eye when deciding whether to apply the “common interest doctrine.”

The “common interest doctrine” (known alternately as the “community of interest doctrine” or “joint defense privilege”) creates an exception to the rule of waiver. Although the doctrine finds its genesis in criminal law, it has equal application in the civil arena. Succinctly stated:

The ‘common interest’ doctrine applies when multiple persons are represented by the same attorney. In that situation, communications made to the shared attorney to establish a defense strategy remain privileged as to the rest of the world. The clients may not, however, later assert the privilege against each other after their interests become adverse.

Generally, communications subject to attorney-client privilege or work-product protection are waived. The “common interest doctrine” carves out an exception to the general rule, especially when the multiple parties who are represented by a single attorney share a common goal. Further, the “common interest doctrine” protects parties who have a common legal goal as opposed to a commercial goal. When encountering a common interest argument, courts also examine whether the communication made by the separate parties was designed to further their efforts in sharing a common goal and whether the privilege has not been waived.

Initially, when dealing with an underlying claim, both cedent and reinsurer are aligned in the objective to avoid groundless claims and focus only on those claims that merit compensation. In order to further this objective, both parties must share facts concerning their current and potential exposure. In the course of this information-sharing period, both parties have every reason to expect strict confidentiality. There is a possibility, however, that a reinsurer may strive to completely avoid a settlement with its cedent, rather than cooperate with the cedent in denying the underlying claim. This begs the question whether a reinsurer genuinely shares a common goal with its cedent. Courts are conflicted as to how to rule on

83. Burrows & O’Leary, supra n. 78, at 303.
84. N. River (Columbia), 1995 WL 5792 at *3.
86. Pursuant to Fed. R. Civ. P. 26(b)(3): “[T]he court shall protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation.”
90. Burman, supra n. 10, at 747.
whether certain communications lose their privileged status when provided by a cedent to its attorneys.91

As noted above, the "common interest doctrine" comes into the fore when the same attorney represents multiple persons. In North River (Philadelphia),92 paraphrasing United States v. Moscony,93 the court stated "[c]ommunications to an attorney to establish a common defense strategy are privileged even though the attorney represents another client with some adverse interests." In this case, North River, the reinsured, argued that its reinsurer, CIGNA Reinsurance Company ("CIGNA Re"), must indemnify North River for costs that it incurred in connection with claims made by its underlying insured, Owens-Corning Fiberglass Corporation ("OCF"). OCF incurred thousands of liability actions during the 1970s and 1980s from its sales of products containing asbestos. As OCF’s excess insurer, North River, along with numerous other insurers of asbestos manufacturers, entered into the Wellington Agreement.94 Pursuant to the Wellington Agreement, unless an issuer’s policy explicitly excluded payment of defense costs, issuers were obligated to pay such costs.95 Given the number of claims, the Wellington Agreement also enforced a strict scheduling procedure for those who sought to contest claims.

North River and OCF arbitrated their claims and following an extensive six-day evidentiary hearing. The arbitrator ruled that North River failed to follow the Wellington Agreement’s scheduling procedure and therefore waived its right to contest paying OCF’s defense costs. Alternately, the arbitrator ruled that, in accordance with the Wellington Agreement, North River was obligated to indemnify OCF unless there existed a clause in the reinsurance agreement stating otherwise.96 Initially, North River appealed the alternative dispute resolution decision but abandoned the appeal shortly thereafter. Accordingly, North River began submitting claims to CIGNA Re for defense costs that it incurred with OCF.

The issues presented in North River (Philadelphia) typify the emerging tensions between cedents and reinsurers in today’s post-asbestos and environmental claims arena. On appeal before the U.S. District Court, District

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91. Id. at 747-48; see also N. River (Columbia) 1995 WL 5792 at *4 (stating that: “[A]s in the direct insurance context, the interests of the ceding insurer and the reinsurer may be antagonistic in some respects and compatible in others. Thus, a common interest cannot be assumed merely on the basis of the status of the parties.”).
92. 797 F. Supp. at 363. This was a dispute between North River and CIGNA Re.
93. 927 F.2d 742, 753 (3d Cir. 1991), cert. denied, 501 U.S. 1211 (1991); see also Eisenberg v. Gagnon, 766 F.2d 770, 787-88 (3d Cir. 1985) (holding that it is only when the clients’ interests are completely adverse that the privilege will be denied); Jack B. Weinstein et. al., Weinstein’s Evidence vol. 3, § 503.21 (Matthew Bender & Co., Inc. 2005).
94. See supra pt. II(A).
96. Id.
of New Jersey, CIGNA Re contended that North River’s failure to preserve its rights by its failure to comply with the Wellington Agreement’s scheduling procedure trumped its obligation to indemnify North River for its defense costs.  

The central issue facing the District Court was whether attorney-client communications between North River and its counsel were discoverable during the alternative dispute resolution proceedings. CIGNA Re sought discovery of these attorney-client communications to show that North River should bear its own defense costs because it had wrongly decided to abandon the arbitration decision appeal. Understandably, North River contended that none of the communications were discoverable.

