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6 **IN THE UNITED STATES DISTRICT COURT**
7 **FOR THE DISTRICT OF ARIZONA**
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9 Western Surety Company,
10 Plaintiff,
11 v.
12 United States of America,
13 Defendant.
14

No. CV-16-00761-TUC-CKJ

ORDER

15 *Background*

16 In October 2018, the Court was made aware of a discovery dispute between Plaintiff
17 Western Surety Company (“Western”) and Intervenor Defendant Employers Mutual
18 Casualty Company (“EMC”). This dispute arose in connection with EMC’s discovery
19 requests seeking reserve amounts set by Western relating to Select Development &
20 Construction, Inc. (“Select”). Western objected to those requests claiming they were
21 burdensome and sought information that was confidential and privileged. Oral argument
22 was held on November 7, 2018 to discuss those issues. After oral argument, Western’s
23 counsel informed the Court that Western’s attorney, Doug Mraz (“Mr. Mraz”), was solely
24 responsible for setting the reserve amounts relating to Select and filed a memorandum on
25 November 21, 2018 alleging that the information is protected by the attorney-client
26 privilege and work-product doctrine. (Doc. 81). EMC filed a response memorandum on
27 November 30, 2018, opposing Western’s claims of privilege and confidentiality. (Doc. 82).

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1 *Factual Background*

2 In February 2012, Select entered into a contract with the County of Pima, Arizona,
3 in connection with a road construction project (“La Canada Project”). Western provided
4 Select with performance and payment bonds totaling \$18,750,777.34 for this project
5 naming Pima County as the obligee. In June and October 2013, Select entered into two
6 contracts with Pima County in connection with two construction projects (“Magee Road
7 Project” and “Homer Davis Project”). EMC provided Select with performance and
8 payment bonds for these projects in the amount of \$10,969,001.40 naming Pima County
9 as the obligee.

10 Select failed to comply with its contractual obligations for the La Canada, Magee
11 Road, and Homer Davis Projects leaving Western and EMC with substantial losses in
12 excess of \$1.3 million. In April 2017, Pima County entered into a Settlement Agreement
13 with Western in connection with unpaid funds arising out of the La Canada Project in the
14 amount of \$1.3 million. Subsequently, Pima County became aware that multiple parties,
15 including EMC, were exercising their rights to that \$1.3 million settlement amount and
16 Pima County filed a motion to interplead those funds. (Doc. 32). The motion was granted
17 and that \$1.3 million is currently in dispute between Western and EMC. (Doc. 46).

18 In connection with EMC’s claim to the interpleaded funds, EMC alleges that
19 Western’s financial loss for the La Canada Project was due to Western’s reimbursement of
20 Select’s payroll expenses. EMC claims that those reimbursement expenditures are not a
21 performance bond loss since Western was under no contractual obligation to assist Select
22 with continuing their business operations. In connection with this argument, EMC states
23 that it requires the reserve amounts set by Western to determine if Western suffered the
24 financial losses it claims.

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1 *Analysis*

2 Federal Rule of Civil Procedure 26(b) establishes the relevant scope of discovery
3 and provides, in pertinent part:

4 Parties may obtain discovery regarding any nonprivileged matter that is
5 relevant to any party's claim or defense and proportional to the needs of the
6 case, considering the importance of the issues at stake in the action, the
7 amount in controversy, the parties' relative access to relevant information,
8 the parties' resources, the importance of the discovery in resolving the issues,
9 and whether the burden or expense of the proposed discovery outweighs its
likely benefit. Information within this scope of discovery need not be
admissible in evidence to be discoverable.

10 The Court has broad discretion to determine whether to compel disclosure of
11 discovery. *Phillips ex rel. Estates of Byrd v. General Motors Corp.*, 307 F.3d 1206, 1211
12 (9th Cir. 2002).

13 EMC propounded the following contested discovery requests upon Western:

- 14 • **Request for Production:** Please produce any documents that support your
15 responses to the Requests for Admission and Non-Uniform Interrogatories
16 set forth above, including but not limited to any documents relating to
17 reserves set by Western Surety relating to Select Development &
18 Construction, Inc.
- 19 • **Interrogatory:** If Western Surety set reserves for a Performance Bond claim
20 on the La Canada Project, please state the date any such reserves were set
21 and the corresponding amount of money for the reserves.

22 Western objected to these requests claiming “that information pertaining to reserves
23 set in this matter is irrelevant, privileged, confidential, and proprietary, as it involves
24 Western Surety’s unique evaluation processes which is also protected as a trade secret.”
25 (Doc. 82-1, pg. 3). The Court will examine EMC’s discovery requests pursuant to
26 Western’s objections based on: (1) relevancy; and (2) privilege.

