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Insurance Disputes





DISPUTE RESOLUTION SECTION

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“Disputes arise across a broad spectrum of relationships and substantive areas of the law. Alternatives to litigation may best serve client needs for resolving many of these disputes. The NYSBA Dispute Resolution Section has prepared a series of White Papers to set forth some of the special advantages of mediation and arbitration in the various contexts in which disputes commonly arise.”

*Edna Sussman, Chair, NYSBA Dispute Resolution Section
David Singer, Chair, White Paper Subcommittee*

INSURANCE /REINSURANCE ARBITRATION AND MEDIATION

BY CHARLES PLATTO, PETER A. SCARPATO AND SIMEON H. BAUM *

At the heart of the insurance business is the resolution of claims. Insurers routinely adjust claims and provide for indemnity and defense. Accordingly, some have said that the business of insurers is litigation. In fact, it is more accurate to say that the business of insurers is dispute resolution: including negotiation, mediation, neutral evaluation, and arbitration, as well as litigation.

Where insurers and reinsurers find themselves consistently involved in matters that are heading towards or involved in litigation, it is no surprise that the industry currently makes extensive use of a variety of dispute resolution processes. In this paper, our focus will be on mediation and arbitration, in handling: (1) insurers with an obligation to defend/indemnify the insured, (2) subrogation matters; (3) insurance coverage disputes between insurer and insured, (4) disputes between insurers, and (5) reinsurance disputes.

As with other areas covered by this series of White Papers, the mediation and arbitration processes offer a wide range of benefits to the insurance industry, providing effective and efficient processes for the resolution of disputes. We will consider both benefits and special uses of alternative dispute resolution processes in these various scenarios. In all areas of insurance it pays to apply the questions of “who, what, when, where, and why”: who should or

will be attending the dispute resolution process; what process should be selected; the ideal timing of the use of that dispute resolution process; the forum or venue for the procedure – court-annexed or otherwise; and the reasons for selecting one process over another – keeping in mind the players, goals, opportunities and circumstances.

1) Insurance Defense and Indemnity – Third Party Claims

The typical liability policy requires the insurer to defend and indemnify the insured against claims asserted by one or more persons. These are known as “third party claims” because the persons asserting the claim against the insured are not parties to the insurance agreement. By contrast, first party claims are those presented by the insured party to its insurer under policies that cover the insured against risk of harm or loss to its own person or property. In this section, we will focus on the use of alternative dispute resolution processes for third party claims. Third party coverage is offered in a wide range of areas, including, *inter alia*: automobile, homeowners, commercial general liability, professional liability (also known as Error & Omissions), Directors & Officers, employment practices liability, and products liability insurance.

Arbitration is used in a number of arenas for the resolution of third party claims, including automobile no-fault cases, small claims and civil court matters, and for certain Workers Compensation¹ claims. Arbitration, for these and commercial matters, can be an effective means of obtaining a decision from a neutral without going through a trial. Mediation is frequently used across the board for third party claims, both privately and through court-annexed panels. Mediation vests control in the parties, offering an informal, flexible and inexpensive process, with resolutions tailored for and by the parties. Mediation’s popularity is reinforced by the benefit derived from a neutral who can keep parties and counsel engaged in constructive dialogue, and from the fact that there tend to be no pre-dispute arbitration clauses running between third party claimants and the insured.

¹ Workers’ Compensation insurers may initiate subrogation arbitrations to recover payments of health benefits from third parties if the defendant companies or their insurers and the subrogated insurer are parties to a Special Arbitration Agreement. In addition, persons involved in the administration or determination of Workers’ Compensation benefits hearings may also arbitrate their own claims. *See*, NY Workers Compensation Law, Section 20.2.

There has been much discussion on “when” – the ideal timing for holding a mediation. As a general rule, the sooner one mediates the better. This enables the insurer to take funds that would otherwise be used in the defense of a claim and instead contribute them to the settlement pot. The sooner a dispute is resolved, the less parties will harden in their positions, and the less there will be a build up of emotion and resentment (not only by parties but also by counsel). Early resolution lessens the sunk cost phenomenon, in which parties and counsel who have invested time and expense hold out for a better return on investment – making it harder to settle a case. Another consideration that impacts timing is the need to develop information. Parties might feel a need to conduct an Independent Medical Examination, do destructive testing, nail down certain testimony in a deposition, test legal theories with a motion to dismiss or for summary judgment, or obtain an expert’s report. At each juncture there is a balancing test of whether the information to be gained will offset the benefit of settling before the outcome is known. Conversely, its pursuit might, hydra-like, simply lead to additional questions, uncertainty, cost, and hardening of positions. Certain parties observe that “the heat of the trial melts the gold,” and prefer to wait until they are at the courthouse steps – or even with an appeal pending – before conducting a mediation. Frankly, mediation can be useful at any stage. It is our view, however, that the earlier done, the better. In all instances, good judgment dictates giving serious consideration to the timing question.

