CPCU Society
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Reinsurance Interest Group Quarterly
RISE

Volume 25 Number 2 December 2007

Chairman's Corner: Philadelphia Is the Place To Be in 2008!

by Richard T. "Rick" Blaum, CPCU, ARe

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He graduated with a B.S. in history from Mt. St. Mary's College in Emmitsburg, MD in 1972.

I hope many of you were able to join us in Hawaii in September for the CPCU Society's 2007 Annual Meeting and Seminars. It's a long jaunt, but well worth the effort, for it is, after all pretty close to paradise. In addition to working on your tan lines, you were offered a wide array of interesting, enlightening, and thought-provoking educational seminars, not the least of which was the "Reinsurance: State of the Art" seminar developed by the Reinsurance Interest Group. You will find a recap of that seminar in this issue on page 7.

But we've left Hawaii, we're all back home, the tans are fading as autumn settles in and winter approaches, and now it's time to focus on 2008! As we know all too well, this is no longer "your father's reinsurance industry." Mergers, acquisitions, synergies, and redundancies are terms that are now commonplace in the reinsurance vernacular. We all must work harder and smarter; do more with less. We can curse the darkness or light a candle. Those of us on the Reinsurance Interest Group Committee are determined to follow the latter course of action. Admittedly, we are coming off what has not been our best year, with several initiatives falling short of fruition, but we were still awarded the silver Circle of Excellence Award for 2007.

We are determined to "reclaim the gold," and the path toward that goal runs through Philadelphia. As you read this, we are in the midst of putting together the agenda and recruiting speakers for our Reinsurance symposium, which we plan to bring back to Philadelphia in the spring. Details will follow as the various items get firmed up, but we also plan to include a ceremony for ARe completers. Those of you who have attended before will agree that it is usually one of the leading educational forums involving reinsurance in any given year, and one and one-half days well spent. We plan to make this one even better!

CPCU: Heritage & Horizons
CPCU Society Annual Meeting and Seminars
September 6–9, 2008 • Philadelphia, PA

Then, in September, the "City of Brotherly Love," will also host the CPCU Society's 2008 Annual Meeting and Seminars. The overall theme for next year's meeting will be "Heritage and Horizons." The Reinsurance Interest Group will once again develop a

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Chairman's Corner: Philadelphia Is the Place To Be in 2008!

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two-hour panel discussion featuring senior executives representing all phases of the reinsurance loss transfer mechanism—direct writer reinsurer, brokered reinsurer, primary carrier, and reinsurance broker. In keeping with the theme, we hope this panel will help us look back at our past, assess where we are at present, and set the course for our future. As George Santayana said, "Those who cannot remember the past are condemned to repeat it." We believe this panel will assist us all in setting the proper course for our future as an industry.

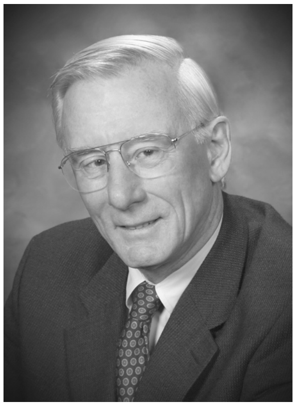
There will also be several other events throughout the year, including another joint venture with REACH in Chicago in February. We used our meeting time in Hawaii to set an ambitious schedule for 2008, as we recommit ourselves to offering the highest quality educational forums in the reinsurance industry. We hope you join us by supporting these efforts. I'm looking forward to seeing many of you in Philadelphia and at various CPCU Society events throughout the coming year! ■

■ *Members of the Reinsurance Interest Group Committee began planning activities for the upcoming year. From left: Ralph K. Riemensperger, CPCU; Donald E. McGrath, CPCU; Gordon J. Lahti, CPCU; and Richard T. Blaum, CPCU, ARe.*

■ *The Reinsurance Interest Group Committee met in Hawaii at the 2007 CPCU Society's Annual Meeting and Seminars. Front row, left to right: Gordon J. Lahti, CPCU, ARe; Richard T. Blaum, CPCU, ARe; and Donald E. McGrath, CPCU. Back row, left to right: Connor M. Harrison, CPCU, ARe; Charles W. Haake, CPCU, ARe; Diane N. Houghton, CPCU, ARe; Sandra L. LaFevre, CPCU, CPIW, ARe; Richard G. Waterman, CPCU, ARe; and Ralph K. Riemensperger, CPCU. Committee members not pictured: Barbara R. Burns, CPCU; Eric F. Hubicki, CPCU; and Nicholas J. Frnazi, CPCU, ARe.*

Reinsurance Black Swans

by Richard G. Waterman, CPCU, ARe



■ **Richard G. Waterman, CPCU, ARe,** is president of Northwest Reinsurance, Inc., a Minnesota-based management consulting firm specializing in the fields of insurance, reinsurance, and alternative dispute resolution. Waterman is the former president and chief executive officer of American Equity Insurance Company and GRE-RE of America Corp. In addition to working with both ceding and assuming companies involving treaty and facultative contract formation, structure analysis, risk exposure, and claim settlement issues in his consulting practice, Waterman has served as an arbitrator or umpire on more than 110 panels to resolve industry disputes as well as serving as a neutral mediator, facilitator, and fact-finder assisting parties to work out differences in a confidential setting. Waterman has been a member of the CPCU Society since 1978 and has served on the Reinsurance Interest Group Committee for nearly 10 years.