As noted in *North River (Philadelphia)*, courts generally recognize the “common interest doctrine” in the context of the insured/insurer relationship whereby the insurers have either retained or paid for counsel in order to defeat the underlying claim. In this context, insureds and insurers share a common interest in defeating the underlying claim. Consequently, courts recognize that a unified defense to any third party claims against an insurer require a mutual disclosure of attorney-client communications regarding underlying facts giving rise to the claim. It is noteworthy, however, that the privilege does not extend to communications “that relate to an issue of coverage.”

This distinction arises “because the interests of the insurer and its insured with respect to the issue of coverage are always adverse.”

Unlike the classic common interest example as noted by Professor Wigmore, the instant case differed because North River had independently retained its own counsel without any direction, guidance or control from CIGNA Re. Nevertheless, CIGNA Re relied heavily on *Waste Management, Inc. v. International Surplus Lines Insurance Co.* to support its position for compelling production of attorney-client documents.

CIGNA Re, in its first issue on appeal, contended that the common interest doctrine entitled it to discover the reinsured’s attorney-client communications. But as the court noted, and this note addresses, unlike cases between insureds and insurers, there is scant jurisprudence addressing the application of the common interest doctrine between reinsureds and reinsurers.

Despite CIGNA Re’s allegations that the reinsured/reinsurer

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97. *Id.* at 366.
98. *Id.* at 366.
100. *Id.*
101. See *Staring, supra* n. 3.
102. 579 N.E.2d at 336.
104. *Id.*
relationship was highly analogous to that of the insured/insurer, the court nevertheless determined that it need not examine such similarities or differences between the two contexts because the documents at issue were not discoverable. In reaching its decision, the court noted that the case at hand did not fit neatly within the confines of classic common interest doctrine.

Not unexpectedly, the court challenged the outer contours of the doctrine and denounced the common interest doctrine when pertaining to the cedent-reinsurer relationship. The court emphatically proclaimed “the common interest doctrine is completely unleashed from its moorings in traditional privilege law when it is held broadly to apply in contexts other than where there is dual representation.” Citing *Waste Management*, the court deemed that holding overly broad in extending the common interest doctrine to those instances where an insurer has neither retained an attorney for its insured nor has represented its insured. The court reigned in the common interest doctrine in the context of the reinsured/reinsurer relationship in stating that the following situations must arise before waiving the attorney-client privilege: (1) dual representation of both parties; (2) the privilege was otherwise waived; (3) contractually waived; or (4) a party’s conduct waived the privilege.

*North River (Philadelphia)* also illustrates the effect of a claims cooperation clause on the insurer/reinsurer relationship. As a fallback position to its argument that North River was obligated to produce documents because it had waived its attorney-client privilege pursuant to the common interest doctrine, CIGNA Re sought document production via the “cooperation clause” in the reinsurance certificates. The clause read as follows:

The company [North River] shall furnish the Reinsurer with a copy of its policy and all endorsements thereto which in any manner affect this certificate, and shall make available for inspection and place at the disposal of the Reinsurer at reasonable times any of its

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105. *Id.*
106. By way of illustration, in the insured/insurer construct, when applying the common interest doctrine to compel production of the insured’s attorney-client communications regarding the underlying claim, the court relied on Professor Wigmore’s succinct example where “[a] communication by A to X as the common attorney of A and B, who afterwards become party opponents, is not privileged as between A and B since there was no secrecy between them at the time of communication.” *Id.* at 366 (citing *J. Wigmore on Evidence* § 2312, 605-06).
107. *Id.* at 367.
108. *Id.*
109. *Id.* at 367-68.
records relating to this reinsurance or claims in connection therewith.  

Here again the court found the Illinois Supreme Court’s holding in Waste Management overly broad. Whereas in Waste Management the court enforced a broadly worded claims cooperation clause even after the parties had become adverse, the North River (Philadelphia) court sided with the holdings of Remington Arms Co. v. Liberty Mutual Insurance Co. and Bituminous Casualty Corp. v. Tonka Corp. In fact, in denouncing Waste Management, the North River (Philadelphia) court unabashedly quoted Bituminous by declaring “the reasoning of the Illinois Supreme Court to be fundamentally unsound.” In Bituminous, the court noted “[t]o hold that an insurance policy creates a contractual waiver of the attorney-client privilege, even when the insurance company later sues the insured contending the insured’s claim is not covered by the policy, would completely eviscerate the attorney-client privilege.”

Accordingly, in North River (Philadelphia) the court ultimately held that absent explicit language to the contrary, a reinsured does not give up its right to preserve the confidentiality of communications with its counsel regarding coverage determinations concerning the underlying claim, notwithstanding the contractual requirements that a claims cooperation clause may impose. The court noted, however, that the reinsured still bears a duty of being forthright with its reinsurer in handling the underlying claims and in producing facts or documents in its possession relevant to the underlying claim. The court further restricted a reinsured’s requirement to issue documents pursuant to a claims cooperation clause to those instances where the reinsured had retained legal advice “with a reasonable expectation of confidentiality.” The reinsured, however, must treat such documents, from their inception with “a greater degree of secrecy and expectation of confidentiality.” Needless to say, reinsureds should heed this advice in order to bolster their arguments to withhold certain documentation on the eve of a forthcoming documentation request.

