MEALEY'S™ LITIGATION REPORT
Insurance Bad Faith

This Mediation Is Confidential, Right?

by
Kimberly N. Gorak
and
Anita Devi P. Misir

Butler Pappas Weihmuller Katz Craig LLP

A commentary article reprinted from the November 21, 2013 issue of Mealey's Litigation Report: Insurance Bad Faith

LexisNexis®

Commentary

This Mediation Is Confidential, Right?

By
Kimberly N. Gorak
and
Anita Devi P. Misir

[Editor's Note: Kimberly N. Gorak is a senior associate and Anita Devi P. Misir is an associate with the law firm of Butler Pappas Weihmuller Katz Craig LLP, which has offices in Tampa, Chicago, Philadelphia, Charlotte, Mobile, Tallahassee, and Miami. Comments in this article are those of the authors and not Butler Pappas or Mealey's.

Mediation is an effective dispute resolution tool because it allows participants to openly discuss all aspects of a dispute without the fear of recourse or retribution. Confidentiality is a critical component of this process. Litigants and insurers participating in mediation often proceed under the assumption that all communications and conduct occurring during mediation will be cloaked with protection. However, exceptions to confidentiality are slowly eroding what is commonly referred to as the absolute "mediation privilege."

Exceptions to confidentiality present unique issues for insurers involved in mediation as litigants (in first-party disputes) or as non-party participants (in third-party disputes). This is particularly true when the extent to which settlement offers were extended by the insurer at mediation is a point of contention in a subsequent bad-faith suit. When the basis for a bad-faith claim is unreasonable failure to settle, the mediation privilege is a double-edged sword for insurers. Insureds and third-party claimants may seek to present evidence of the insurer's conduct at mediation to demonstrate the absence of a meaningful offer to settle. Insurers, on the other hand, may seek to present evidence of offers extended during the course of mediation to demonstrate their good-faith efforts to resolve the claim. Accordingly, insurers should be cognizant of the fact that, in most jurisdictions, the mediation privilege is not absolute.

I. Sources Of The Mediation Privilege

The increasing use of alternative dispute resolution has resulted in the enactment of state statues or rules of procedure in most jurisdictions designed to preserve the confidentiality of communications exchanged during mediation.[1] While many of these statutes and rules purport to provide blanket protection, they are often riddled with loopholes and exceptions.

Under certain circumstances, the exceptions built into the applicable statutes virtually swallow the privilege. For example, some state statutes offer protection for all mediations, including voluntary mediations conducted before suit is filed.[2] Others only extend to "court-ordered" mediations.[3] Even when the proceeding itself is protected by statute, certain communications exchanged during that proceeding may fall outside the scope of the statutorily-defined privilege. Pursuant to some statutes, confidentiality only extends to the particular subject matter in dispute during the mediation.[4] Further, evidence that is otherwise obtainable, admissible or discoverable does not necessarily become privileged merely because it is exchanged during the course of mediation.[5]

In federal courts, Rules 408 and 501 of the Federal Rules of Evidence provide the foundation for mediation confidentiality. Rule 408 restricts the admissibility of offers of compromise and settlement negotiations; however, it does not provide protection for such statements

when offered for the purpose of showing bias, prejudice, or negating a contention of undue delay.[6] Notably, Rule 408 only governs the admissibility of settlement negotiations; it does not prohibit discovery of information related to those negotiations.[7]

Rule 501 provides that, in a civil case, state law governs privilege regarding a claim to which state law applies.[8] Accordingly, if the basis for federal jurisdiction is diversity of citizenship, Rule 501 requires the application of state laws governing privilege in the federal court proceeding.[9] If the governing state's law offers no protection, communications exchanged during the course of mediation may be used as evidence.

