Mediating the Insurance Coverage and Bad Faith Case

By: Bruce A. Friedman, Esq.

In general, I believe that the approach to the mediation of an insurance coverage and bad faith case is similar to mediations in other substantive areas of law. However, there are a few differences; including the analysis of the insurance policy, the cases construing the policy, and the rules applicable to the interpretation of insurance policies. While insurance policies do come with a body of law interpreting what they mean and a set of court established rules of construction that are unique to insurance contracts, insurance policies are, without question, the most difficult and least understood contracts in general use.

In presenting the case to the mediator, it is counsel's job to educate the mediator on: 1) the policy provisions which are at issue in the case; 2) how the policy has been construed by the courts; and 3) the applicable rules with respect to interpretation of the policy. And remember: Counsel must supply the mediator with a copy of the insurance policy. I have been surprised by the number of times I have had to ask for the policy after receiving the mediation briefs from both sides.

There also may be choice of law issues that may have a significant impact on the interpretation of the policy. For example, is the policy to be interpreted under California law because the underlying case is in California or under the law of the state of residence of the insured where the courts consider the policy to have been issued? Choice of law can have a significant impact on many issues. If an issue in the case is notice of the claim or suit, California has a notice prejudice rule that requires that the insurer prove that it has been prejudiced by the late notice. Other states may enforce the notice clause without regard to prejudice to the insurer. When it comes to the issue of waiver of coverage defenses, the California Supreme Court has adopted a rule that the insurer does not waive coverage

defenses not mentioned in its initial denial or reservation of rights letter. Other states have a more policyholder-oriented rule that states coverage defenses are waived if not specifically raised by the insurer at the outset of the claim. On the other hand, the California Supreme Court (in the Johansen decision) subjects an insurer to a bad faith claim if it does not settle a case notwithstanding the existence of coverage issues. Many other states do not have this rule.

There are also different burdens of proof as to the coverage grant in the policy and the exclusions. The policyholder generally has the burden to establish that the risk is covered by the coverage grant of the policy. The insurer bears the burden of proof with respect to the applicability of exclusions.

The mediator must review the policy, law, and rules of construction and be prepared to ask questions of counsel about the issues and outcome of the case in the event that the policy is construed in a different manner than the party is arguing, or if the court determines that the policy does not apply at all. It is also possible that the policy may be construed in a manner different than either party is arguing and the mediator should be able to recognize that scenario and to address it with the parties. It is my experience that in order for the mediation to end in settlement, the mediator must use an evaluative approach. This requires an assessment of the strengths and weaknesses of the parties coverage positions and the effective communication of that assessment.

It is very important for the policyholder to have counsel that is sophisticated in the construction and litigation of insurance coverage issues. The insurer's counsel will undoubtedly be a coverage lawyer (since she is hired on a routine basis to advise and litigate coverage issues on behalf of insurance companies). The policyholder needs the same level of expertise to level the playing field. If the policyholder is not represented by sophisticated counsel, the mediator's job is much more challenging. The mediator is put in the place of having to explain insurance law and interpretation to counsel, who may not appreciate the subtleties of the policy language.

This difference in the level of sophistication may also extend to the policyholder who may be dealing with his first and only insurance coverage case (whether it is

an individual or corporate insured). The insurer's claim representative, on the other hand, does this work for a living. This presents another challenge for the mediator. In the policyholder's caucus room, the mediator needs to take the time to explain the issues to the insured and make sure that the insured understands them. In the insurer's caucus room, the mediator's challenge is to overcome the attitude that the adjuster and counsel have heard all of the arguments before and do not have the patience to work through the issues that are specific to the case in mediation. Ultimately, it is the mediator's understanding and communication of the strengths and weaknesses of the parties' positions that will assist in bringing the parties together.

As far as the bad faith element of insurance coverage cases is concerned, it generally does not play a major role in the mediation of the case unless the insurer's coverage denial is clearly wrong or the insurer failed to communicate its coverage position to the prejudice of the insured. Under those circumstances, the insurer may be motivated to settle and pay the claim at the higher end of the damages spectrum. Insurers generally argue either that there is no coverage, and therefore, no bad faith, or that the issue of coverage is a close call and the law does not impose bad faith liability on an insurer where its coverage position is reasonable. Insurers may also raise the advice of counsel defense to the imposition of punitive damages arguing that the insurer relied on advice of counsel in denying coverage for the claim. This requires both an analysis of the advice given by counsel and a determination whether it was reasonable for the insurer to rely on it. Finally, insurers rarely pay punitive or extra contractual damages in a mediated settlement and it is important for policyholders to be advised of that by their counsel prior to the mediation and by the mediator at the outset of the mediation. Ultimately, it is the mediator's job to create reasonable expectations with respect to the outcome of the mediation in order to provide the parties with a rational opportunity to settle their dispute.

Bruce A. Friedman is a mediator with a national practice. With years of litigation experience behind him, he understands the needs of the parties and counsel in the mediation process and will do his best to ensure that they are met. For more

information on the mediation services that Bruce A. Friedman provides, check out his website at http://www.FriedmanMediation.com or call him at (310) 201-0010.