IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

September 2005 Term

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No. 32777

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November 30, 2005
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SUPREME COURT OF APPEALS
OF WEST VIRGINIA

STATE OF WEST VIRGINIA EX REL.
ERIE INSURANCE PROPERTY & CASUALTY COMPANY,
Defendant Below, Petitioner

v.

THE HONORABLE JAMES P. MAZZONE, JUDGE
OF THE CIRCUIT COURT OF OHIO COUNTY,
AND ELIZABETH MURFITT,
Respondents

Petition for a Writ of Prohibition

WRIT GRANTED

Submitted: October 5, 2005
Filed: November 30, 2005

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CHIEF JUSTICE ALBRIGHT delivered the Opinion of the Court.

JUSTICE DAVIS concurs and reserves the right to file a concurring opinion.

SYLLABUS BY THE COURT

1. "When a discovery order involves the probable invasion of confidential materials that are exempted from discovery under Rule 26(b)(1) and (3) of the West Virginia Rules of Civil Procedure, the exercise of this Court's original jurisdiction is appropriate." Syl. Pt. 3, *State ex rel. United States Fidelity and Guaranty Co. v. Canady*, 194 W.Va. 431, 460 S.E.2d 677 (1995).

2. "A circuit court's ruling on discovery requests is reviewed for an abuse of discretion standard; but, where a circuit court's ruling turns on a misinterpretation of the West Virginia Rules of Civil Procedure, our review is plenary. The discretion that is normally given to a trial court's procedural decisions does not apply where the trial court makes no findings or applies the wrong legal standard." Syl. Pt. 5, *State ex rel. Medical Assurance of West Virginia v. Recht*, 213 W.Va. 457, 583 S.E.2d 80 (2003).

3. "The question of the relevancy of the information sought through discovery essentially involves a determination of how substantively the information requested bears on the issues to be tried." Syl. Pt. 4, in part, *State Farm Mut. Auto. Ins. Co. v. Stephens*, 188 W.Va. 622, 425 S.E.2d 577 (1992).

4. When presented with a challenge to discovery of insurance reserves information, the trial court is required under the provisions of Rule 26(b)(1) of the West Virginia Rules of Civil Procedure to make a preliminary determination of whether the requested information is relevant in that it is admissible or is reasonably calculated to lead to the discovery of admissible evidence.

5. In making a determination in the context of discovery about the relevancy of insurance reserves information, the trial could should take into account the nature of the case, the methods used by the insurer to set the reserves and the purpose for which the information is sought, and only grant requests for disclosure when its findings of fact and conclusions of law support a determination that the specific facts of the claim in the case before it directly and primarily influenced the setting of the reserves in question.

Albright, Chief Justice:

As the defendant below, Erie Insurance Property & Casualty Company (hereinafter referred to as "Erie"), invokes the original jurisdiction of this Court in order to prohibit enforcement of the March 30, 2005, order of the Ohio County Circuit Court directing disclosure of claims file documents in an underlying third-party bad faith action brought by Elizabeth Murfitt, plaintiff below. The particular Erie documents at issue pertain to reserve information detailing amounts and dates on which those amounts were set. Erie claims that the reserve information represents opinion work product which warrants heightened protection from disclosure. In consideration of the argument of the parties and applicable legal authorities, we grant the requested writ of prohibition on a ground other than the reason asserted.

I. Factual and Procedural Background

Ms. Murfitt initiated the underlying third-party bad faith action against Erie based on Erie's handling of a claim arising out of a motor vehicle accident involving Ms. Murfitt and Erie's insured. Within the context of the third-party bad faith suit, Ms. Murfitt served a request for production of documents upon Erie, seeking a copy of the Erie claims file relative to the accident. Erie produced a redacted version of its entire claims file and provided a detailed privilege log which identified each document withheld or redacted as

well as noting whether the attorney-client privilege and work product doctrine warranted the reservation or redaction. As to its reason for objecting to disclosing reserve information within the claims file, Erie maintained that such information was protected as opinion work product.

On February 24, 2004, Ms. Murfitt filed a motion to compel disclosure of the reserve information. In response, the lower court conducted an *in camera* review of the documents in question, examined Erie's privilege log and heard oral argument on the motion. The court below then issued an order on March 30, 2005, wherein the court detailed which documents were subject to disclosure in whole or in part. Additionally, with respect to those documents to be produced in their entirety or in redacted version, the order stated that any information contained in the discoverable documents bearing on reserves was subject to disclosure.