II. Discovery And Admissibility Of Mediation Communications In Bad-Faith Cases

A. Evidence Of Bad Faith

In recent years, a number of courts have relied upon exceptions to the mediation privilege to conclude that communications made during the course of mediation are discoverable and/or admissible in subsequent bad-faith suits. Frequently, these mediation communications are offered for the purpose of establishing that the insurer failed to take advantage of a reasonable settlement opportunity or engaged in improper conduct during the mediation.

Communications regarding issues that are not directly in dispute at the mediation may not be protected. In *Mutual of Enumclaw v. Cornhusker Casualty Insurance Company*, the Eastern District of Washington found that an insurer's conduct and communications during mediation regarding issues that were not in dispute during the mediation were discoverable in a subsequent bad-faith lawsuit.[10] In the underlying case, the insurer identified a potential coverage defense but notified the insureds that it would not raise any such coverage defense against them. During mediation in the underlying lawsuit, the insurer relied upon the coverage defense as a basis for limiting its contribution toward the settlement of the case. As a result, the claims against the insureds were not resolved at mediation. In the bad-faith action, the insurer filed a motion for protective order seeking to prohibit discovery regarding its statements during mediation.[11]

Sitting in diversity jurisdiction, the court looked to substantive state law in its analysis of the admissibility of mediation communications.[12] According to Washington State's Uniform Mediation Act, "mediation" is defined as "a process in which a mediator facilitates communications and negotiation between parties to assist them in reaching a voluntary agreement *regarding their dispute*."[13] The underlying mediation involved a dispute over the damages resulting from the injuries sustained by the claimant, not insurance coverage.[14] Therefore, the court determined that any communications regarding insurance coverage were discoverable in the subsequent bad-faith suit.[15]

If the disclosure of mediation communications will be limited to those parties who actually participated in the mediation, the mediation privilege will probably not apply in a subsequent bad- faith suit. In *Altheim v. GEICO General Insurance Company*, the Middle District of Florida found that the mediation privilege did not bar discovery seeking information exchanged during mediation in a first-party bad-faith case.[16] The court explained that, by definition, the privilege contemplates protecting disclosure of communications that were made during mediation to others outside of the mediation process.[17] Since both the plaintiff-insured and the defendant-insurer were mediation participants[18] and there had been no attempt to disclose mediation communications[19] to any third-parties, the court found that the mediation privilege did not apply.[20]

If a mediation communication is offered for purposes other than establishing liability, it may very well be admissible. In *Sharbono v. Universal Underwriters Insurance Company*, a Washington appellate court upheld the trial court's decision to consider communications exchanged during mediation in support of the insureds' bad-faith claim.[21] A wrongful death claim was asserted against the insured by the family of the motorist who was killed when the insureds' daughter lost control of her truck. The insureds believed they had purchased three separate $1,000,000 personal umbrella policies. However, the insurer contended that there was only $1,000,000 in umbrella coverage applicable to the accident. Personal counsel for the insureds requested the insurer's underwriting files, which were necessary to resolve the issue and settle the wrongful death claim, but the insurer refused to produce the files.[22]

During the bad-faith action, the trial court considered a videotape played during mediation and statements made by the insurer's representative suggesting that

the insureds would have to sue the insurer before obtaining its underwriting files.[23] The insured offered this evidence in the bad- faith suit to demonstrate the importance of the insurer's underwriting file and the harm caused to the insured as a result of the insurer's refusal to produce the file. The trial court admitted the videotape and statements as evidence of the insureds' state of mind.[24] Because the trial court admitted the testimony for purposes other than establishing liability, the appellate court found no abuse of discretion.[25] Further, the court explained that the insurer failed to meet its burden to establish that the mediation was a result of a court order, a written agreement, or a statutory mandate, as required to trigger confidentiality under the applicable state statute.[26]

B. Evidence Of Good Faith

If, under certain circumstances, mediation communications are discoverable and admissible to establish bad faith, then it stands to reason that the cloak of confidentiality should be lifted to the same extent when insurers seek to offer evidence of mediation communications as evidence of their good faith. For example, insurers may wish to introduce statements made during mediation to establish that a reasonable settlement offer was rejected or that there was never a reasonable opportunity to settle a claim within the available policy limits.

