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Repetitive Stress

How New Jersey Courts Handle Common Discovery Disputes Between Policyholders and Insurers

By Paul Alp

Rita: *Have you ever had déjà-vu?*
Phil: *Didn't you just ask me that?*

Attorneys litigating insurance coverage disputes may find themselves feeling like Bill Murray's character Phil Connors in the 1993 movie *Groundhog Day,* given the rate at which various types of conflicts repeat themselves, often involving a recurring casts of characters. In particular, discovery disputes between policyholders and insurers often involve the same categories of discovery that policyholders seek from insurers and which insurers frequently refuse to provide. This is no less true in New Jersey, which remains a popular forum for the filing of coverage actions. This article discusses categories of discovery sought by policyholders from insurers that commonly give rise to motion practice and how New Jersey courts have resolved such disputes.

In a typical insurance coverage action, a policyholder may seek discovery from its insurer concerning the following categories of information: 1) information concerning the insurer's handling of analogous claims of other policyholders, 2) the insurer's communications with reinsurers, and 3) information concerning reserves set by the insurer.

Much of the information sought by broad discovery requests concerning these categories is not likely to lead to information relevant to or admissible in the coverage dispute between the policyholder and its insurer. Moreover, responding to such discovery requests places considerable burdens on insurers and raises serious concerns about the disclosure of confidential, privileged, or proprietary information.

As a general matter, although the New Jersey Rules permit broad discovery, they do not permit a broad-based fishing expedition into matters not relevant to the dispute being litigated. *See Gierman v. Toman*, 77 N.J. Super. 18, 24, 185 A.2d 241, 244 (Law Div. 1962) (although the rules permit broad discovery, "a party should not be permitted an unbridled excursion into matters not essential"); *K.S. v. ABC Prof'l Corp.*, 330 N.J. Super. 288, 291, 749 A.2d 425, 427 (App. Div. 2000) ("[t]he scope of discovery is not infinite"). A survey of New Jersey cases suggests that it can be sometimes difficult to extract universal generalizations about how New Jersey trial courts rule on discovery motions. Nevertheless, a careful look at available case law suggests that some conclusions may be drawn with respect to requests for information concerning other policyholders, reinsurance, and reserves.

As one New Jersey court has observed, "[d]emands for discovery by insureds cover categories that any intelligent lawyer can think of." *Unisys Corp. v. Ins. Co. of N. Am.*, No. L-143494-S (Law Div., Nov. 18, 1996), slip op. at 4. However, "merely because almost anything may lead to admissible evidence in the context of current case law is not a reason to compel discovery on what are concededly the more peripheral issues that arise." *Id.* at 5.

'Other Policyholder' Information

Policyholders in coverage cases often seek the production of massive amounts of information concerning the handling of claims submitted by policyholders whose policies contain provisions "similar" to the policies at issue in the coverage litigation. Such requests for "other policyholder" information are frequently invalidated by courts because they have no possible relevance to the issues before them, are unduly burdensome to gather and produce, and are protected by the attorney-client privilege and the work product doctrine.

The lack of relevance of information concerning the handling of claims of other policyholders is manifest. Courts in New Jersey routinely deny discovery of such information due to this lack of relevance. *E.g., Pfizer, Inc. v. Employers Ins. of Wausau*, No. MID C-108-92 at 8 (Law Div., Mar. 13, 1995) (denying policyholder's request for information concerning other policyholders); *Primerica Holdings, Inc. v. Employers Ins. of Wausau*, MID-L-12342-90 (Law Div., Nov. 9, 1993), reprinted in Mealey's Litig. Rpts. (Ins.) Vol. 8, No. 5 (Dec. 1, 1993) at H-3 (ruling that "information concerning claims made by other policyholders ... is denied as being idiosyncratic, collateral and not reasonably calculated to lead to the discovery of admissible evidence for this trial"); *Jefferson Smurfit Corp. v. Aetna Cas. Co.*, No. L-7068-99 (Law Div., Dec. 13, 2000 and supplemented Jan. 15, 2001) at 4, *reprinted in* Mealey's Litig. Rpts. (Ins.) Vol. 15, No. 13 (June 12, 2001) at D-1 to D-4 (information and documents concerning other policyholders not reasonably calculated to lead to the discovery of admissible evidence). In this way, New Jersey courts are consistent with the majority of courts in other jurisdictions, which refuse to compel discovery of "other policyholder" information. *See, e.g., North River Ins. Co. v.*

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Mayor & City Council of Baltimore, 343 Md. 34, 67, 680 A.2d 480, 497 (Md. 1996) (majority of courts regularly deny production of "other policyholder" information).

A request for an insurer to produce documents pertaining to the handling of claims of other policyholders may impose a large burden on the insurer. Because insurers typically organize their claim files on a policyholder-by-policyholder basis, a request for the handling of claims involving "similar" policy language would require a search of a voluminous number — in some cases millions — of documents kept in other policyholders' files to locate potentially responsive documents. Moreover, these other policyholders' files can contain privileged, confidential, and proprietary business information relating to such matters as the financial status, trade secrets, and business operations and procedures of the other policyholders. If an insurer were compelled to provide such information, the insurer would potentially be impinging upon the rights of its other policyholders and inviting adverse consequences for its ongoing business relationships.