In his captivating new book, *The Black Swan,* Nassim Nicholas Taleb examines the hidden role of randomness as incomplete information in assessing risk. He dubbed the term Black Swan (and capitalized it) to denote a rare event. In his analogy, no amount of observation of white swans can allow the inference that all swans are white. Just because you have not seen a black swan does not mean one does not exist, and proving that a black swan does not exist would take an infinite number of observations. The subsequent discovery of a jet-black swan in Australia invalidated the assumption that all swans are white. The sighting of the first black swan illustrates a severe limitation to learning from observation or past experience as a predictive value for assessing the risk that something else might take place.

For Nassim Taleb, a Black Swan is a highly improbable event with three principle characteristics. First, a Black Swan is unpredictable because it lies outside the realm of regular expectation. Second, it carries an extreme impact. Third, in spite of its randomness, human nature makes us concoct explanations for is occurrence after the fact, making it explainable and predictable. The events of September 11, 2001, the devastation caused by Hurricane Katrina, and the collapse of Minnesota's 35W bridge were Black Swans. Black Swans can also be positive events like the astonishing success of Google or the introduction of new technology such as Apple's iPhone. The author also points out that Black Swans can be the nonoccurrence of a highly probable event.

In the risk measurement domain, the only thing we know with certainty is that we have not experienced an unmanageable Black Swan event. The severe circumstances of the next random Black Swan catastrophe are unknown, unexpected, and not included in industry historical statistics. It is, therefore, unlikely that an insurance company will fail due to a potential large event that is incorporated into risk assessment models, while a highly improbable event would have a major impact. Behavioral psychologists refer to this phenomenon as "anchoring." We tend to take recent events and project them into the future in a straight line. We "anchor" our projection on information we have recently experienced. Tomorrow will be like today. That is why many industry risk assessments conclude that future catastrophes will be manageable because they will look like recent memorable events. Nonetheless, consider for a moment the situation of a turkey. It is fed every day by friendly members of the human race, has plenty of water, and a comfortable place to live. Life is good. Learning from past experience, the turkey expects tomorrow to be like yesterday. However, the next day is Wednesday before Thanksgiving. Something unexpected happens.

So What Should Reinsurers Worry About?

Black Swan-prone risks are usually ceded to reinsurers. For example, there has been a steady rise in weather-related natural catastrophes during recent decades. Taking inflation into account, economic losses in the past 10 years have more than doubled. Catastrophe modeling tools have been developed as a means to evaluate the accumulation of risk exposure and to determine adequate risk premium. While the modeling techniques for natural catastrophes are in theory useful, in application the results are often woefully misleading. When a Black Swan event occurs, the risk modeling tools become meaningless at precisely the time you most need measurement tools to work. The crux of the matter is that assessment of catastrophe exposure

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Reinsurance Black Swans

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based on past observations is a modeling shortcoming. After each event, the modelers revise meteorological and vulnerability assumptions to take into consideration the new information. As Nassim Taleb explains in his book, "the rarer the event, the less we know about its odds. It means that we know less and less about the possibility of a crisis." The seriousness of not knowing the value of a Black Swan terrorist strike or a major natural catastrophe is highlighted by the federal government's plans to extend the terrorism insurance backstop as well as proposals for government to take over or subsidize a national catastrophe fund.

. . . what risk managers really need to worry about is the extreme Black Swan event that could potentially wipe out an insurance company's policyholders surplus . . .

Nassim Taleb also challenges traditional probability risk assessment concepts that risks are normally distributed in a Gaussian or bell-shaped curve. Statistically, everything has to fit within the curve. There is little room in the Gaussian bell curve for events that are far from the center. However, what risk managers really need to worry about is the extreme Black Swan event that could potentially wipe out an insurance company's policyholders surplus, especially if you believe that extreme catastrophes may become more frequent in the future. The extreme ends of a bell curve are often referred to as fat tail risks. Generally, the insurance and reinsurance industry do not factor extreme risk very well. No one, for instance, reasonably conceived the magnitude of the terrorist attack of September 11, 2001, nor did anyone reasonably believe that Minnesota's 35W bridge would collapse. Although fat tail events are rare and unpredictable, they have an extraordinarily dramatic impact. That is why the author suggests we need to learn more about the uncertainty of fat tail risk distribution to better understand and measure potential Black Swan events.