110. Id.
116. Id.
118. Id.
Conversely, whereas the court in *North River (Philadelphia)* considered its case at bar as one which tread upon the outer reaches of the common interest doctrine and accordingly did not extend the efficacy of the doctrine under its unique facts, the court in *North River (Columbia)* noted that the weight of authority determined that the common interest doctrine “extend[s] at least to situations ‘where a joint defense effort or strategy has been decided upon and undertaken by the parties and their respective counsel.’”\(^\text{119}\) According to the court, for the common interest doctrine to attach the parties must pursue a common legal enterprise notwithstanding having separate legal counsel.\(^\text{120}\) North River sought reimbursement from Columbia Casualty for asbestos-related losses incurred by the underlying insured, OCF, under an excess liability insurance policy it had issued to OCF in 1974.\(^\text{121}\) Initially, North River submitted that it had no obligation to reimburse OCF, but later agreed to submit the claim to binding arbitration through an alternative dispute resolution (“ADR”) proceeding where an arbitrator ruled in OCF’s favor and ordered North River to pay OCF’s defense costs. North River appealed and later abandoned the appeal.\(^\text{122}\) North River then filed suit against eight reinsurers, Columbia Casualty among them, claiming they each owed a portion of OCF’s defense costs.\(^\text{123}\) Columbia Casualty argued the excess policy between OCF and North River did not cover defense costs, and most importantly, North River’s failure to preserve its rights under the Wellington Agreement trumped any obligation on Columbia Casualty’s part to pay a share of the defense costs.\(^\text{124}\)

At issue was Columbia Casualty’s Rule 26(c) motion, which read as follows:

> We need all documents between, among or with respect to Crum & Forster [North River’s parent company] and its attorneys (including Simpson Thacher & Bartlett) regarding its dispute with Owens-Corning over North River’s obligation to pay Owens-Corning’s attorney’s fees.\(^\text{125}\)

North River countered and argued that attorney-client privilege and work-product protected the ADR documents from disclosure. In turn, Co-
lumbia Casualty launched a four-part argument using some of the same arguments that CIGNA Re had used against North River in North River (Philadelphia):126 (1) Columbia Casualty claimed it shared a “common interest” in the subject matter of the ADR documents; (2) that North River breached its fiduciary duty to Columbia Casualty; (3) with respect to the ADR, North River placed its good faith conduct in issue; and (4) North River had acted fraudulently by failing to preserve its rights under the Wellington Agreement and then attempted to fraudulently conceal its attempts to shift its burden of defense costs to its reinsurers.127

Addressing the first issue, the court noted that the more difficult application of the doctrine question arises when parties have parallel interests but do not share a common legal strategy.128 Pivotal in determining whether the doctrine should apply is not whether the parties share similar interests but whether the parties demonstrate they have cooperated toward a common legal goal. It is not enough for a court to make such a determination based solely on the relationship of the parties’ because their interests may simultaneously be cooperative and antagonistic.129 The reinsured/reinsurer relationship, the court noted, provides such an example of conflicting interests. Here the court noted that a reinsurer does not share the same obligation to defend an underlying insured as a direct insurer. Therefore, the concomitant obligation to cooperate may not be present.130

In the often cited case, Christiania General, one very strong argument for cedents in their quest to label communications with its reinsurer as privileged stems from the fact that

[t]he relationship between a reinsurer and a reinsured is one of utmost good faith, requiring the reinsured to disclose to the reinsurer all facts that materially affect the risk of which it is aware and of which the reinsurer itself has no reason to be aware.131

Thus, one can argue that given the fact that disclosure is, for the most part, involuntary, applying general rules of waiver are inapposite. But as noted below some recent decisions cast doubt on the vitality of whether the mere stature of the relationship between insurers and reinsurers shields the parties from disclosing communications between them.132

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128. Id. at *3.
129. Id.
130. Id.
131. 979 F.2d at 278.
132. Knoerzer, supra n. 77, at 46.
In *Allendale Mutual Insurance Co. v. Bull Data Systems, Inc.*, plaintiff, Allendale Mutual Insurance Company (“Allendale”), the primary insurer, and its parent company, Factory Mutual International (“FMI”), brought suit against Bull Data Systems, Inc., Zenith D.S. France, S.A., and ZDS Europe (collectively “the ZDS defendants”). Allendale argued that the policy it had issued to defendants did not cover a fire that had destroyed a warehouse and its inventory in France. The value of the insured property was roughly forty-eight million dollars.134 Before the fire Allendale secured reinsurance, retaining 2.5 million and reinsuring 45.5 million. Pursuant to its reinsurance contracts, Allendale agreed to keep the reinsurers informed regarding the status of defendant’s claim and its ongoing coverage litigation. These communications mainly consisted of letters and telephone conversations between Allendale’s claims representative and the reinsurers’ claim representatives.135

The ZDS defendants sought production of these communications, and Allendale and its reinsurers refused. In defending its objections, Allendale alleged that the documents were protected by either the work-product doctrine or, alternatively, attorney-client privilege. Allendale further asserted that it had not waived these privileges when it passed these communications to its reinsurers because the parties had a common interest in the underlying claim.136 In its analysis, the court ruled that neither doctrine, work-product or attorney-client privilege, applied; therefore, the court chose not to address the applicability of the common interest doctrine.137 Even if the documents at issue were protected by one of these doctrines, the court opined that the common interest doctrine in this case was inapposite.138