In addition, many of the documents in other policyholders' files may be subject to written confidentiality agreements that prohibit production by the insurer. As a result, if the insurer were ordered to produce such information, these confidentiality agreements, court protective orders, contractual confidentiality clauses, and the general duty of confidentiality an insurer owes its policyholders would obligate it to undertake the additional burden and expense of contacting all the affected parties and warning them of the impending disclosure and then taking steps to ensure that any confidential information is not improperly disclosed — an extraordinarily expensive and time-consuming process.

In short, in many instances compelling an insurer to produce information and documents pertaining to claims involving "other policyholders" would impose an undue burden that cannot be justified when compared with the complete lack of relevance of the information sought. For this reason, the district court in *Leksi, Inc. v. Federal Ins. Co.*, 129 F.R.D. 99, 105 (D.N.J. 1989), rejected a policyholder's request for information regarding the manner in which the insurer-defendants "applied the policy language to claims similar to Leksi's made by other insurers." The court concluded that "the information which [the policyholder] seeks concerning the files of other insureds is disproportionate to the declaratory judgment it has filed," and correctly observed that:

> To compel the production of the files of other insureds not only involves enormous inconvenience and management difficulties, but also entails a frightening potential for spawning unbearable side litigation which, in my view, defeats the purpose and spirit of the discovery rules themselves. *Id.* at 106.

Compelling the production of "other policyholder" information may also invite disruptive collateral litigation over non-parties' claims of privilege, trade secret/proprietary status, and business confidentiality. The producing insurer would be obligated to inform its affected non-party policyholders of the impending production of their claims and litigation files, and such policyholders would likely seek to intervene in the litigation to oppose such disclosure.

Requests for such information also raise serious privilege concerns. Communications between an *insurer* and its policyholder in connection with the defense of the policyholder fall within the attorney-client privilege that belongs to the "other policyholders." *See, e.g., State v. Pavin*, 202 N.J. Super. 255, 257, 494 A.2d 834, 835 (App. Div. 1985). The information and documents relating to the carrier's defense of other claims by definition reflect privileged communications between the other policyholders and their defense counsel. Where the attorney-client privilege is applicable, "it must be given as broad a scope as its rationale requires." *United Jersey Bank v. Wolosoff*, 196 N.J. Super. 553, 561, 483 A.2d 821, 825 (App. Div. 1984) (citation omitted).

Materials in an insurer's files prepared in connection with the defense of claims against other policyholders would also be subject to the protections of the work-product doctrine because they have been prepared in connection with underlying litigation against the other policyholders. The protections afforded by this doctrine also belong to the other policyholders.

Reinsurance Information

Policyholders also often seek information concerning the insurer's reinsurance and the insurer's communications with its reinsurers. Such information may encompass proprietary and confidential information concerning the nature of the insurer's reinsurance program as well as admissions made by the insurer in its candid communications with reinsurers. Policyholders argue that such information might reflect the insurer's knowledge and understanding of the underlying claims against the policyholder. This rationale ignores the fact that the relevant documents in the insurer's possession concerning the insurer's understanding of claims and dealings with the specific policyholder would ordinarily be contained in the claim files that the insurer maintains for that policyholder.

For example, the fact that an insurer asserts a "late notice" defense to coverage does not justify the production of the insurer's communications with its reinsurers. With respect to the "late notice" defense, the relevant communications are those between the policyholder and the insurer because of the policyholder's obligation under its policies to provide timely notice to its insurer. *See, e.g.*, *SL Indus., Inc. v. American Motorists Ins. Co.*, 128 N.J. 188, 199-200, 607 A.2d 1266, 1272 (1992) (policyholder "is responsible for promptly conveying to its insurance company the information that it believes will trigger coverage"). The contents of confidential communications between the insurer and its reinsurers have no bearing on whether the *policyholder* provided timely or adequate notice as required by the policies.

The decision to enter into a reinsurance agreement is based on business considerations and not questions of policy interpretation. *Leksi,* 129 F.R.D.

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at 106 (noting that the purpose of reinsurance is to allow an insurer to spread the burden of indemnification). Thus, reinsurance information is not relevant to the interpretation of policies between the insured and its policyholder. Accordingly, numerous New Jersey court decisions have rejected efforts by policyholders to obtain discovery of reinsurance information in coverage cases. *See, e.g., In re Envt'l Ins. Declaratory Judgment Actions*, No. UNN-L-8573-89, at 6-7 (Law Div., Aug. 7, 1990) ("the scope of permissible discovery shall not include ... each carrier's communication with reinsurers"); *Unisys Corp. v. Ins. Co. of N. Am.,* No. MID-L-1434-94-S, at 5-6 (Ch. Div., Nov. 18, 1996) (reinsurance generally not an appropriate avenue of discovery); *Waste Mgmt., Inc. v. Admiral Ins. Co.*, No. HUD-L-931-92, at 19-20 (Law Div., Nov. 16, 1994) (denying motion to compel responses to discovery requests on reinsurance); *Air Prods. & Chem. Inc. v. Hartford Acc. & Indem. Co.*, No. MID-L-17134-89, Tr. at 106, (Law Div. Oct. 5, 1990) (reinsurance information is not relevant and is not designed to lead to relevant evidence); *Schering Corp. v. Evanston Ins. Co.*, No. UNN-L-97311-88, at 30-31 (Law Div., August 4, 1989), *leave to appeal denied*, No. AM-106-89, Order (App. Div. October 23, 1989) (denying request for reinsurance information due to lack of relevance).