On June 24, 2005, Erie filed an original jurisdiction petition in this Court seeking to prohibit the circuit court from enforcing its order. By order dated July 5, 2005, this Court granted review.

II. Standard of Review

The original jurisdiction of this Court in matters of extraordinary writs derives from Article VIII, §3 of the West Virginia Constitution and is codified in West Virginia Code § 51-1-3 (1923) (Repl. Vol. 2000). With specific regard to cases of prohibition, West Virginia Code § 53-1-1 (1923) (Repl. Vol. 2000) provides that "[t]he writ of prohibition shall lie as a matter of right in all cases of usurpation and abuse of power, when the inferior court has not jurisdiction of the subject matter in controversy, or, having such jurisdiction, exceeds its legitimate powers."

The order being challenged in this case involves a ruling granting discovery. While such orders are interlocutory in nature and generally only reviewable on appeal, "[w]hen a discovery order involves the probable invasion of confidential materials that are exempted from discovery under Rule 26(b)(1) and (3) of the West Virginia Rules of Civil Procedure, the exercise of this Court's original jurisdiction is appropriate." Syl. Pt. 3, *State ex rel. United States Fid. and Guar. Co. v. Canady*, 194 W.Va. 431, 460 S.E.2d 677 (1995). This is so because the harm resulting from the disclosure of such information is often not correctable on appeal. *State ex rel. Brison v. Kaufman*, 213 W.Va. 624, 629, 584 S.E.2d 480, 485 (2003). Accordingly, the matter in the instant case is properly before us for review.

We will proceed in our examination of the issues raised by adhering to the standard of review put forth in syllabus point five of *State ex rel. Medical Assurance of West Virginia v. Recht*, 213 W.Va. 457, 583 S.E.2d 80 (2003):

> A circuit court's ruling on discovery requests is reviewed for an abuse of discretion standard; but, where a circuit court's ruling turns on a misinterpretation of the West Virginia Rules of Civil Procedure, our review is plenary. The discretion that is normally given to a trial court's procedural decisions does not apply where the trial court makes no findings or applies the wrong legal standard.

III. Discussion

Erie claims that the lower court exceeded its jurisdiction or legitimate powers by requiring that portions of the company's claims file pertaining to reserve information be disclosed in the underlying third-party bad faith action because reserve information constitutes non-discoverable opinion work product. We do not reach the matter of work product because our examination reveals a more fundamental weakness in the lower court's treatment of the discovery request.

The general test for determining whether information is discoverable is stated in Rule 26 of the West Virginia Rules of Civil Procedure (hereinafter referred to as "Rule 26"), which provides that:

> [p]arties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in

> the pending action, whether it relates to the claim or defense of the party seeking discovery or to the claim or defense of any other party, including the existence, description, nature, custody, condition and location of any books, documents or other tangible things and the identity and location of persons having knowledge of any discoverable matter. It is not ground for objection that the information sought will be inadmissible at the trial if the information sought appears reasonably calculated to lead to the discovery of admissible evidence.

W.Va. R. Civ. P. 26(b)(1). It is clear from the face of Rule 26 that disclosure decisions involve relevancy and privilege determinations.

A threshold issue regarding all discovery requests is relevancy. This is so because "[t]he question of the relevancy of the information sought through discovery essentially involves a determination of how substantively the information requested bears on the issues to be tried." Syl. Pt. 4, in part, *State Farm Mut. Auto. Ins. Co. v. Stephens*, 188 W.Va. 622, 425 S.E.2d 577 (1992). It is only after information is determined to be relevant that consideration is given to whether the information is subject to exclusion based upon the absolute or conditional privilege of attorney-client communications or work-product information respectively.

In the case at hand, Erie objected to disclosing reserve information in response to Ms. Murfitt's request for production of documents. Ms. Murfitt's attorneys filed a motion to compel disclosure of a complete, unredacted copy of the claims file which included the

reserve information. In considering Ms. Murfitt's motion to compel, the lower court conducted an *in camera* review of the documents, examined Erie's privilege log and heard oral argument before it issued its order on March 30, 2005. We have only the lower court's order before us which contains no findings of fact or conclusions of law setting forth the relevancy and materiality of the reserve information sought.