27 *1. Relevancy*

28 Surety companies ordinarily set reserve amounts in advance with a sum sufficient

1 to pay possible claims. Western alleges that the amount in reserves set for Select are
2 irrelevant since it has provided sufficient documents proving the losses it has incurred by
3 producing canceled checks indicating the losses Western claims it has suffered. However,
4 EMC claims that most of Western's alleged losses were losses unconnected to Western's
5 underlying performance bond with Select.

6 While case law discussing the discoverability of reserve information exists, that case
7 law is limited to the context of insurance bad faith and courts are not in agreement on the
8 issue. *See Spahr v. Amco Ins. Co.*, No. CV 09-9174-PA (AGRX), 2010 WL 11459909, at
9 *2 (C.D. Cal. Sept. 29, 2010) ("Whether evidence of loss reserves is discoverable depends
10 upon the issues presented in a given case. In general, loss reserves are not discoverable.")
11 (internal citations and quotations omitted); *Miller v. York Risk Servs. Grp.*, No. CV-13-
12 01419-PHX-JWS, 2014 WL 11515634, at *5 (D. Ariz. June 20, 2014) ("The federal
13 District Courts have generally held that an insurance company's reserve information and
14 aggregate claims information is relevant and discoverable in cases alleging bad faith.");
15 *RKF Retail Holdings, LLC v. Tropicana Las Vegas, Inc.*, No. 214CV01232APGGWF,
16 2017 WL 2292818, at *8 (D. Nev. May 25, 2017) ("Reserve information is relevant in an
17 insurance bad faith lawsuit because the insurer has the contractual duty to defend and
18 indemnify its insured, which also encompasses the duty to reasonably evaluate and settle
19 claims within the policy's coverage.").

20 In insurance bad faith cases, policyholders often seek information pertaining to loss
21 reserves to show "what [the insurer] actually knew and thought, and what motives animated
22 its conduct, which are critical areas of inquiry in bad faith cases and fully fair game for
23 discovery." *Paul Johnson Drywall, Inc. v. Phoenix Ins. Co.*, No. CIV. 13-8124-PCT-PGR,
24 2014 WL 1764126, at *3 (D. Ariz. May 5, 2014) (citing *Bernstein v. The Travelers*
25 *Insurance Company*, 447 F.Supp.2d 1100, 1107 (N.D. Cal. 2006)); *see also Flintkote Co.*
26 *v. Gen. Acc. Assur. Co. of Canada*, No. C 04-01827 MHP, 2009 WL 1457974, at *4 (N.D.
27 Cal. May 26, 2009) ("Since reserves are set for claims that the insurer might be liable to
28 pay, the reserves may indicate an estimate of the amount that defendant believed or knew

1 it would have to pay for plaintiff's asbestos-related claims. This information may be
2 relevant to showing the difference between what defendant thought it would have to pay
3 and its communications with plaintiff regarding its evaluation of the scope of the loss.").

4 As is evident, the established case law pertaining to the discoverability of loss
5 reserves in the insurance bad faith context is not applicable here. EMC is not seeking
6 reserve information to highlight a disconnect between Western's payment of benefits and
7 its evaluation of the scope of loss for the La Canada Project. EMC is seeking reserve
8 information because it alleges Western did not suffer the losses it claims that it suffered.
9 Surety companies pay claims through funds set aside in a claims reserve and Western's
10 reserve amount certainly bears upon the loss amounts it allegedly suffered. Since
11 "[r]elevance is construed broadly to encompass any matter that bears on, or that reasonably
12 could lead to other matter that bears on, any issue that is or may be in the case", *Paul*
13 *Johnson Drywall*, 2014 WL 1764126, at *1, the Court finds that the reserve amounts set
14 by Western are relevant. Whether that information is privileged is a separate inquiry.

15 2. *Privilege*

16 Western asserts that its reserve information is privileged because it was set solely
17 by Mr. Mraz, in his capacity as legal counsel, and, therefore, the information is protected
18 by the: (1) attorney-client privilege; and (2) work-product doctrine. (Doc. 81, pg. 2). It is
19 well recognized "that the burden to establish the applicability of any privilege is on the
20 proponent, and that burden begins with providing an adequate identification of the reasons
21 why the privilege is warranted with respect to each and every communication and each and
22 every document claimed to be protected." *S. Union Co. v. Sw. Gas Corp.*, 205 F.R.D. 542,
23 550 (D. Ariz. 2002).