This ruling did not go unnoticed by one commentator’s ire. In poignantly chastising the court, the commentator observed that “[t]he glaring defect of the Allendale Mutual court’s statement is its misconception of the reinsurance relationship. The court failed to examine the true implications of two parties, the insurer and reinsurer, who are bound by laws of formal contract and thus share a common legal and commercial interest.”139

134. *Id.* at 134. Before launching into the opinion, United States Magistrate Judge Bobrick, so eloquently began with the following quote which this author notes bears repeating so as to protect future groves: “I think that I shall never see / A poem lovely as a tree.” Joyce Kilmer, *Trees* (1913). In defending this apropos poem, Judge Bobrick further noted, “The amount of paper which has so far been expended in this lawsuit is indeed impressive, and no doubt many trees have been cut down to advance the course of this litigation. The court duly notes the sacrifice of those trees in the name of justice.” *Id.*
135. *Id.*
136. *Id.* at 134-35.
137. *Id.* at 140.
138. *Id.*
same commentator also found the *Allendale Mutual* court’s position on applying the common interest exception overly restrictive and went so far as to declare that “[c]ourts refusing to apply the common interest exception in this area have done so because of their ignorance or naiveté concerning the business of reinsurance.”

Other courts are more nuanced than the *Allendale Mutual* court’s summarily dismissive approach toward the common interest doctrine when applied to reinsurance relationships. Noting the similarities and differences of interests between reinsurers and cedents, the court in *North River (Columbia)* observed that given these diverging interests “a common interest cannot be assumed merely on the basis of the status of the parties.”

Further, in ordering an insurance company to produce its correspondence with its insurer, the court in *Reliance Insurance Co. v. American Lintex* found that the insurer-reinsurer relationship alone does not merit raising attorney-client privilege to bar disclosure.

**B. Whether a Fiduciary Relationship Exists Between Reinsurer and Reinsured**

Another ploy advanced by reinsurers is alleging a fiduciary relationship exists with its insured. Turning to Columbia Casualty’s second argument, the court for the most part summarily dismissed its claim that North River’s alleged fiduciary relationship created an exception to attorney-client privilege. The court cited the Second Circuit’s pivotal *Christiana General* decision:

> [Any] characterization of the relationship between a reinsured and reinsurer as being inevitably fiduciary in nature is one we are unable to adopt. To the contrary, because these contracts are usually negotiated at arms length by experienced insurance companies, there is no reason to label the relationship as “fiduciary.”

In concluding that North River did not owe a fiduciary duty to Columbia to reveal the ADR documents, the court drew on the reasoning of *North River (Philadelphia)*. There the court noted that with respect to facultative reinsurance agreements, “[t]he presence of sufficient influence and

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140. *Id.*
143. 979 F.2d at 280-81.
144. See *N. River (Phil.)*, 797 F. Supp. at 370.
control over the affairs of another necessary to give rise to fiduciary responsibilities is absent between reinsured and reinsurer.”

As noted in North River (Philadelphia’s) second footnote, several courts have opined that a fiduciary duty does not arise between reinsured and reinsurer, certainly in facultative agreements, but also in treaty agreements. In International Insurance Co. v. Certain Underwriters at Lloyd’s of London the court declared, “[t]here is very little case law discussing whether an insurer has a fiduciary duty to its reinsurer, and next to nothing about what that duty entails.” Nevertheless, as support for its conclusion, the court in International Insurance drew on the reasoning of International Surplus Lines Insurance Co. v. Fireman’s Fund Insurance Co., where that court upheld its earlier decision and denied the plaintiff’s amended complaint. In its motion to reconsider, the plaintiff, International Surplus Lines Insurance Company (“ISLIC”), had issued to defendant, Fireman’s Fund Insurance Company (“Fireman’s”), a policy of reinsurance covering Fireman’s primary policy with Dow Chemical Company and ISLIC argued that Fireman’s breached its warranty by failing to retain an agreed-upon level of reserved funds as set forth in the reinsurance certificates.

In one of its arguments, ISLIC alleged that a fiduciary relationship existed between Fireman’s and itself. At the first trial the court determined that, under Illinois law, a fiduciary relationship did not exist between an insurer and an insured, and the court declined to extend a fiduciary relationship to that of a reinsurer and its reinsured. The court looked for indicia of domination by the party in whom trust was reposed by the other party and absent evidence of domination or influence on the party placing this trust, a fiduciary relationship cannot be found to exist. This protects the dominated party from being abused. The court adroitly noted that despite some courts holding that the duty of utmost good faith may exist between the reinsurer and its reinsured, this does not in and of itself rise to the level of constituting a fiduciary duty.

Thus, following the reasoning set forth by earlier courts in International Insurance, the court proclaimed that, “[m]ost significantly, both parties to this relationship are experts in the subject around which their relationship centers. If Illinois courts have not deemed a fiduciary rela-

145. Id.
148. Id.
149. Id.
150. Id. (citing Paskas v. Illini Fed. Savs. & Loan Assn., 440 N.E.2d 194 (Ill. App. 5th Dist. 1982)).
151. Id. at *3 (relying on Robacki v. Allstate Co., 468 N.E.2d 1251, 1253 (Ill. App. 1st Dist. 1984)).
tionship to exist between an individual policy holder and a sophisticated insurance company, they are not likely to imply one in a reinsurance relationship."