Most of us tend to look to the future as if it will be Black Swan-free when in fact there is nothing usual about the future. I highly recommend taking some time to read *The Black Swan*. Whether you agree with Nassim Taleb or not, this book will likely change the way you look at the world. ■

Mark Your Calendar for the 2008 Reinsurance Symposium in Philly!

The 2008 edition of the popular Reinsurance Interest Group symposium will be held on March 13 and 14 at Loews Philadelphia Hotel, located at 1200 Market Street.

Your Reinsurance Interest Group leaders are designing an outstanding program, to be delivered by speakers who really know what's going on in your industry.

As always, one of the highlights of the event will be a first-class luncheon at which Associate in Reinsurance designees will be recognized. **Peter L. Miller, CPCU,** president and CEO of the American Institute for CPCU and Insurance Institute of America, will be the luncheon speaker. Pete will share his vision of how the Institutes are transforming insurance education in multiple channels to open new opportunities for CPCUs to advance in their careers.

We'll e-mail information as it becomes available.

See you in Philly in March!

Photo by Jim McWilliams

Refining the Questions Associated with Consolidation of Reinsurance Arbitrations

by Andrew S. Boris, J.D.

■ **Andrew S. Boris, J.D.,** is a partner in the Chicago office of Tressler Soderstrom Maloney & Priess, LLP. His practice is focused on litigation and arbitration of insurance coverage and reinsurance matters throughout the country, including general coverage, professional liability, environmental, and asbestos cases. Questions and responses to this article are welcome at aboris@tsmp.com.

Editor's note: Consolidation of property and casualty reinsurance disputes is a relatively new phenomenon that was not contemplated when existing reinsurance agreements were negotiated. Since most reinsurance disputes are subject to an arbitration clause that includes a provision that the participation of the reinsurer is separate and apart from participations of other reinsurers, courts routinely refused to consolidate arbitrations with multiple parties unless the reinsurance agreement expressly provided for consolidation of similar disputes. Andrew points out in his article, however, that two United States Supreme Court decisions in 2002 have determined that arbitrators, not courts, are empowered to decide whether to consolidate disputes subject to arbitration resolution. This significant change in determining how many reinsurance proceedings should be held and how arbitrators will decide on the number of arbitrations will likely create disputes about how to resolve reinsurance disputes.

The question of whether reinsurance arbitrations involving different parties, programs, contracts, or contract years should be consolidated is not new. Those favoring consolidation trumpet its efficiency and economic advantages, while those opposing consolidation argue that reinsurance contracts include arbitration clauses tailored to address individual disputes involving specific agreements and the contracting parties. Historically, courts refused to consolidate arbitrations citing a lack of authority under the Federal Arbitration Act unless the reinsurance agreement specifically permitted it. Approximately five years ago, the legal landscape changed with two decisions by the United States Supreme Court: *Howsam v Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002) and *Green Tree Fin. Corp. v Bazzle*, 539 U.S. 444 (2003). In those two non-reinsurance related decisions, the Supreme Court held that the responsibility of the courts was to determine the threshold question of whether a particular matter was "arbitrable." The Supreme Court further held that all issues relating to any procedural questions were to be addressed by the arbitrators and not the courts.

The *Howsam* and *Green Tree* decisions provided the support for those involved in reinsurance to argue that the arbitrators (and not the courts) should address questions involving consolidation. Consistent with that approach, courts have recently established a trend to that effect. See *Employers Ins. Co. v Century Indem. Co.*, 443 F.3d 573 (7th Cir. 2006); *Certain Underwriters at Lloyd's v Cravens Dargan & Co., Pacific Coast*, No. 05-56154, consolidated with No. 05-56269, 2006 U.S. App. LEXIS 20853 (9th Cir. Aug. 14, 2006); and *Certain Underwriters at Lloyd's v Westchester Fire Ins. Co.*, 489 F.3d 580 (3d Cir. 2007). These decisions rejected the proposition that the courts should be the decision-makers with respect to the question of whether multiple arbitrations should be consolidated. Instead, the courts ruled that the proper audience for the consolidation dispute is the arbitration panel.

As one might expect, one decision or trend leads to additional issues or complications, and the recent decisions addressing reinsurance arbitration consolidation have raised new problems. One such issue is which arbitration panel (when there is more than potentially one panel in place) is to decide the question of consolidation. A recent decision by the federal district court for the Eastern District of Pennsylvania addressed that very issue. See *Argonaut Insurance Company v Century Indemnity Company, as successor to Insurance Company of North America*, No. 05-5355, 2007 WL 2668889 (E.D. Pa. September 6, 2007).