In order most effectively to utilize the mediation or arbitration process where an insurer is involved, perhaps the most significant of our questions is “*who* is involved and what role should the insurer play?” It is critical to be sure that the proper parties are engaged in deciding to enter mediation, preparing for the mediation, and attending the mediation session. Whether it is an adjuster with responsibility for monitoring the case,² or a lawyer or other official of the claims department, the person involved should have a full appreciation of the way mediation or

² A number of people are ordinarily involved in handling claims presented to an insurer. Chief among them is the insurer’s claims department or claims handling unit. This can be a group within the insurer and can also involve outside adjusters or third party administrators. Claims handlers are involved from the moment notice of a claim is received, through initial efforts to assess and possibly adjust a claim, and through all stages of litigation. The claims group triggers the issuance of any letter to the insured accepting the claim, assuming the defense but reserving rights to deny coverage. Claims appoints or approves counsel to handle the defense; sets reserves for the risk; and monitors the defense of a case. Moreover, claims evaluates case strengths and weaknesses, assessing liability and damages, and ultimately determines whether and under what terms to settle the claim. Other key players are counsel who are appointed to defend and must routinely report to the insurer; any counsel separately responsible for coverage questions; and, of course, the insured, who owes a duty of cooperation to the insurer. On the other side of the equation tend to be the claimant and claimant’s counsel.

arbitration can be used effectively, full authority to resolve the matter, and sufficient knowledge of the case and the issues to be appropriately involved in the process and make a reasoned decision. This means that the claims department should be actively engaged in evaluating the matter and reassessing reserves, and the person with full authority, ideally, should attend the mediation session. When dealing with a corporate claimant, it also means bringing the person with full settlement authority. If that claimant is an individual, say, with a personal injury claim, it might mean seeing that certain family members are also involved or, at least, on board. It pays for claims adjusters and counsel on both sides to educate themselves well on negotiation strategy and techniques and on the nature and role of the mediator, so that they can take full advantage of the opportunities presented by using the mediation process. In addition to persons with authority, experts or persons familiar with certain facts may be helpful to have present at a mediation. Of course, a mediation is not a hearing, but the presence of these people might aid the parties in coming to a common understanding of the facts and adjust their assessment of the matter. In all instances, the best prepared attendees should be cautioned to maintain an open mind so that they get the full benefit of the mediation process, including the capacity to learn and make adjustments in accordance with reality.

The “what” and “why” of mediation include using a neutral party to help all involved conduct a constructive dialogue, getting past many of the snags that arise with traditional positional bargaining. The mediator can help cut through posturing and can keep people on course. When a large demand or tiny offer threatens to end negotiations, the mediator is the glue keeping people in the process, encouraging them to stick with it and reach the goal of resolution. The mediator can help counsel and parties understand legal risks that “advocacy bias” might blind them to, help them develop information that is key to assessing and resolving the matter, and help them as they make their bargaining moves. While some cases involve claims for damages which one party believes can best and most favorably be resolved by a jury and others involve a legal issue which call for a judicial resolution, the vast majority of claims and litigations, particularly involving insured matters, are ultimately resolved by settlement. A mediation can fast forward the camera, truncating procedures and shrinking costs, by bringing about the inevitable settlement much sooner. Claims adjusters, risk managers, and counsel are well advised to consider the myriad benefits of mediation listed in the general introduction – the “why” – at the commencement of a matter, so that they can make an informed choice of process – the “what” – initially and reevaluate process choices throughout the course of handling the claim.

Development of information needed for an informed settlement decision can, in fact, be expedited through the use of mediation in the third party claim context. Rather than awaiting depositions or extensive document production, parties can use mediation to conduct truncated disclosure -- getting the information that is most essential to the resolution decision. Good use and development of information is critical to taking full advantage of mediation in the insurance

context. Prior to the mediation session, it is good practice for the insurer's team to assess damages and liability and develop a good sense of the reserve for the case. This can include obtaining expert reports, appraisals, photographs or other key information. Pre-mediation conference calls can facilitate interparty disclosures that will provide parties with information needed to prepare or to conduct a meaningful discussion when they arrive at the mediation session. It is also valuable to help the mediator get current with information in the form of pre-mediation conference calls and written submissions, with exhibits. Further useful disclosures for the benefit of the parties can occur in the confidential mediation session, enabling parties to adjust their views and assessment of damages and liability. Even if the matter does not settle at the first mediation session, information can be further developed thereafter bringing the matter to resolution.