Ms. Murfitt asserts in her brief that information concerning the amount of reserves set with regard to her claim is "obviously relevant" to her bad faith claim, explaining by footnote that the data is "relevant in establishing Erie's evaluation of the claim . . . [and] in establishing when Erie became aware of the tortfeasor's umbrella coverage." While the relevancy of some types of information may be unmistakable, we are not convinced that reserve information merits such distinction and our research has not revealed that other jurisdictions follow such a cavalier approach to disclosure of reserve information. To the contrary, we observe that courts in other jurisdictions have found reserve information to neither be subject to automatic disclosure nor automatic protection from discovery. The Supreme Court of Colorado expressly stated that "[r]eserves are subject to the same relevancy standard for discovery as other information." *Silva v. Basin Western, Inc.*, 47 P.3d 1184, 1189 (Colo. 2002). *See also Lipton v. Superior Court*, 56 Cal.Rptr.2d 341, 343 (Cal.Ct.App. 1996) (reserves cannot automatically be deemed irrelevant to an insured's bad-faith claim

against an insurer). This is no doubt due to the very nature of how insurance companies go about setting reserves.

Generally speaking, reserves are value approximations made by an insurance company regarding what will be sufficient "to pay all obligations for which the insurer may be responsible under the policy with respect to a particular claim." *Lipton* at 348-49. In *Maryland Casualty Company v. United States*, 251 U.S. 342 (1920), the United Supreme Court explained that:

> The term "reserve" or "reserves" has a special meaning in the law of insurance. While its scope varies under different laws, in general it means a sum of money, variously computed or estimated, which with accretions from interest, is set aside, "reserved," as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims, and claims accrued, but contingent and indefinite as to amount or time of payment.

Id. at 350. It has been said as well that "setting of reserves . . . is merely a preliminary estimate of potential liability that does not necessarily take into account all of the factual and legal components that make up a particular case . . . . [H]ow insurers calculate reserves and what they represent depend greatly upon which insurer or surety makes the computation. Timothy M. Sukel & Mike F. Pipkin, *Discovery and Admissibility of Reserves*, 34 Tort & Ins. L.J. 191, 193 (1998).

Insurance companies operating in this state set reserves for each claim in compliance with statutory requirements. *See e.g.* W.Va. Code § 33-2-9 (2005) (Supp. 2005) (examination of insurers by insurance commissioner); § 33-7-5 (1957) (Repl. Vol. 2003) (liabilities chargeable against assets to determine insurer's financial condition); § 33-8-22 (2004) (Supp. 2005) (how the amounts set aside as reserves should be maintained). While insurance statutes demand that reserves be set, the manner in which each company arrives at the figure depends on a variety of factors. One source has identified four commonly used methods to set reserves as: (1) worst-case scenario; (2) average of paid losses over a given time; (3) paid loss development; and (4) incurred loss development. *See* 34 Tort & Ins. L.J. 191, 194. The worst-case scenario method is described as setting "an amount of money that reflects a settlement or verdict value in the event all decisions fall against the insurer," whereas the paid loss development method predicts ultimate losses on open claims based on similarity of characteristics with resolved claims. *Id.* The paid loss development and incurred loss development methods involve actuarial expertise. *Id.* This same authority further notes that additional facts considered in employing these methods for setting reserves include an assessment of the expertise of counsel on both sides of the case, consideration of whether plaintiffs' verdicts predominate in the venue, the seriousness of the allegations and an evaluation of the particular parties involved. *Id.* It becomes apparent then that the methods by which an insurance company sets a reserve in a particular claim has a direct bearing on whether reserve amounts are relevant in a case like the one before us.

Relevance in the context of discovery means that the information sought is admissible evidence or is "reasonably calculated to lead to the discovery of admissible evidence." W.Va. R.Civ.P. 26(b)(1); *see also* Syl. Pt. 4., in part, *Keplinger v. Virginia Elec. and Power Co.*, 208 W.Va. 11, 537 S.E.2d 632 (2000); Syl. Pt. 4, in part, *State Farm Mut. Auto. Ins. Co. v. Stephens*, 188 W.Va. 622, 425 S.E.2d 577 (1992). It seems clear that unless the court thoroughly considers the specific way the particular insurance company in a particular case determines reserves for a particular claim, the court can not make a decision as to whether the reserve information is relevant. Take, for example, the method for calculating reserves described earlier as "average of paid losses over a given time." Serious doubt is raised regarding whether reserves developed using this approach would be relevant, that is admissible or likely lead to admissible evidence, when heavy reliance is placed on past experience rather than the particular facts in the individual open claim.