The disclosure of reinsurance information may likely compromise the interests of an insurer to a degree disproportionate to any possible argument of relevance that it could have in a coverage dispute between the insurer and its insured. Communications between insurers and their reinsurers contain proprietary information concerning pricing and coverage of each reinsurance agreement. Information regarding amounts of reinsurance, risks reinsured, and even the identity of an insurer's reinsurer is closely held and treated as proprietary information by insurers. Moreover, reinsurance agreements often require the insurer to provide certain information concerning the underlying loss to the reinsurer. Such information will likely contain the work product and analysis of the insurer's attorneys, which is protected from disclosure. If a court orders such communications to be disclosed, the result may be to chill the communications by the insurer to the reinsurer, thus precluding full disclosure of information to the reinsurer. As one commentator has observed:

> Without truthful, freeflowing and accurate information, the cedent-reinsurer relationship would be severely hampered. ... The mere possibility that this information — intended to be confidential — may be disclosed to policyholders will adversely affect the open lines of communication between insurers and their reinsurers. Note, *Confidential Insurer-Reinsurer Communications: Are Courts Placing The Reinsurance Relationship In Jeopardy By Ordering Disclosure?*, 27 Rutgers L.J. 727, 754 (Spring, 1996).

Reserve Information

Policyholders often argue that information concerning reserves set by an insurer is relevant to the insurer's understanding of the underlying claims. This argument reflects a misunderstanding of the practice of setting reserves. An insurer's act of setting reserves does not demonstrate an assessment of the merits of the policyholder's claim. Rather, the setting of a reserve can be unrelated to the merits of a specific claim, such as reserves mandated by statutory requirements. *See, e.g., Primerica Holdings, Inc. v. Employers Ins. of Wausau*, No. MID-L-12342-90, at 2 (Law Div., Nov. 9, 1993) (reserves "are the result of state regulations, and do not necessarily reflect a true evaluation of the claim by the particular carrier"). For example, the New Jersey statute regulating insurance requires insurers to set reserves "in the aggregate" as part of the capitalization requirements for doing business in the state:

> Every insurance company ... shall, at all times, maintain reserves in an amount estimated in the aggregate to provide for the payment of all losses and claims incurred, whether reported or unreported, which are unpaid and for which such company may be liable, and to provide for the expenses of adjustments or settlement of such losses or claims. N.J.S.A. §17:17-18.

Even where a reserve is not compelled by statute or regulation, the process of setting reserves is often inexact, based on preliminary information about a claim, and is far removed from the ultimate determination of whether coverage of the claim should lie.

The fact that an insurer has set a reserve provides no information about whether a particular claim is actually covered. The existence of coverage depends solely on the application of the underlying facts to the specific insurance policies at issue, and not statutory insurance company capitalization requirements, an insurer's other business considerations, or the general impressions of a claims handler at an early stage in the development of the facts of the claim. An insurer's reserving practices simply cannot change what is written in the contract and do not affect the contractual analysis. Because the connection of reserve information to disputed issues between a policyholder and its insurer is tenuous at best, courts in New Jersey and around the nation routinely deny motions to compel the discovery of reserve information. *See, e.g., Leksi*, 129 F.R.D. at 106 ("I find that reserve information is only tenuously relevant to whether insurance coverage exists in this matter and this information is not discoverable at this time"); *Waste Mgmt., Inc. v. Admiral Ins. Co.*, No. HUD-L-931-92, at 20 (Law Div., Nov. 16, 1994) (denying motion to compel production of reserve information); *In re Envt'l. Ins. Declaratory Judgment Actions*, No. UNN-L-8573-89, at 6-7 (Law Div., Aug. 7, 1990); *Pfizer, Inc. v. Employers Ins. of Wausau*, No. MID-C-108-92, at 8-9 (Ch. Div., Mar. 31, 1995). *See also Silva v. Basin Western, Inc.,* 47 P.3d 1184, 1191 (Col. 2002) ("as a general rule, reserves and settlement authority are not reasonably calculated to lead to discoverable evidence and are therefore not subject to discovery").

Relevant discovery on the complex issues presented in a typical coverage action can be extremely burdensome and costly to all of the parties involved. There is no point in compounding this

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burden by directing insurers to expend needless and overwhelming time and expense to provide what would be irrelevant additional discovery. Any discovery request must be reasonably calculated to lead to the discovery of admissible evidence, must not seek the disclosure of privileged information, and must not impose an undue burden on or harass the responding party. As shown above, New Jersey trial courts typically deny, for good reason, requests by policyholders for discovery from insurers of information concerning other policyholders, reinsurance, and reserves.

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