Additional points to keep in mind include the potential for conflicts or different interests or priorities between the insured and the primary and excess carriers and reinsurers. Also, insurance policies historically placed the burden of a complete defense on the primary carrier regardless of limits. While this is still the case in an automobile policy or an occurrence-based commercial general liability policy, a variety of claims made and specialized policies may provide for defense costs to be deducted from and be subject to the limits of coverage. Additionally, the claim may exceed the limits of primary coverage and impact excess coverage and/or the primary coverage may be typically reinsured in whole or in part. These may be important practical factors to keep in mind in evaluating the "who, what, when, where and why" of mediations and arbitrations in insured matters.

In sum, the insurer, parties, and counsel should be proactive in addressing our journalist's questions – and in developing, exchanging, and analyzing information – so that a mediation can be held at an appropriately early stage – and indeed, if not initially resolved, in pursuing further mediation as the case evolves.

Case Study: The Multi-Party Subrogation Claim

Have you ever participated in a negotiation or mediation involving multiple defendants, each pointing the finger at another? In the third party insurance world, this is a frequent occurrence. Often, counsel or claims adjusters will enter a negotiation with a predetermined percentage which they believe their company should bear relative to the other defendants. Moreover, they have set views on the percentage responsibility the other parties should bear as well – particularly party X, whom they deem to be the chief target, or party Y, who was in a position similar to their own insured's. The latter scenario can generate feelings among professionals not unlike sibling rivalry.

In one case involving a construction site with twelve defendants, the mediator used an approach he calls the *consensus based risk allocation model*. This approach was undertaken with the recognition that, sometimes, shifting from percentages to hard dollars, and getting people to focus on their own pot rather than the other defendants', is a good way to move from stalemate to progress. First the mediator conducted an initial joint session and one or more caucuses (private, confidential meetings with fewer than all parties) in which he got a good sense of what the Plaintiff would need to settle the case. Then he held some caucuses with the entire group of defendants and subgroups of defendants in which the mutual finger pointing became apparent. To address this problem, the mediator held a series of caucuses with each of the defendants. In each caucus he asked the same set of questions: do you think plaintiff will win at trial, and, if so, how much? What percentage liability do you think will be allocated to each defendant? How much will it cost to try this case? Answers to these questions were recorded on an Excel spreadsheet, with a line for each defendant's answer, including columns for each defendant discussed.

When the interviews were completed, the mediator created different economic scenarios: (1) the average of the amount the plaintiff was predicted to win, with and without applying predicted defense costs, (2) the amount the mediator guessed the plaintiff would need to settle the case (the realism of which was assessed in light of the first set of numbers), and (3) amounts smaller than the projected settlement number which might serve as initial pots in making proposals to the plaintiff. The mediator then applied the average of all defendants' views of each defendant's relative liability to these economic scenarios. The result was a listing of dollar numbers allocated to each defendant for each economic scenario. The mediator then held a joint conference call with all defense counsel. He explained what he had done and inquired whether they would like to hear the outcome of this experiment. Not surprisingly, all asked to hear the outcome and agreed to share with one another this information that had been derived from their private, confidential caucuses.

Essentially, the mediator presented to the defendants three packages for presentation to the plaintiff – an initial, a subsequent, and a final pot – identifying, by dollar figure only, each defendant's contribution to each of these three pots. As a result, a doable settlement path appeared in place of what had been a field of warring soldiers. Defendants got their approvals to each pot – one pot at a time – and the case settled. This is just one way mediation can help create productive order out of multi-party bargaining sessions in third party liability cases.

2) Subrogation

Another area that has lately benefited from the use of mediation is subrogation. In subrogation matters, an insurer that has already paid a first party claim for a loss suffered by its insured stands in the shoes of that insured and seeks recovery of damages for that loss from third parties who caused the loss. Over the last decade or two, subrogation has risen in the insurance industry's regard as one of the three chief ways in which insurers gain funds, along with premiums and return on investments.

The same considerations that apply to the mediation of all third party claims apply here. Unique features include that plaintiff is a professional insurer, and, typically, insurers are involved on the defense side, as well. As a consequence, some of the emotional issues that might be generated by parties seeking recovery of damage or loss to their own personal or property are diminished. Negotiations can proceed on a steady course. Yet, special challenges also arise when professionals engage in strategic bargaining. *See*, for example, the multi-party finger pointing discussed in the inset above. Some certainty on the size and nature of the loss is gained where the claim has already been adjusted by the subrogated insurer, but other issues take center stage: if the insurer paid replacement value, should the defendants' exposure instead be limited to actual, depreciated value of the property? Were payments made for improvements, rather than losses? And, of course, questions on liability, causation and allocation among multiple parties remain. Mediators can be quite helpful in organizing these discussions, developing information, assisting in assessments of exposure, and helping multiple parties stay on track to reach a conclusion. Sometimes, the mediator's phone follow up after a first mediation session is the key to keeping the attention of multiple parties, with many other distracting obligations, focused on the settlement ball.