In *Argonaut*, between April and May of 2005, Century sent four different arbitration demands to Argonaut. Three of the demands pertained to separate, single claims under the same reinsurance agreement. Century did not appoint an arbitrator when it sent each of the first three arbitration demands. Following receipt of each of the arbitration demands, Argonaut demanded that Century appoint an arbitrator for each of the arbitration demands within the time period identified in the controlling contract. Prior to the expiration of the time period for Century to appoint its arbitrators, it forwarded a fourth arbitration demand to Argonaut that sought a consolidated arbitration for numerous claims, including the claims that were at issue in the first three arbitration demands sent to Argonaut. When Century did not subsequently appoint its arbitrators in connection to two of the first three arbitration demands, Argonaut appointed arbitrators on Century's behalf. Century contended, in response, that the fourth arbitration demand superceded the prior demands by

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including all claims in dispute (including those previously placed at issue) between the parties. Further, in what was described as an effort to clarify any confusion, Century purportedly withdrew the two first arbitration demands.

The court was presented with the question of which arbitration panel should be charged with the responsibility of addressing whether consolidation was proper. Both parties contended that the first arbitration panel that was completely formed should decide the question of consolidation. As might be expected, the parties could not decide which panel was, in fact, formed first. The court rejected the proposition that it should address the question presented. The court opined that the arbitrators should decide the questions of whether: (1) Century properly withdrew some of the arbitration demands; and (2) consolidation was appropriate under the circumstances.

. . . greater attention is being paid to the drafting of arbitration clauses with parties evaluating how consolidation should be addressed.

Although the court recognized that it was inefficient, it ordered that four separate arbitrations should move forward consistent with the four arbitration demands that Century sent to Argonaut. The court noted that unless the two sophisticated business litigants could sensibly and jointly design a procedural roadmap, the panels would be charged with identifying a reasonable solution as to which panel must decide the issues.

This case points out some of the challenges that are associated with arbitration consolidation. Parties are trying to address the questions both at the drafting stage and when disputes involving consolidation arise.

Undoubtedly, greater attention is being paid to the drafting of arbitration clauses with parties evaluating how consolidation should be addressed. With respect to disputes involving consolidation, some parties are agreeing to convene one panel whose sole responsibility is to address the consolidation dispute. Obviously, this approach is costly and does not promote a quick resolution of the parties' fundamental dispute, but it does help to reduce a number of peripheral disputes. Nonetheless, despite the attempts to proactively address the issue, consolidation questions will continue. ■

Privilege, Waiver, and the Voluntary Disclosure of Privileged Documents to Reinsurers

by Teresa Snider

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Note: This article originally appeared in the first quarter 2007 issue of *ARIAS•U.S. Quarterly* and is reprinted here with permission.

Editor's note: Attorney-client privilege is the right to effective counsel and confidentiality in seeking legal advice. Teresa's highly informative article puts in understandable language the importance of the attorney-client privilege and work product doctrine in a reinsurance setting. Also, Teresa explains how the typical access to records clause made part of most reinsurance agreements and the common interest doctrine permits a reinsurer to share privileged information about claims it has been asked to pay when the ceding company and reinsurer are not engaged in a reinsurance coverage dispute. Although attorney-client privilege and the work product and common interest doctrines are complex subjects, Teresa's article provides an awareness of the concepts to keep in mind the next time you are in search of legal advice from an attorney.

Ceding companies have grown more sensitive to the possibility that they might waive the protection afforded to privileged coverage and defense documents by disclosing those documents to their reinsurers. If the documents lose their protection as privileged communications, they are vulnerable to discovery by policyholders and others. Because such documents may reveal case weaknesses or strategy decisions that could be exploited by policyholders or claimants to the disadvantage of the ceding company (and its reinsurers), cedents are increasingly cautious in disseminating privileged documents to reinsurers.

The Attorney-Client Privilege and Work Product Doctrine

There are two general categories of "privilege": the attorney-client privilege, and the work product doctrine. The parameters of the privileges may vary from jurisdiction to jurisdiction, but the general outlines of the privileges are relatively constant. A document is subject to the attorney-client privilege if it is (1) a communication; (2) made between an attorney and a client; (3) in confidence; and (4) for purposes of seeking, obtaining, or providing legal advice. A document is protected pursuant to the work product doctrine if it is prepared (1) by or for a party or that party's representative (usually an attorney); (2) in anticipation of litigation or for trial. The requirement that a document be prepared "in anticipation of litigation" has both a temporal element (was there a likelihood of litigation at the time the document was prepared?) and a motivational element (was the document created because of the prospect of an adversarial proceeding?).

The work product protection is not absolute. The extent of the work production protection has been codified in Federal Rule of Civil Procedure 26(b)(3) (and in the Federal Rules of Criminal Procedure), which govern all cases tried in the federal courts. This is different than the attorney-client privilege, where federal courts will look to the forum state's law of privilege. Federal Rule of Civil Procedure 26(b)(3) provides that:

> a party may obtain discovery of documents and tangible things otherwise discoverable . . . and prepared in anticipation of litigation or for trial by or for another party or by or for that other party's representative . . . only upon a showing that the party seeking discovery has substantial need of the materials in the preparation of the party's case and that the party is unable without undue hardship to obtain the substantial equivalent of the materials by other means. In ordering discovery of such materials when the required showing has been made, the 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.