The court in *North River (Philadelphia)* pointed out that establishing a fiduciary relationship between a reinsurer and its reinsured is unwarranted; nevertheless, the reinsurer has a right to associate as an adequate tool to protect the reinsurer’s interests. In rejecting CIGNA Re’s argument that it was incumbent upon North River to disclose its attorney-client communications given its fiduciary relationship with CIGNA Re, the court noted:

The presence of sufficient influence and control over the affairs of another necessary to give rise to fiduciary responsibilities is absent between reinsured and reinsurer. The reinsurer’s ‘right to associate’ gives it adequate means by which to keep informed of events that may give rise to coverage under its agreement, and also provides a sufficient means to protect its own interests. Reinsurance agreements are negotiated at arms-length between equally sophisticated parties. Reinsurers are well aware of the risks inherent in reinsurance obligations and are adequately situated to protect their interests. 154

Perhaps the following quote best describes the judiciary’s reluctance to find a fiduciary relationship between a reinsurer and its reinsured: “[M]ost contractual relationships have opportunities for ordinary cheating without rendering either or both parties fiduciaries.”155

C. Implied Waiver of Attorney Client Privilege Under the “In Issue” Doctrine

The “in issue” or “at issue” doctrine comes into play “when the party has asserted a claim or defense that he intends to prove by use of the privileged materials.”156 When raised, the proponent argues that the insured may not rely upon the doctrines of work-product or attorney-client privilege because the insured has waived the privilege when it places in issue an otherwise privileged communication.157 Courts are not aligned, however, in their application.158

153. Id. at *4.
158. Id.
In *Christiana General*, CIGNA Re asserted the same argument in its quest to discover withheld documents. There the court also relied on the reasoning in *Remington Arms* where the court stated that the “in issue” doctrine should be construed narrowly. It is only in those instances where the party places the contents of the privileged communication at issue that merits an implied waiver of the attorney-client privilege. Recognizing a split in authority concerning the appropriate application of the “in issue” doctrine, the court opined:

The way in which courts have dealt with this type of waiver has become inconsistent and unnecessarily complicated. If the information is actually required for a truthful resolution of the issue on which the party has raised by injecting the issue, the party must either waive the attorney-client privilege as to that information or it should be prevented from using the privileged information to establish the elements of the case.

Whereas, the *Remington Arms* court noted that the Connecticut Supreme Court has provided little guidance regarding the proper application of the in issue doctrine, the court did find guidance from Connecticut’s lower courts on this issue. For example, in *Reichhold Chemicals v. Hartford Accident & Indemnity Co.* the court noted that the doctrine could apply in some instances:

Because a plaintiff puts a question ‘at issue’ which would normally be, as in this case, creating a divergence of claims between the parties who would normally be on the same side, does not in itself mean that the plaintiff has to give up, blanket-wise, all of the privileges that have been bestowed upon attorneys by our law.

Here the court essentially reserved the right to determine whether attorney-client privilege when pressed against the “at issue” doctrine applies to certain documents.

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159. *Remington Arms*, 142 F.R.D at 416 (Applying Connecticut law the U.S. District Court, Delaware, held that in the coverage determination suit that the insurer’s motion to produce documents relating to the underlying actions against the insured for environmental damage, the insurer was not entitled to the production of documents because the insured had not waived its attorney-client privilege.).

160. *Id.* at 415.

D. Claims Cooperation Clauses, Attorney-Client Privilege and Work-Product

Cooperation clauses are also used to attain privileged documents. However, the Remington court noted that Connecticut courts explicitly reject the notion that cooperation clauses could pierce the wall of attorney-client privilege and work-product privilege in insurance cases.\(^\text{162}\)

Therefore, it appears that courts look for certain indicia before allowing a party to use the common interest doctrine to obtain documents generally protected by attorney-client privilege. For the court in North River (Columbia), the indicia consisted of the following: (1) whether the same counsel represented the reinsured and reinsurer; (2) whether the reinsurer contributed to the reinsured’s legal expenses; (3) whether the reinsurer exercised any control over the proceedings; and (4) whether the parties coordinated their litigation strategy.\(^\text{163}\) Absent the presence of the aforementioned indicia, the court found the common interest doctrine did not apply.

E. Other Cases

In a recent New York intermediate appellate court decision, despite citing several cases that addressed the common interest and work-product doctrine, the court ruled that Massachusetts Bay Insurance Company and third-party defendant, Hanover Insurance Company (“the insurers”), had waived the attorney-client privilege when it transmitted certain documents to its reinsurer and reinsurance intermediary, Munich Reinsurance Company and Wilcox Incorporated Reinsurance Intermediaries, respectively.\(^\text{164}\)

The appellate court remanded the matter for an in camera review to determine whether the documents constituted work-product.\(^\text{165}\)

As support for its ruling, the court cited Aetna Casualty and Surety Co. v. Certain Underwriters at Lloyd’s London.\(^\text{166}\) In Aetna, a group of London reinsurers sought the return of over 1,300 pages of documents that they inadvertently produced during discovery to the plaintiff, Aetna, in its suit seeking reimbursement from the reinsurers for its settlement of a chemical company’s environmental liability claims.\(^\text{167}\) Some of the documents contained meeting or workshop summaries of the Environmental