24 A. *Attorney-Client Privilege*

25 "The Ninth Circuit has set forth the following 'essential elements' for invocation of
26 the attorney-client privilege: (1) legal advice is sought; (2) from a professional legal adviser
27 in his or her capacity as such; (3) the communication relates to that purpose; (4) is made in
28 confidence; and (5) by the client." *S. Union Co.*, 205 F.R.D. at 546 (citing *Admiral Ins. Co.*

1 v. *U.S. Dist. Ct. D. Ariz.*, 881 F.2d 1486, 1492 (9th Cir. 1989)). The privilege is meant to
2 protect confidential communications between an attorney and a client securing legal advice
3 from the attorney. *U.S. v. Chen*, 99 F.3d 1495, 1501 (9th Cir. 1996).

4 The threshold question here is whether or not the setting of a surety reserve is “legal
5 advice.” “In order to show that a communication relates to legal advice, the proponent of
6 the privilege must demonstrate that the ‘primary purpose’ of the communication was
7 securing legal advice.” *United States v. ChevronTexaco Corp.*, 241 F. Supp. 2d 1065, 1076
8 (N.D. Cal. 2002) (citing *United States v. Chevron Corp.*, No. C-94-1885 SBA, 1996 WL
9 264769, at *3 (N.D. Cal. Mar. 13, 1996), amended, No. C 94-1885 SBA, 1996 WL 444597
10 (N.D. Cal. May 30, 1996).).

11 Western claims that its reserve information is subject to the attorney-client privilege
12 “because its Senior Claims Counsel, Doug Mraz, in his capacity as legal counsel, solely set
13 the reserves pertaining to the bonds issued to Select Development . . . In setting the reserves
14 and in making subsequent adjustments to the reserves, Mr. Mraz handled all aspects
15 including the dates the reserves were set or adjusted, the amounts of the reserves, and all
16 other information pertaining to the reserves which reflected his understanding of and
17 mental impressions regarding the status of the Select Development matter.” (Doc. 81, pg.
18 2-3). This is not a sufficient reason to invoke the attorney-client privilege. “The purpose
19 behind the attorney-client privilege is to promote complete and candid communications
20 between attorneys and their clients in order to allow attorneys the ability to render informed
21 and sound legal advice. The privilege is to be strictly construed.” *Resolution Tr. Corp. v.*
22 *Dean*, 813 F. Supp. 1426, 1428 (D. Ariz. 1993) (citations omitted).

23 Western has provided no evidence that the setting of its reserves by an attorney
24 constitutes legal advice. If the attorney-client privilege attached each time legal counsel
25 became involved in a matter, the privilege would be impermissibly magnified and would
26 permit corporations to offensively wield the privilege and successfully object to any
27 discovery request involving their attorneys. It is well established that “in-house attorneys
28 can serve multiple functions within [a] corporation. In-house counsel may be involved

1 intimately in the corporation's day to day business activities and frequently serve as
2 integral players in business decisions or activities. Accordingly, communications involving
3 in-house counsel might well pertain to business rather than legal matters. The privilege
4 does not protect an attorney's business advice. Corporations may not conduct their business
5 affairs in private simply by staffing a transaction with attorneys." *ChevronTexaco Corp.*,
6 241 F. Supp. 2d at 1076. Western has not demonstrated that its reserve information is
7 anything but "business advice." Since only "legal advice" is protected by the attorney-
8 client privilege, the Court finds that Western has not met its burden.

9 *B. Work-Product Doctrine*

10 Ordinarily, for documents to qualify for protection under the work-product doctrine:
11 "(1) they must be prepared in anticipation of litigation or for trial, and (2) they must be
12 prepared by or for another party or by or for that other party's representative." *In re Grand*
13 *Jury Subpoena (Mark Torf/Torf Envtl. Mgmt.)*, 357 F.3d 900, 907 (9th Cir. 2004) (internal
14 citations and quotations omitted). In support of its claim that reserve information is
15 protected by the work-product doctrine, Western writes:

16 It should be noted that the case at bar is far from the first piece of litigation
17 in which Western Surety has been involved as a result of its issuance of the
18 Bonds to Select Development; Western Surety has been a named defendant
19 in various cases related to Select Development dating back to 2013, the date
20 Mr. Mraz first set reserves, and was certainly aware of the possibility of
21 litigation before the first complaint was filed. In setting the reserves and in
22 making subsequent adjustments to the reserves, Mr. Mraz handled all aspects
23 including the dates the reserves were set or adjusted, the amounts of the
24 reserves, and all other information pertaining to the reserves which reflected
25 his understanding of and mental impressions regarding the status of the
26 Select Development matter.

