DISCOVERY FROM INTERMEDIARIES:

WINNING THE PEACE

By

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I. The Lever

The legal and policy issues involved in discovery from reinsurance intermediaries in arbitration proceedings have been recounted at length elsewhere[1] and need not be repeated here. It is sufficient to note that the National Association of Insurance Commissioners ("NAIC") saw fit in early 2006 to provide a regulatory solution as an amendment to the Insurance Intermediary Model Act. The following language has been inserted into the Model:

> 1. A RB [reinsurance broker] or RM [reinsurance manager] shall comply with any order of a court of competent jurisdiction or a duly constituted arbitration panel requiring the production of non-privileged documents by the RB or RM, or the testimony of an employee or other individual otherwise under the control of the RB or RM with respect to any reinsurance transaction for which it acted as a RB or RM.
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> 2. Compliance shall be subject to the right of the RB or RM, and the parties to the transaction, to object to the court or arbitration panel concerning the nature or scope of the documents or testimony or the time within which it must comply with the order. Failure to comply with the order shall be deemed to be a material non-compliance with the Act. However, in no event shall this section be construed to require more than one appearance by the same witness in a single action or arbitration.

Violation of this language may subject the intermediary to certain penalties, including loss of license.

The California legislature has passed AB 2400 which contains a version[2] of this language and it has been signed by the governor. It will go into effect on January 1, 2007.

This action has the potential to conclude the struggle over discovery from intermediaries. Major intermediaries must possess a license in California to do their business. The California Insurance Department believes that it has the power to regulate the activities of California-licensed entities (*e.g.* insurers and reinsurers) which take place outside the state of California and often seeks to do so. Intermediaries, and other regulated entities, cannot put their business activities on hold in California for several years while they mount a constitutional challenge to the Insurance Department's effort to regulate in an extra-territorial fashion. Thus, this new California law is a major lever for arbitration panels in the effort to obtain necessary information from intermediaries.

II. Responsibility with Respect to the Lever

It is no accident that the language adopted by the NAIC and enacted into law by California, in effect, gives intermediaries standing to object to the arbitration panel concerning the "nature or scope of the documents or testimony or the time within which it must comply with the order." This is not just a due process afterthought.

When subpoenas are issued to parties, their affiliates or employees, the parties are quick to object to over breadth, irrelevancy, unrealistic timeframes and the like. A party is often much less inclined to make the same objections on behalf of a third party such as an intermediary. Indeed, it is questionable whether a third party has standing, in a contractual arbitration proceeding, to make such objections on its own behalf.

The dynamics of an arbitration proceeding are that arbitrators respond most readily to objections about discovery. Even for those arbitrators who look closely at third party subpoenas without objections, it may be difficult to judge the reasonableness or unreasonableness of a third party subpoena without input from the third party.

Intermediaries have their own businesses to conduct. While they should be responsible to provide a reasonable amount of discovery in a reasonable time frame, it is easy to conjure "all documents" subpoenas for materials not readily available in electronic form within a short timeframe in the midst of renewal season. Scope of discovery has become a significant problem in arbitrations and visiting it on intermediaries is not a solution.

III. The Way Forward

There is a practical way to get counsel and arbitration panels the information they need to resolve disputes between the intermediaries' clients and markets without shutting down the intermediaries' business operations. Counsel need to describe to intermediaries with some precision the type of information being sought *i.e.* placement package for the 2000 First Excess of Loss Treaty between cedent A and its reinsurers. A request for "all documents related to cedent A" is seldom necessary and is certain to meet resistance.

Secondly, counsel need to discuss with intermediaries the form in which the desired information may be obtained. Information in a particular form may be very expensive or

difficult to provide. Substantially the same information in a somewhat different form may be readily available. Cost effectiveness must be an important consideration.

Finally, the panel itself needs to make itself available to referee problems with intermediary discovery, not just in formal proceeding with respect to a subpoena but informally, before a license may be at stake. Having worked at companies and intermediaries, the panelists will have a good idea where relevant information can be found most readily and what types of information will be most probative with respect to the relevant issues.

IV. Conclusion

The lever enacted in California concerning discovery from intermediaries opens the door to more cooperation among the relevant parties and a better focus on the information necessary for arbitration panels to resolve disputes between cedents and reinsurers. Hopefully, this lever will never have to be utilized. If so, we will have won the peace.

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[1] Cohen, Royce F., Lewin, Robert, Lewner, Andrew S., Jacobson, Michele J., *Obtaining Discovery from Reinsurance Intermediaries and Other Non-Parties – Updated Caselaw and Commentary,* ARIAS – US Quarterly, Third Quarter 2005 at 2; Hall, Robert M., *Intermediaries and Discovery in Reinsurance Arbitrations,* Mealey's Litigation Report: Reinsurance December 2, 2002 at 30.

[2] AB 2400 deletes the last sentence of the language adopted by the NAIC prohibiting testimony more than once by the same witness. This deletion was brought about by trial lawyers in the legislature and was not proposed or supported by any of the insurance industry proponents of this provision.