\(^{162}\) Remington Arms, 142 F.R.D at 416-17.
\(^{163}\) N. River (Columbia), 1995 WL 5792 at *5.
\(^{165}\) Id. at 708.
\(^{166}\) Id. (citing Aetna Cas. & Sur. Co., 676 N.Y.S.2d 727, 730 (N.Y. App. Div. 1998)).
\(^{167}\) Aetna Cas. & Sur. Co., 676 N.Y.S.2d at 729.
Claims Reinsurance Group ("ECRG") that were attended by London-based insurance companies.\textsuperscript{168} It is noteworthy that in footnote two of the court’s decision, the court stated, “[t]he court is not aware of any rule that would require the return of inadvertently produced totally irrelevant material.”\textsuperscript{169} Accordingly, the court determined that the only question before it was whether the reinsurers could establish that the documents were relevant and therefore should not have been produced.\textsuperscript{170} In its review of the documents, the court acerbically noted the London reinsurers “were seeking to keep environmental losses on this side of the Atlantic.”\textsuperscript{171}

Recall that, as discussed above, the common interest doctrine protects parties who have a common legal goal as opposed to a commercial goal.\textsuperscript{172} In analyzing whether the common interest doctrine attached, thereby protecting the reinsurers’ documents from discovery, the court concluded that the parties’ common interests were for the most part exclusively commercial in nature.\textsuperscript{173} The court’s document review revealed that the reinsurers simply sought to further their commercial interests by maintaining the London reinsurance market’s viability, to attain new business from its cedents and lastly, to keep “[t]he environmental claims at bay.”\textsuperscript{174} Thus, the court decided it would not “apply the ‘common interest’ privilege except where the underlying circumstances require that communications be protected, as with ordinary attorney-client matters, and the common legal interest impacts potential litigation against all of the participants.”\textsuperscript{175}

On appeal, the New York Supreme Court’s Appellate Division denied Lloyd’s of London’s appeal.\textsuperscript{176} Here again, the court focused on the predominately commercial as opposed to legal nature of the communications. The court further noted that the parties never indicated that the communications were confidential. With respect to appellant’s argument that the documents were covered by work-product, the court expounded, “neither the aforementioned minutes nor the interviewee list were entitled to protection as attorney work product.” The court went on to explain that, “they were not ‘uniquely the products of a lawyer’s learning and professional skills.’”\textsuperscript{177}

\textsuperscript{168} Id. at 730.
\textsuperscript{169} Id. at 729 n. 2.
\textsuperscript{170} Id. at 729.
\textsuperscript{171} Id. at 731.
\textsuperscript{172} See supra pt. II(A); see also Staring, supra n. 3, at § 15:02[a].
\textsuperscript{173} Aetna, 676 N.Y.S.2d at 733.
\textsuperscript{174} Id.
\textsuperscript{175} Id.
\textsuperscript{177} Id. at 386.
F. What Conduct Constitutes Waiver of Work-Product or Attorney-Client Privilege?

It is noteworthy that with respect to the work-product doctrine, some courts employ a temporal analysis in deciding whether the doctrine governs. For example, some courts require that litigation be imminent while others only require that the motivating factor for generating the document was to further future litigation.\(^{178}\)

In a 1999 case, an Illinois federal court ruled favorably for a cedent who inadvertently sent documents to a reinsurer and reinsurance intermediary and then sought to protect these documents from disclosure to its insureds.\(^{179}\) Fortunately for the cedent, the court concluded that the documents contained attorney work-product that afforded protection from disclosure and rejected the reinsurer’s argument that the cedent waived its privilege when it mistakenly provided the documents to the reinsurer and intermediary.\(^{180}\) In reaching its decision, the court relied heavily on *Allen-dale Mutual*, for its recitation on the common interest doctrine and held that the documents were protected from disclosure given the fact that a common interest existed between cedent and reinsurer.\(^{181}\)

However, as one commentator notes, whereas the ruling in *Minnesota School Boards* may support cedents who share concerns about potential discoveries of documents by insureds in coverage disputes, good lawyering warrants consummate care when proffering documents to reinsurers under the guise that attorney-client privilege or work-product protects the documents. Given the fact that the common interest doctrine does not ubiquitously prevail among all courts, one must carefully review local case law.\(^{182}\)

In an interlocutory appeal, the plaintiff, Metropolitan Life Insurance Company, sought to reverse the trial court’s ruling which required it to disclose documents pertaining to an insurance coverage dispute with the defendants, Aetna Casualty, its second level excess liability insurer, regarding the settlement of more than 200,000 underlying actions for personal injuries cause by asbestos exposure.\(^{183}\) The Supreme Court of Connecticut ruled the documents were protected by the attorney-client privi-

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178. Schiffer & Kennedy, supra n. 88.
180. *Id.*
The court declined to address whether the documents were protected by the work-product doctrine.

In discussing whether the trial court properly ordered disclosure, the Supreme Court of Connecticut, for the first time addressed the “at issue” exception to the attorney-client privilege in Connecticut and then determined whether, as defendants claimed, it applied to the instant case. Recognizing the sanctity of the attorney-client privilege, the court explained that “[b]ecause of the important public policy considerations that necessitated the creation of the attorney-client privilege, the ‘at issue,’ or implied waiver, exception is invoked only when the contents of the legal advice is integral to the outcome of the legal claims of the action.”

