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Mediation of Insurance Coverage Disputes: Wise or Waste?

By Mark Plumer

Mediation of complex insurance disputes is on the rise. It may be required by a court, or it may be agreed to by the parties. Where it is voluntary, is mediation worth the effort? The answer to this question likely is yes, though certainly not in all circumstances. Mediation offers the prospect of an efficient resolution to disputes that may be costly and distracting to litigate where private attempts at settlement have failed. On the other hand, most mediations of complex insurance disputes do not succeed. Successful mediations require a genuine commitment by the parties to the process, a sensible process tailored to the dispute and a good mediator.

Mediation is a negotiation between two or more parties facilitated by a third-party neutral known as a mediator. Mediation adds structure to simple negotiations between the parties but is less rigid than an arbitration or traditional litigation. Mediation's great strength is that it offers parties an opportunity to create a process that suits the nature and size of their claim and involves an objective and respected third-party neutral, all of which increases the chances the parties will find common ground. Mediators do not in normal course issue rulings or make decisions that are binding on the parties; instead mediators attempt to create an environment likely to result in a settlement.

At a high level, mediators may be classified as either facilitative or evaluative. Facilitative mediators seek to facilitate settlement primarily by helping the parties understand each other's positions while acting as a neutral intermediary. Facilitative mediators tend to be impartial and avoid expressing their view of the relative strengths and weaknesses of the parties' positions. Evaluative mediators, on the other hand, are more likely to evaluate the merits of the parties' respective legal theories and claim valuations. It is not uncommon for able mediators to employ both facilitative and evaluative approaches at different points in a mediation based on their assessment of what tactic is most likely to move the parties toward resolution.

Mediation As Applied to Insurance Disputes

Insurance disputes are prime candidates for mediation for a number of reasons. It allows the parties to gain the insight of an agreed-upon, truly neutral expert in insurance law and practice, a characteristic not shared by all judges. It allows the parties to more candidly identify (through the mediator) their true obstacles to settlement and to address complex scientific and economic issues that are often not well-suited for litigation, such as the allocation of loss among potentially liable insurers. Finally, it allows the parties to settle issues in a more comprehensive – and often creative – fashion than may be possible in litigation, with the assistance of someone who likely has a better understanding of what the market will bear in similar circumstances.

On the other hand, insurance disputes often involve multiple insurers, which creates mediation challenges. If not handled properly, mediation with a group of insurers may give

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rise to a "pack" mentality among the insurers, each assuring the other that its position is sound as well as exacerbating insurers' natural tendency to avoid any settlement that may appear to require them to overpay vis-a-vis their co-insurers on the risk. An insurance mediation also may be a fruitless exercise if the insurers do not involve sufficiently high-ranking principals to enable them to engage in a meaningful dialogue at the mediation.

Threshold Strategic Considerations

Choosing a Mediator

A mediation is only as good as its mediator. Unless ordered to mediation by a court, parties get to choose their mediator. This decision should not be taken lightly. From a policyholder's perspective, there is often value to agreeing to an insurer's choice of mediator, assuming the mediator is otherwise qualified and unbiased. It is more likely that an insurer who trusts a mediator will follow that mediator's advice and counsel. A policyholder that wins the battle to use its own mediator over an insurer's objection almost certainly will lose the mediation war, as mediation is a voluntary process and no party can be forced to settle no matter what the mediator says. The decision to use a former trial court judge, former appellate court judge, lawyer or other insurance expert depends on the parties and issues in dispute. Similarly, choosing a mediator with a more facilitative or evaluative bent often turns on the individual facts and circumstances at hand.

In choosing a mediator, policyholders should seek to identify someone smart enough to quickly grasp the key issues, experienced enough to manage difficult counsel and to see through counsel's rhetoric, creative enough to identify hard-to-find paths to settlement, and persistent enough to work through hard issues.

Process Considerations

Just as all mediators are not alike, there is no one correct form of mediation process. In the "typical" mediation, the parties will submit pre-mediation statements or briefs to the mediator. The purpose of these submissions is to educate the mediator about each party's position and support for their position; these submissions enable the mediator to understand the dispute and its context, including, for example, prior attempts at private settlement or perhaps prior mediations. Similarly, in the "typical" mediation, the mediator will hold a short joint session with all of the parties and then meet with each of the parties separately (where there are multiple insurers, they may all be placed together in one room). The mediator will then practice some form of shuttle diplomacy.

But the process used to mediate may take many forms, limited only by the parties' and mediator's creativity. Some mediators will ask to be provided more information and more latitude to understand the claim up front, including the opportunity to meet with each of the parties separately in advance. Submission agreements may set out a thoughtfully designed process for mediating a dispute, including limiting the issues to be addressed during the mediation, setting out some form of agreed-upon schedule and limits for briefing and reply, protocols for oral argument by a designated representative of each party during the joint session at the outset of the mediation, the use of technical experts to assist the mediator in understanding scientific or economic complexities, and identification of who must attend the mediation for each party and how many days of mediation the parties agree to attend.