27 (Doc. 81, pg. 2-3).

28 Western suggests that when Mr. Mraz first set the reserves in this case, he was
"aware of the possibility of litigation before the first complaint was filed." What is material
is not whether Mr. Mraz was "aware of the possibility of litigation" but whether Mr. Mraz
prepared and set reserve amounts in anticipation of litigation or for trial. Surety companies

1 set reserve amounts as a course of business. Western has not provided any evidence
2 indicating that Mr. Mraz specifically prepared these surety reserve amounts in anticipation
3 of litigation or for trial. The mere fact that in-house-counsel was aware of the possibility
4 of litigation is not sufficient to apply the work-product doctrine. “One of the primary
5 purposes of the work product doctrine is to prevent one party from exploiting another
6 party’s efforts to prepare for litigation.” *RKF Retail Holdings, LLC*, 2017 WL 2292818, at
7 *5. It is highly likely that every corporate representative is aware that any business
8 transaction can result in litigation.

9 Here, Mr. Mraz established reserve amounts in the ordinary course of the surety
10 business and “[d]ocuments prepared in the ordinary course of business are not protected
11 by the work product doctrine because they would have been created regardless of the
12 litigation.” *City of Glendale v. Nat’l Union Fire Ins. Co. of Pittsburgh, PA*, No. CV-12-
13 380-PHX-BSB, 2013 WL 1797308, at *12 (D. Ariz. Apr. 29, 2013). Western provides no
14 evidence that this information was prepared specifically in anticipation of litigation or for
15 trial and, therefore, the work-product doctrine does not apply.

16 *Conclusion*

17 Western’s reserve information is relevant and not protected by either the attorney-
18 client privilege or the work-product doctrine. However, while the raw reserve numbers
19 requested in EMC’s Interrogatory are discoverable, EMC’s Request for Production is
20 impermissibly broad and encompasses documents and communications between Mr. Mraz
21 and Western that will very likely be protected by the attorney-client privilege or work-
22 product doctrine.

23 The cases cited by EMC in their November 30, 2018 memorandum are instructive
24 as they only provide that reserve amounts and dates are discoverable. *See Loyal Order of*
25 *Moose, Lodge 1392 v. Int’l Fid. Ins. Co.*, 797 P.2d 622, 628 n. 14 (Alaska 1990) (“The
26 **existence** and **amount** of any loss reserve is not a protected confidential communication
27 made for the purpose of facilitating the rendition of professional legal services.”) (emphasis
28 added); *State ex rel. Erie Ins. Prop. & Cas. Co. v. Mazzone*, 648 S.E.2d 31, 43 (W. Va.

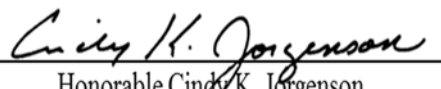
1 2007) (“We simply have no basis to find either that the lower court erred as a matter of law
2 or abused its discretion by concluding that the **reserve amounts** and the **dates** the amounts
3 were set are subject to discovery in this case.”) (emphasis added). EMC even distinguishes
4 a case cited by Western as inapposite because it “involved settlement reserve documents,
5 not amounts/dates of general claim reserves, with documents that ‘contain legal advice
6 provided . . . by counsel.’” (Doc. 82, pg. 6).

7 Furthermore, Western’s reserve amounts are likely proprietary and Western’s fear
8 that it would be providing confidential information to a competitor is legitimate. To
9 mitigate Western’s concerns, the Court will order that the parties draft and file a protective
10 order designating any information provided in connection with Western’s reserves to be
11 for attorney’s eyes only.

12 IT IS HEREBY ORDERED:

- 13 1. Plaintiff Western Surety Company must respond to Intervenor Defendant
14 Employers Mutual Casualty Company’s Interrogatory seeking reserve amounts.
- 15 2. Plaintiff Western Surety Company need not respond to Intervenor Defendant
16 Employers Mutual Casualty Company’s Request for Production seeking documents
17 relating to reserve amounts.
- 18 3. The parties are directed to file a stipulated protective order that any information
19 pertaining to reserve amounts provided by Plaintiff Western Surety Company shall
20 be designated “attorney’s eyes only.”

21 Dated this 21st day of December, 2018.

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23 Honorable Cindy K. Jorgenson
24 United States District Judge
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