3) Insurance Coverage Disputes Between Insurer and Insured

Disputes can arise between the insurer and the insured in either the first party (e.g., property) or third party (e.g., liability) context. Such disputes can be particularly complicated in the third party context where the insurer owes a duty to defend if there is any possibility of coverage for one or more claims even if the carrier has potential unresolved coverage defenses. In all events, the carrier owes a duty of good faith and fair dealing to the insured and may have to consider settlement offers within policy limits in third party claims even if coverage issues are unresolved. Similarly, in the first party context, although the defense obligation may not be present, the carrier does have an obligation to process claims in a fair and efficient manner.

Notwithstanding these complications and obligations, the carrier does have the right to deny coverage if it believes that the policy does not cover or excludes a claim, or the carrier may defend under a reservation of rights if it believes there is a possibility of coverage, especially if

that possibility is dependent on the outcome of the underlying claim, *e.g.*, was the conduct that gave rise to the claim intentional (not covered) or negligent (covered).

A typical way of raising and resolving insurer/insured coverage disputes (after the carrier sets forth its initial coverage position generally by letter) is by a declaratory judgment action. Such an action may be brought by the insurer or the insured. In some states, *e.g.*, New Hampshire, a declaratory judgment action is required as a condition of denying coverage or requesting a denial.

As with all other disputes, insurance coverage disputes can be effectively resolved by mediation or arbitration (whether provided for in certain complex sophisticated insurance policies or voluntarily).

Mediation or arbitration is especially attractive in the first party context where the question of timing and amount of payment, if any, may turn on a prompt and efficient resolution of the insurance coverage dispute. While at first blush, it might appear that the insurer has an advantage or disincentive in this regard to the extent it could benefit from a delay in payments, there have been significant developments throughout the country, including in New York (in the *Bi-Economy* and *Panasia* cases, 10 N.Y.3d 187,200 (NY 2008)), adopting a tort of first party bad faith or other analysis or remedies which protect the insured in first party insurance coverage disputes and give the insurer an incentive to resolve such disputes.

In the third party claim context, the timing and coordination of any insurance coverage dispute and the resolution thereof is particularly sensitive. Simply put, if the underlying case is resolved by settlement or otherwise before the coverage dispute is resolved, the opportunity to resolve the coverage dispute in an effective fashion may be lost to the carrier or the insured. The parties may, therefore, have a genuine interest in resolving the coverage issues in coordination with the underlying claims in one way or the other. Mediation, or arbitration, involving some or all parties and some or all claims may be effective in this regard.

Case Study– Mediating the Dream within the Dream

In one mediation of a multi-party third party property damage case, one of the defendants had a coverage issue arise between its primary and excess insurer. The mediator called a “time out” and conducted a separate, abbreviated mediation of that coverage dispute by phone caucuses. The coverage issue was resolved and the parties then moved on to resolve the original third party claim.

Apart from these complexities, the same who, what, when, and why consideration noted above apply. In endeavoring to coordinate an underlying claim proceeding with an insurance coverage dispute, the when of any mediation and the who is involved amongst the parties and their representatives becomes critical. On the insurer side for example, there is typically and appropriately, a separation between the adjusters or claims representatives handling the defense of the underlying litigation, and those responsible for the coverage dispute. This is where they need to coordinate. The why includes the potential benefit of resolving the coverage issue which may impede resolution of the underlying claim and/or resolving the underlying claim which may be impacting the resolution of the coverage dispute. The what may involve a mechanism to bring together in a single forum, e.g., before a mediator, parties involved in different proceedings or aspects thereof.

Finally, a word about the need for subject matter expertise in mediators or arbitrators. In arbitration, expertise is what is often sought in a decision maker, although some have argued that non-experts might approach a case with a more open mind. In mediation, maintaining an open mind is essential in the mediator; and process skills are of paramount importance. Nevertheless, users of these processes in insurance coverage matters, find it helpful if their mediators or arbitrators are conversant with insurance policy interpretation and implementation.

4) Insurer v. Insurer Disputes

Another area where mediation or arbitration may be particularly effective is in insurer v. insurer disputes.

Because of the complexity of the world we live in, it is not uncommon to encounter situations where multiple carriers and policies may respond to one or more potentially covered claims. This may give rise to disputes among carriers under "other" insurance clauses which seek to prioritize coverage obligations between carriers, or pursuant to subrogation rights, or where primary and excess carriers are involved, or there are additional insured claims, etc.

Disputes between insurers present a perfect opportunity for mediation or arbitration. One reason for this is that since insurers will often find themselves on one side of an issue in one case and on the opposite side of that issue in another case, or even on both sides of an issue in the same case, e.g., with affiliated carriers or the same carrier involved for different insureds, there are multiple situations where it would be in the carriers' interest to have an efficient effective resolution of the particular case without setting a precedent for one position or another.