Fed. R. Civ. P. 26(b)(3). Rule 26(b) thus draws a distinction between "opinion" work product and "ordinary" work product. While ordinary work product is subject to discovery on a showing of need or hardship, opinion work product is more protected.

Waiver of Privileges

Even when a document meets the requirements necessary to establish the existence of the attorney-client privilege, the privilege will not be recognized if it has been waived. The client holds the privilege and it is the client's purview to decide whether to waive the privilege, although counsel acting on a client's behalf, a successor-in-interest, and a trustee in bankruptcy stand in the shoes of the client and thus can also waive the privilege. Most often the waiver will occur because of a disclosure—inadvertent[1] or deliberate—that vitiates the confidential nature of the communication. The purposeful disclosure of privileged documents to a third-party is generally viewed as waiving the privilege as to all others—unless the disclosure is between privileged parties (e.g., between parties with a common interest or within the control group of a corporation).

While the attorney-client privilege is often treated as waived by any voluntary disclosure, only disclosures that are "inconsistent with the adversary system" are deemed to waive work product protection. This is because strategic disclosure of work product is consistent

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with the work product doctrine. Thus, voluntary disclosure to an adversary is almost invariably seen as total waiver. See *In re Steinhardt Partners, L.P.*, 9 F.3d 230, 234-35 (9th Cir. 1993) (voluntary disclosure of protected work product to SEC, with whom trader was in an adversary relationship, waived protection in subsequent litigation with private parties). A waiver can occur without actual disclosure to an adversary if a substantial risk of disclosure to an adversary has been created. A confidentiality agreement concerning disclosed work product may be sufficient to show an intent to protect the work product from actual or potential litigation adversaries. *Blanchard v Edgemark Fin. Corp.*, 192 F.R.D. 233, 236 (N.D. Ill. 2000). When confidentiality is protected, disclosure of documents for legitimate business reasons is unlikely to waive the work product doctrine. Where parties have a common adversary in litigation and are conducting a joint defense, they may share work product without thereby waiving the protection of the doctrine. *In re Sunrise Sec. Litig.*, 130 F.R.D. 560, 583 (E.D. Pa. 1989) (no waiver when work product shared with one having interests in common under understanding of confidentiality and of pursuing a joint defense).

The Common Interest Doctrine—Generally

The common interest doctrine enables a party to share privileged documents with another party with whom it shares a "common interest" in litigation against a common adversary while still maintaining the ability to assert the privilege against third parties. See *Miron v BDO Seidman, LLP,* No. Civ.A 04-968, 2004 WL 3741931, at *2 (E.D. Pa. October 21, 2004). However, courts are reluctant to expand the common interest doctrine to include cases where the parties merely share a common business interest rather than a common legal interest. For example, in *Aetna Casualty & Surety Co. v Certain Underwriters at Lloyd's London,* 676 N.Y.S.2d 727 (Sup. Ct. N.Y. Cty. 1998), the court did not accept that communications among reinsurers were privileged where the reinsurers were engaged in strategic discussions of business issues, and the attorneys present at the meetings merely acted as scriveners rather than providing legal advice:

> any "common interest" privilege must be limited to communications between counsel and parties with respect to legal advice in pending or reasonably anticipated litigation in which the joint consulting parties have a common legal interest. . . [i]t may not be used to protect communications that are business oriented or are of a personal nature. . . This court does not find that the limited New York authority on the subject permits the carving out of a large class of communications between potential parties so as to immunize their communications between themselves and counsel for other parties.

Id. at 732-33. Thus, a "common interest," standing alone, is insufficient to establish the existence of a legal privilege.

Access to Records Clauses

The typical access to records clause, on its face, seemingly entitles the reinsurer to broad access to the cedent's records, including privileged documents.

> Sample A: The Reinsurer or its designated representatives shall have free access at any reasonable time to all records of the Company which pertain in any way to this reinsurance.[2]

> Sample B: The Reinsurer or its designated representatives shall have access to the books and records of the company on matters relating to this reinsurance at all reasonable times for the purpose of obtaining information concerning this Contract or the subject matter hereof.

Some cedents are sufficiently concerned about the potential for third parties to gain access to privileged documentation as a result of disclosure to reinsurers that they add language to the Access to Records clause explicitly removing access to both attorney-client privileged documents and attorney work product documents. Reinsurers may object to such carve-outs, contending that the result is to deny the reinsurers access to relevant information about claims they have been asked to pay.