Even more unusual process changes may be agreed to. The parties may agree to use two mediators working together as a team, known as co-mediation. The parties may agree to a combination of mediation and arbitration, where the parties agree to mediate first and then, if mediation is unsuccessful, to submit the dispute to arbitration in front of the former mediator. The parties also may agree to engage in a binding mediation, which provides the mediator the opportunity to decide the dispute within agreed-upon parameters following receipt of all of the parties' submissions.

Commitment

All of the foregoing should make clear that a successful mediation is not something that just happens. Indeed, regardless of how good the mediator and how good the process, a mediation is unlikely to succeed unless both the policyholder's and insurer's counsel have properly prepared. From the policyholder perspective, this means understanding the claim's strengths and weaknesses sufficiently to allow the client to meaningfully assess the proper value of the claim. From the insurer perspective, it requires sufficient internal up-front work to obtain a reasonable level of authority, which may for example require applicable reinsurance assets to be properly understood. A policyholder contemplating mediation can improve the chances of mediation being successful by making sure that its insurers understand the claim before the mediation, including giving its insurers the chance to ask questions and to ascertain the key facts before the mediation begins.

Mediation Pros and Cons

Upon this backdrop, some additional pros and cons of mediating complex insurance disputes not previously discussed are set forth below.

Pros

1. Process is Confidential

Mediation is a form of settlement negotiation and therefore is virtually guaranteed to be confidential pursuant to the rules of evidence and, usually, a specific confidentiality agreement signed in advance of any mediation. Confidentiality ensures a freer flow of information, as parties do not have to fear their words and documents prepared for use in a mediation being turned against them in litigation. Moreover, a successful mediation allows a policyholder to avoid publicly re-living events that gave rise to an insurance claim – events that may represent dark moments in the company's history.

2. Less Expensive Than Litigation or Arbitration

No matter what the process, mediation is far less expensive than litigation or arbitration.

3. Expedites Resolution Where Successful

Whereas litigation takes several years, including appeals, a mediation ordinarily takes a few months from beginning to end. For a policyholder, this means a quicker path to recovery, assuming success.

4. Provides a Non-Binding Reality Check

A beneficial aspect of mediation is that a neutral third-party will objectively evaluate the case. An evaluative mediator, at least, will help each party to better understand the strengths and weaknesses of their cases. Even if a mediation does not result in a settlement, this improved understanding may lead the parties to focus their claims or arguments in a way that streamlines future negotiations or litigation.

5. Preserves Business Relationships

Mediation is less contentious than litigation. It does not require depositions of key employees nor does it allow for the same degree of posturing. Because any successful resolution includes a compromise, it has the potential to preserve important business relationships. Insurers with active underwriting businesses have no desire to alienate their policyholders. Likewise, the preservation of certain insurance relationships are critical to policyholders, particularly when the dispute involves insurance issued by important insurers in hard insurance markets.

Cons

1. Failure Rate is High

As described above, mediations are more likely to succeed where there are committed parties, a good mediator and a thoughtful process, tied to the facts and circumstances of the dispute. More often than not, mediation is not taken so seriously, making the process a waste of time and money.

2. Less Expensive Than Litigation Does Not Mean Inexpensive

At a minimum, a mediation requires the retention of a mediator, the payment of legal fees to prepare and attend the mediation, and costs to travel to and participate in the mediation. As the process becomes more complex, the costs increase. Costs of serious brief writing, the retention of experts and multiple meetings can amount to hundreds of thousands of dollars in a complex case. While less costly than litigation, mediation costs may be substantial.

3. Faster Than Litigation Does Not Mean Fast

Although a "typical" mediation takes a few months to plan and execute, the process sometimes may take far longer. Multi-party mediations may take a year or more and may require multiple negotiating sessions. Courts often are willing to stay pending litigation so long as a reputable mediator will certify that good faith negotiations are continuing. However, policyholders should be aware that resolving complex disputes will take considerable time and effort.

4. Likely Costs May Outweigh Likely Benefits

Policyholders need to weigh carefully whether engaging in a mediation serves their interests. Insurers sometimes agree to mediate simply to delay paying a claim, or to obtain "free" informal discovery. Insurers sometimes agree to mediate without any evil intent, but also without any real commitment to the process. From the policyholder perspective, a mediation will not provide any useful precedent if the claim being pursued is likely to repeat. For these and a host of other good and reasonable reasons, mediation is not a panacea and is not right for every policyholder in every situation.

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Mediation is an increasingly popular mechanism for resolving complex insurance coverage disputes. The decision whether and how to pursue mediation must be made on a case-by-case basis with careful consideration of the factors discussed above.

For more information on this topic, the reader may wish to review the author's chapter on mediation in the *New Appleman Insurance Law Practice Guide,* Vol. 2, Chapter 25 (2008).