Again, relying on Remington Arms, the court explained that relevant communications relating to underlying actions do not necessarily rise to the level of placing them at issue – hence, waiver. In furthering the need to protect the public policy considerations upon which the attorney-client privilege is built, the court declared:

If admitting that one relied on legal advice in making a legal decision put the communications relating to the advice at issue, such advice would be at issue whenever the legal decision was litigated. If that were true, the ‘at issue’ doctrine would severely erode the attorney-client privilege and undermine the public policy considerations upon which it is based.

Accordingly, the court ruled that the “at issue” doctrine did not apply because the plaintiff did not rely on the communications to prove that the underlying settlements were reasonable. In its final comment on the issue, the court cited the seminal Supreme Court case Hickman v. Taylor where the work-product doctrine had its origin and noted that compelling disclosure of documents under the guise of the “at issue” doctrine could chill attorney-client communications and could demoralize the legal profession by weakening its protections. Ultimately, the court noted, this would undermine the cause of justice and the interests of clients.

184. Id. at 66.
185. Id. at 60 n. 17.
186. Id. at 60.
187. Id.
188. Id. at 61.
189. Id.
190. Id.
191. Id. at 62-63 (citing Hickman v. Taylor, 329 U.S. 495 (1947)).
192. Metro. Life Ins. Co., 730 A.2d at 57, 63; Hickman, 329 U.S. at 516 (Jackson, J., concurring) (“Discovery was hardly intended to enable a learned profession to perform its functions either without wits or on wits borrowed from the adversary.”).
In a case of first impression before the U.S. District Court, Kansas, Employer’s Reinsurance Corp. v. Clarendon National Insurance Co. provides another twist to the attorney client-privilege and work-product doctrines. There, the reinsurer, Employer’s Reinsurance Corp. (“Employer’s”) brought suit against its insured, Clarendon National Insurance Company (“Clarendon”), a provider of non-standard automobile insurance. Clarendon had sued its managing general agent who underwrote and administered nonstandard policies issued by Clarendon for gross negligence and willful misconduct for its claims handling. Employer’s, in turn, filed suit against its insured alleging Clarendon’s managing agent was reckless and grossly negligent in its claims handling, underwriting and administration and by extension alleged Clarendon was not only reckless but also grossly negligent in its supervision of the managing agent.

During the discovery phase, Clarendon inadvertently produced a four-page affidavit by an actuary it had retained during its lawsuit against the managing agent and later realized that the information therein contained damaging information that merely bolstered its reinsurer’s allegations. Of note, the actuary placed the notation “ATTORNEY WORK PRODUCT” at the top of the affidavit. After receiving this document, Employer’s then forwarded the affidavit to an expert it had retained to estimate the damages caused by Clarendon’s misconduct. Relying largely on the affidavit, the expert then deposed an individual apparently employed by Clarendon, who claimed he did not recognize the document; ultimately, he did not answer any questions about the document. Clarendon’s counsel then notified Employer’s counsel that the document was privileged, that they produced it inadvertently, and asked Employer’s to return all copies of the document and to also strike the deposed testimony relating to it. Employer’s did not acquiesce and Clarendon then sought a court order.

Determining the actuary’s status became the central issue for the court because Clarendon argued that the actuary acted as a non-testifying consultant; therefore, pursuant to Fed. R. Civ. P. 26(b)(4)(B), his work constituted work-product that was not subject to discovery. Employer’s...
claimed that given Clarendon’s failure to demonstrate that the actuary was, in fact, a non-testifying consultant, that the strictures of Fed. R. Civ. P. 26(b)(4)(A) apply, thereby subjecting the affidavit to discovery. The court noted a key distinction between subparts (A) and (B) of Fed. R. Civ. P. 26(b)(4). Under Fed. R. Civ. P. 26(b)(4)(A), the expert designation as a witness for the party who has retained the expert becomes the touchstone for whether the adversary may seek discovery. Thus, obtaining discovery turns on one’s status as a non-testifying or testifying witness; therefore, one may argue that this creates an opportunity for a party to change the expert’s status to avoid a discovery request. The court correctly pointed out that Fed. R. Civ. P. 35(b) allows discovery of a non-testifying expert’s facts or opinions only “upon a showing of exceptional circumstances.” Further, the general tenor of this rule deals with physical and mental examinations which did not apply to the case at bar.

The court grappled with what legal standard to apply to protective orders where the documents, for the most part, were generated by a consulting expert as opposed to a testifying expert and then allegedly produced inadvertently to a party opponent. The court recognized that the affidavit, despite the “WORK PRODUCT” adornment at the top of the document, was not accorded the protections of attorney work-product because an expert, as opposed to an attorney, created the document. Conversely, as noted in dicta, the court also acknowledged that some courts have deemed such materials work-product.

With no cases clearly addressing protective orders seeking the return of inadvertently produced documents generated by a non-testifying expert, the court relied on a line of cases in its district where the courts applied a five-factor test to determine whether inadvertently producing the document constituted a waiver of attorney-client privilege or work-product.