Additionally, while the method an insurance company employs to set reserves is critical to a relevancy determination, that information can not be considered in a vacuum. We have found that other jurisdictions while examining this question have looked not only at the method by which loss reserves for individual claims are set by a given insurer but also at the nature of the underlying litigation and the purpose for which the information is sought. 34 Tort & Ins. L.J. at 194-95. In other words, it is widely recognized that relevancy of reserve information turns on the unique factors presented in each case. *See e.g. Signature*

Dev. Co., Inc v. Royal Ins. Co. of America, 230 F.3d 1215 (10th Cir. 2000); *Indep. Petrochemical Corp. v. Aetna Cas. & Sur. Co.*, 117 F.R.D. 283 (D.D.C. 1986); *Leksi, Inc. v. Fed. Ins. Co.*, 129 F.R.D. 99 (D.N.J.1989); *Champion Int'l Corp. v. Liberty Mut. Ins. Co.*, 128 F.R.D. 608 (S.D.N.Y. 1989); *Fid. & Deposit Co. of Maryland v. McCulloch*, 168 F.R.D. 516 (E.D.Pa. 1996); *Samson v. Transamerica Ins. Co.*, 636 P.2d 32 (Cal. 1981); *In re Couch*, 80 B.R. 512 (S.D. Cal. 1987); *Silva v. Basin Western, Inc.*, 47 P.3d 1184 (Colo. 2002); *Hoechst Celanese Corp. v. Nat'l Union Fire Ins. Co.*, 623 A.2d 1099 (Del. Super. Ct. 1991); *Groben v. Travelers Indem. Co.*, 266 N.Y.S.2d 616 (N.Y. Sup. Ct. 1965); *Fretz v. Mut. Benefit Ins. Co.*, 1998 WL 1005133 (Pa.Com.Pl. 1998).

Based upon all of the above considerations, we hold that when presented with a challenge to discovery of insurance reserves information, the trial court is required under the provisions of Rule 26(b)(1) of the West Virginia Rules of Civil Procedure to make a preliminary determination of whether the requested information is relevant in that it is admissible or is reasonably calculated to lead to the discovery of admissible evidence. In making a determination in the context of discovery about the relevancy of insurance reserves information, the trial could should take into account the nature of the case, the methods used by the insurer to set the reserves and the purpose for which the information is sought, and only grant requests for disclosure when its findings of fact and conclusions of law support a

determination that the specific facts of the claim in the case before it directly and primarily influenced the setting of the reserves in question.

The case at hand has not proceeded to the point where we have the information necessary to meaningfully consider whether the reserve information is relevant. We observe from our research that courts in other jurisdictions generally do not find that reserve information is relevant in cases involving insurance coverage, but have sometimes found relevancy in bad faith cases. *See e.g. Lipton v. Superior Court*, 56 Cal.Rptr.2d 341 (Cal.Ct.App. 1996); *Tackett v. State Farm & Cas.*, 558 A.2d 1098 (Del.Sup.Ct. 1988); *Groben v. Travelers Indem. Co.*, 266 N.Y.S.2d 616, 619 (N.Y.Sup.Ct. 1965) (finding "[b]ad faith is a state of mind which must be established by circumstantial evidence" and to this extent "[t]he actions of the . . . [insurance company regarding reserves] are relevant.") . *But see Fid. & Deposit Co. of Maryland v. McCulloch*, 168 F.R.D. 516, 525 (E.D.Pa. 1996) (concluding that reserve information was irrelevant because "such data would merely suggest what [the plaintiff] can already demonstrate . . ., namely, that the cost of defending the . . . claims increased over time). These cases make it clear that a case-by-case examination of the factors we have previously identified is necessary for a court to be able to conclude that information involving reserves is admissible or "reasonably calculated to lead to the discovery of admissible evidence" and, as a result, is subject to disclosure. W.Va. R.Civ.P. 26(b)(1). Since the lower court neglected to address the key issue of relevancy in the instant

case, we grant the writ of prohibition as requested. The issuance of this writ as to the order in question does not prohibit a subsequent proper application for disclosure of reserves supported by the required showings of the parties, analyzed by the trial court through its findings and conclusions, as indicated in this opinion.

IV. Conclusion

Based upon the foregoing, the relief in prohibition is granted to bar the enforcement of the March 30, 2005, discovery order of the Ohio County Circuit Court directing disclosure of reserve information.

Writ granted.