Despite these concerns by cedents, however, courts have not been so quick to find that such clauses waive legal privileges held by the ceding company. For example, in *Gulf Insurance Co. v Transatlantic Insurance Co.*, 13 A.D.3d 278 (N.Y. App. Div. 2004), the appellate court overruled the lower court's decision finding that the access to records clause waived legal privileges that would have been otherwise applicable to documents held by a cedent:

> Access to records provisions in standard reinsurance agreements, no matter how broadly phrased, are not intended to act as a per se waiver of the attorney-client or attorney work product privileges. To hold otherwise would render these privileges meaningless. Id. at 279.

Thus, the access to records clause did not constitute a blanket waiver of privilege and thereby entitle the reinsurer to access to the cedent's privileged documents. Id. at 280. Similarly, the court in *North River Insurance Co. v Philadelphia Reinsurance Corp.*, 797 F. Supp. 363 (D.N.J. 1992), interpreted a cooperation clause, which provided that the insurer would provide to the reinsurer "any of its records relating to this reinsurance or claims in connection therewith," so as not to result in an automatic waiver of the attorney-client privilege. Id. at 368–69. In that case, the reinsurer moved for production of documents that the insurer, on the basis of the attorney-client privilege, refused to produce. The court held that the reinsurer was "not entitled under a cooperation clause to learn of any and all legal advice" that had been obtained "with a reasonable expectation of confidentiality." Id. at 369 (citation omitted). Rather, "more explicit language" was necessary to show that the cedent had "wholesale" given up its rights to preserve the confidentiality of privileged information. Id.

The Existence or Absence of a Common Interest between a Cedent and Its Reinsurers

At least in instances in which a cedent and its reinsurer are not engaged in a reinsurance coverage dispute, some courts have held that cedents and their reinsurers enjoy a common interest such that the cedent can share privileged information with its reinsurer without waiving the privilege as to other third parties. See, e.g., *Durham Indus. Inc. v North River Ins. Co.*, No. 79 Civ. 1705 (RWS),1980 WL 112701, at *3 (S.D.N.Y. Nov. 21, 1980) (surety bondholder's motion to compel production of cedent's privileged communications denied even though communications were disclosed to reinsurer because "where the reinsurers bear a percentage of liability on the bond, their interest is clearly identical to that of defendant [cedent]" and no waiver of the privilege occurred as a result of the disclosure); *Minn. School Bds. Assoc. Ins. Trust v Empl. Ins. Co. of Wausau*, 183 F.R.D. 627, 631-32 (N.D. Ill. 1999) (finding that because of common interest between cedent and reinsurer, cedent did not waive work product privilege by providing privileged documents to reinsurer, and thus quashing subpoena issued by insured to reinsurer to obtain privileged documents); *Hartford Steam Boiler Inspection & Ins. Co. v Stauffer Chem. Co.*, Nos. 701223, 701224, 1991 WL 230742, at *2 (Super. Ct. Conn. Nov. 4, 1991) (finding that cedent did not waive privilege by disclosing privileged documents to reinsurer because cedent and reinsurer shared legal and economic common interest, and thus denying insureds' motion to compel production of those privileged documents); *Lipton v Superior Court of Los Angeles County*, 48 Cal. App. 4th 1599, 1618 (Cal. App. Ct. 1996) (Communications to a reinsurer may contain advice from counsel for the ceding insurer relating to coverage, exposure and other liability issues. These would, in all probability, be protected by the attorney-client privilege.") (citing Cal. Ins. Code § 622).

However, in certain circumstances, courts have held that, regardless of the interests a reinsurer may share with its cedent, such interests alone are not sufficient to protect the voluntary production of privileged documents from effecting a waiver of that privilege. For example, in *Reliance Insurance Co. v American Lintex Corp.*, No. 00 CIV 5568 WHP KNF, 2001 WL 604080 (S.D.N.Y. June 1, 2001), on a motion by Reliance's policyholder, the court compelled Reliance to produce to the policyholder a privileged letter that Reliance had sent to its reinsurer. Reliance argued that the attorney-client privilege had not been waived "because primary insurers and reinsurers share a 'unity of interest.'" However, the court held that Reliance:

> failed to establish that Reliance and its reinsurance underwriter share a common legal interest that warrants the extension of the attorney-client privilege to the document in question. While their commercial interests coincide, to some extent, no evidence has been proffered that establishes that Reliance and its reinsurer share the same counsel or coordinate legal strategy in any way. Id. at *4.

Unlike the *Reliance* case, most cases that have failed to find a common interest between the cedent and its reinsurer have done so in the context of a reinsurer asking a court to compel its cedent to produce privileged materials, and thus, by definition, after a dispute has arisen between cedent and reinsurer. See, e.g., *North River Ins. Co. v Columbia Cas. Co.*, No. 90 Civ. 2518 (MJL), 1995 WL 5792, at *4–*5 (S.D.N.Y. Jan. 5, 1995). The court in *Columbia Casualty* rejected the reinsurer's motion to compel the cedent to produce privileged documents from an underlying coverage dispute, holding that no common interest existed between North River (the cedent) and Columbia Casualty (the reinsurer) because (1) they were not represented by the same attorney in the proceeding in which the privileged documents were generated; (2) the reinsurer did not contribute to the cedent's legal expenses; (3) the reinsurer did not exercise any control over the cedent's conduct of the underlying proceedings; (4) the parties did not coordinate litigation strategies; and (5) the parties' legal interests diverged. Id. at *5. The court further stated that "Columbia Casualty's only argument for finding a common interest is that the two parties stand in the relation of reinsurer to ceding insurer, and that is insufficient." Id. at *5.