A party may, through interrogatories or by deposition, discover facts known or opinions held by an expert who has been retained or specially employed by another party in anticipation of litigation or preparation for trial and who is not expected to be called as a witness at trial, only as provided in Rule 35(b) or upon a showing of exceptional circumstances under which it is impracticable for the party seeking discovery to obtain facts or opinions on the same subject by other means.

203. Employer’s Reinsurance Corp., 213 F.R.D at 424. Fed. R. Civ. P. 26(b)(4)(A) reads as follows: “A party may depose any person who has been identified as an expert whose opinions may be presented at trial. If a report from the expert is required under subdivision (a)(2)(B), the deposition shall not be conducted until after the report is provided.”
205. Id. at 425.
206. Id.
207. Id.
208. Id. at 427 n. 14.
209. Id. at 428.
court applied the following five factors to settle whether Clarendon waived its Fed. R. Civ. P. 26(b)(4)(B)’s protections:

(1) the reasonableness of the precautions taken to prevent inadvertent disclosure;
(2) the time taken to rectify the error;
(3) the scope of the discovery;
(4) the extent of disclosure; and
(5) the overriding issue of fairness.

The court carefully analyzed each of the five factors. As for first factor, despite some precautions taken by Clarendon to prevent inadvertent disclosure, the court determined that Clarendon’s failure to proffer the privilege log to Employer’s in a timely manner constituted a waiver of Fed. R. Civ. P. 26(b)(4)(B)’s protections. Given the fact that Clarendon promptly notified Employer’s that it sought the documents’ return after discovering the inadvertent disclosure shortly thereafter, the court deemed this second factor weighed against waiving Fed. R. Civ. P. 26(b)(4)(B)’s protections. Further, because Clarendon had produced approximately 10,800 pages of documents, the court concluded that when examining the third factor, the scope of discovery, Clarendon had not waived Fed. R. Civ. P. 26(b)(4)(B)’s protections. The court applied a standard set forth in Zapata v. IBP, Inc. for assessing the extent of disclosure whereby “[m]eaningful use of the documents disclosed is often sufficient to find extensive disclosure.” Here the court noted that Clarendon produced the affidavit not only to Employer’s damages expert but to other key personnel as well. The court, again, however, noted the significance of the “ATTORNEY WORK PRODUCT” heading adorning the top page of the affidavit.

Clarendon, however, argued that pursuant to ABA Ethics Opinion 92-368, Employer’s was ethically bound to notify Clarendon that it had produced a document bearing the “Work Product” notation and should not have forwarded this document to its own expert for review. Nevertheless, the court was not persuaded that such a designation, coupled with the

210. Id. at 424; see Fed. R. Civ. P. 26(b)(4)(B).
212. Id. at 429.
213. Id.
214. Id.
216. Id.
217. Id. at 430.
ABA’s ethical pronouncement, passed muster. The court acerbically noted:

Labels such as “Attorney Client Privilege” and “Attorney Work Product” are overused on documents that do not truly qualify for protection. To impose an obligation on opposing counsel to notify an adversary of every document that is produced during discovery with such a label is overkill. It would provide an incentive for commonplace use of these types of labels and would be a wholly inefficient method to monitor production.

The court noted that it would be disingenuous for Employer’s to argue that Clarendon had not met its burden under the fourth factor given the fact that its attorney had failed to proactively determine whether opposing counsel had inadvertently produced it. Accordingly, the court determined that the fourth factor weighed in Clarendon’s favor. The standard the court applied towards the fifth factor, fairness, was whether the document was relevant. Here the court quickly ascribed the affidavit as relevant to the litigation and fairness dictated preventing Employer’s from using the affidavit.

After balancing all five factors the court concluded that Fed. R. Civ. P. 26(b)(4)(B)’s protections trumped production of the affidavit to Employer’s.

IV. CONCLUSION

In this new landscape littered with the after-effects of long-tail claims and millions, and oftentimes billions, of dollars at stake, courts must seek innovative solutions for resolving issues that have arisen as a result of the dynamic and changing relationships between cedents and reinsurers. For example, courts must address common interest privilege with a greater understanding of the relationship between a cedent and its reinsurer. Courts must stress the need for greater transparency between the cedent and reinsurer because doing so will ultimately yield lower transaction costs and hence, greater efficiencies.

For example, let us suppose that courts applied a more liberal approach toward the common interest doctrine by allowing a more expansive release
of documents. Further, in this hypothetical, imagine a reinsurer seeks documents from its insured, and as most of the case examples set forth in this note demonstrate, the insured seeks to block production of the documents. This author submits that over time, primary insurers would pay closer attention to their underwriting functions and elicit greater care in assessing potential underlying insureds. Primary insurers would also take heed when allocating losses to their reinsurers, knowing that documents pertaining to their decision-making process could ultimately be subject to discovery.

The flip side to this argument, of course, rests with the increased responsibility of reinsurers to pay claims promptly and avoid dilatory tactics that would prevent a cedent’s recovery if merited. After all, the insurer-reinsurer relationship found its principled roots in one of utmost good faith. Whereas it is unrealistic to return to a time when a handshake cemented reinsurance agreements, greater transparency is one way to resurrect this once congenial and trustworthy relationship.