However, Columbia Casualty also sought the production of two privileged documents that North River had previously provided to another reinsurer, CIGNA. North River objected to the disclosure, arguing that it was entitled to use the common interest doctrine as "a shield" to resist disclosure even though it had asserted that Continental Casualty was not entitled to use the common interest doctrine as "a sword" to compel disclosure. Id. at *7. The court was not persuaded, and concluded that there had been no common legal interest between North River and CIGNA at the time of the disclosure, and that North River had waived the attorney-client privilege with respect to those documents:

> In the process of seeking payment from CIGNA under their reinsurance contract, North River provided the . . . Memos, apparently hoping that CIGNA would be persuaded to pay. It was not and litigation ensued. At no point did North River and CIGNA engage in a common legal enterprise and the common interest doctrine therefore does not apply. Id. at *8.

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Having waived the privilege with respect to CIGNA, North River could not reassert the privilege to preclude Columbia Casualty from obtaining the documents at issue.

In evaluating the rationale underlying the common interest doctrine, the court also pointed out that "[w]hat is important is not whether the parties theoretically share similar interests but rather whether they demonstrate actual cooperation toward a common legal goal." Id. at *4. Thus, in the *Columbia Casualty* case, the court focused on a functional analysis of the common interest doctrine rather than relying on the status of the parties. A cedent and its reinsurer cannot be said to be cooperating "toward a common legal goal" once one party has contemplated suing or has actually sued the other over reinsurance coverage. See also, e.g., *North River Ins. Co. v Phila. Reinsurance Corp.*, 797 F. Supp. at 366–67 (because relationship between cedent and insurer "does not fall within the confines of the classic common interest doctrine," court denied reinsurer's motion to compel production of cedent's privileged documents).

Conclusion

The critical conclusion that necessarily follows from these decisions is that voluntary production of privileged materials—even in situations where the interests of the cedent and the reinsurer are aligned—could effect a waiver of privilege. Moreover, once a dispute between a cedent and its reinsurer ripens, any "common interest" arguably ceases to apply, rendering the cedent even more vulnerable to an argument that voluntary production to its reinsurer of privileged materials (such as those relating to the cedent's coverage analysis or to the defense of the underlying claims against its policyholders) waives any applicable privileges. Although more is required to waive the work product protection than the attorney-client privilege, disclosure to a reinsurer with which the cedent is in an adversarial relationship creates the very real prospect of such a waiver. ■

Endnotes

1. Courts take a number of different approaches to whether inadvertent disclosure waives the privilege. This paper does not examine the varying approaches because the issue addressed herein is the potential impact on privilege of a cedent's deliberate disclosure of privileged documents to its reinsurer.
2. These sample clauses (with emphasis added) have been obtained from the Brokers & Reinsurance Markets Association Contract Wording Reference Book.

Reinsurance: State of the Art

by Thomas M. Pavelko, J.D., CPCU

Market cycles, the influence of rating agencies and government's involvement, assistance and regulation of the marketplace—these were the key topics discussed at "Reinsurance: State of the Art" at the 2007 CPCU Society Annual Meeting and Seminars. The Reinsurance Interest Group developed and presented this panel discussion among industry leaders to discuss current topics and trends in reinsurance. **Tracey W. Laws,** senior vice president and general counsel for the Reinsurance Association of America, moderated the program. The panel, representing a cross-section of reinsurance companies, reinsurance buyers, and reinsurance intermediaries, consisted of **Kenneth W. Brandt,** senior vice president, Transatlantic Reinsurance Company; **Paul E. Picardo,** managing director, Guy Carpenter LLC; **Darin Kath, CPCU, AU,** president and CEO, Jewelers Mutual Insurance Company, and **Michael Hale,** CEO, Claims Professional Liability Insurance Company.

Brandt started the discussion on market cycles in his opening comments. While reasonable minds might disagree on whether we are in a soft market or a softening market, Brandt noted that we can all agree that the underwriting cycle is not hard anymore. Regardless of where we are in the market cycle, however, historically, the performance of underwriters has been consistent, not cyclical-consistently bad! From 1973 to 2003, the industry has sustained underwriting losses of $45 billion. The year 2006 was spectacular (one of the top 10 of all time) helped by a benign catastrophe year. You have to go back to the 1930s and 1940s to find the other nine, Brandt said.

So how have we, as an industry, survived? According to Brandt, we have used investment gains to subsidize the underwriting losses. So we've taken a lot of volatility without the big return. In doing so, we underperform all industries as a whole. If we are truly in a soft market, now is the time to show that underwriting counts, because we won't be able to cover underwriting shortcomings with investment income forever.

Focusing further on the soft or softening market, Laws then quoted S&P as saying that 2008 will be a watershed year for the reinsurance industry. She then asked the panel whether that was accurate. Brandt responded that it will be fascinating. We have had 18 months of making money, so 2007, if it remains benign, could bring in an ugly 2008 with rate pressure. The problem, Brandt noted, is that there is too much money chasing a finite amount of insurance premium. "We aspire to behave, but will we walk away from business?" he wondered.

Picardo agreed with Brandt. "We are at the middle of the hurricane season. If it stays calm, you will have to see mergers, or capital being returned to investors and therefore off the table." Picardo said that if that did not happen, we are already looking at 10 to 15 percent reductions and it may go down further.

Laws then asked the panelists how the industry will meet its return in a softening market. Brandt predicted that it will not, and so participants may try to manage capital out. Otherwise, have to grow. Some will grow smartly, but some will cut prices, make ill-advised acquisitions. Kath noted that we are in the twenty-ninth consecutive month of a softening market. Based on historical graphs, Kath said we can correct this only with disciplined underwriting. "Companies must remain focused on adequate rates despite market pressure," he said.

Thereafter, discussion turned to the rating agencies and whether they have become de facto regulators. Kath said that at his company, the A.M. Best conference call has become a huge process now. "It is as close to a regulatory body as possible without actually being one. But there is a benefit—they are getting the players to talk about things that they were not talking about before."

As the broker representative on the panel, Picardo noted that they see some clients buy reinsurance to the level they do because the rating agency says so. So there is no doubt in his mind that these agencies have influence. As the reinsurance representative on the panel, Brandt opined that in reinsurance, there are really only two scores from the rating agencies—one that is acceptable, and one that is unacceptable. But Hale, who runs a risk retention group, said that for him the key issue in choosing a reinsurer is about market security and whether it has the surplus to pay claims.

Kath, another reinsurance buyer, talked about rating agencies' tendency to stress diversification. "Our results are good, so we have not been pressured to diversify. When penetration into this market is topped, however, we will get that pressure, too. But our response will not be to start writing bowling alleys. If we diversify, it will be within our core competencies." An example of that might be fine arts, Kath said.

Next, the panel tackled the issue of government intervention and regulation. For example, after Katrina, the big issue was flood. Is it insurable in the marketplace? What should the federal government's role be in it? Brandt spoke forcefully against the federal flood program. "Government does not belong in natural catastrophes, including flood. But it has a long tradition there. Flood is just much more complicated to write than hurricanes. It has many sources. The reason there is no private market is that there is no demand to build the models needed to rate it. The government should get out." Later, he noted that the flood program is out of money, yet in spite of the horrific events the industry has sustained in recent years, relatively few insolvencies have resulted. "This industry is resilient enough to handle the spread of risk. But we need to be able to charge sound rates."

A panel of industry leaders discussed market cycles, rating agencies, and government intervention and regulation at the "Reinsurance: State of the Art" seminar held at the 2007 CPCU Society Annual Meeting and Seminars.

Hale thinks it is interesting that the big issue right now regarding the flood program is that claims adjusters are being accused of paying too much under the federal flood program. Large lawsuits have been filed, he said, in which plaintiffs are trying to be the government's collection agencies and get back some of these claims. "Usually, when the private sector alone is in the business alone, it's rare for anyone to complain of overpayment."

On terrorism, the panelists agreed that the government should have some role. Kath noted that government does not exist to provide terrorism insurance, "but if TRIA is not extended, I am not sure how the market will address it, especially regarding nuclear, biological, chemical, and radioactive." Brandt agreed. "It is impossible to predict. You can't diversify it away. TRIA has been a successful partnership between the government and the insurance industry. If it does not renew, there won't be a market to replace it. A small market, maybe, but not big enough to cover it thoroughly. A nuclear event is a solvency risk for the industry."

What did the panelists think the future holds for the reinsurance industry? Hale believes risk retention groups will grow in importance. Kath believes that complacency could set in due to the lack of events, like hurricanes and terrorism. This, he said, would be dangerous. "It will accelerate a softening market." Picardo thought that enterprise risk management, as it takes hold, will cause a confluence or building of risks that we did not see before. Brandt thought the reinsurance industry was well prepared for most things. "But I am most concerned about the potential socialization of our industry by states and other government entities." ■

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Reinsurance Interest Group Quarterly
is published four times a year by and for the members of the Reinsurance Interest Group of the CPCU Society.

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Volume 25 Number 2 December 2007

RISE

Reinsurance Interest Group Quarterly

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