Once the insurer's settlement strategy has been called into question, a claimant asserting a bad- faith claim cannot invoke the mediation privilege to prevent the insurer from offering evidence of its good faith. In *Bobick v. U.S. Fidelity & Guaranty Company*, the claimant filed a bad-faith action alleging that the insurer engaged in unfair settlement practices.[27] The claimant then attempted to characterize the insurer's settlement offer as a privileged mediation communication under section 23C of Massachusetts General Laws Annotated.[28] Unconvinced, the court found that the claimant implicitly waived the privilege, at least with respect to the issue of whether such an offer was made, when the claimant accused the insurer of failing to make a reasonable settlement offer.[29] The insurer's offer to settle was admissible and relevant to demonstrate the insurer's continuing attempt to settle the plaintiff's claim.[30]

An insurer may also seek to offer evidence of mediation communications to establish that it employed a well-reasoned settlement strategy at mediation. In *Shin Crest PTE, Ltd. v. AIU Insurance Company*, the Middle District of Florida considered the settlement offers extended at mediation and found no bad-faith conduct on the part of the insurer.[31] Based upon the facts known to the insurer at the time of the mediation, the court held, as a matter of law, that the insurer's settlement strategy at the mediation could not be characterized as bad-faith handling of the claim.[32] Recognizing the need for insurers to retain some negotiating power at mediation, the court declined to punish the insurer for its well-reasoned decisions as to the timing of its settlement offers. An insurer "should not be penalized for following a reasonable and rational strategy when making its offers."[33]

III. Preserving The Mediation Privilege

The extent to which mediation communications will actually remain confidential depends, in large part, upon the language of the applicable statute in the jurisdiction in which the mediation occurs. Mediation participants should carefully scrutinize the controlling statutes in order to ensure that the proceeding falls within the scope of the statute, paying careful attention to any enumerated exceptions.

If there is any doubt that confidentiality will extend to all aspects of the mediation, including statements made by the insurer, mediation participants may want to consider entering into a written confidentiality agreement. Such an agreement can be crafted to preclude the use of any statements or conduct in any subsequent proceedings related to coverage or extra-contractual issues. However, confidentiality agreements should be considered on a case-by-case basis so as to avoid an unintended effect, such as the exclusion of any evidence of good-faith settlement offers extended during mediation.

Mediation is a process that encourages candor in order to reach a common goal– settlement. In order to maintain any faith in the process, mediation participants must be able to negotiate freely, without the fear that they will be penalized for their chosen strategy. Exceptions to the mediation privilege could have a chilling effect and actually discourage negotiated settlements.

Endnotes

1. For example, in Massachusetts, Section 23C and Rule 514 provide a "blanket confidentiality protection on the mediation process." Mass. Gen. Laws. Ann. ch.

233, § 23C; Ma. R. Evid. § 514; Modern Continental Const. Co., Inc. v. Zurich American Ins. Co., 21 Mass. L. Rptr. 114, at *6 (Mass. 2006) (quoting Leary v. Geoghan, 2002 WL 32140255 (Mass. 2002)). In Pennsylvania, the mediation privilege is codified at 42 Pa. C. S. § 5949 and is recognized as one of the broadest privileges in the state, encompassing all communications including demands for settlement or offers in compromise. Executive Risk Indem., Inc. v. Cigna Corp., 81 Pa. D. & C. 4th 410 (Com. Pl. 2006); Aetna, Inc. v. Lexington Ins. Co., 76 Pa. D. & C. 4th 19 (Com. Pl. 2005). In Florida, the legislature enacted section 44.405 in 2004, recognizing a privilege for all mediation communications, including mediations that are not court-ordered. § 44.405, Fla. Stat.; Sun Harbor Homeowners' Ass'n, Inc. v. Bonura, 95 So. 3d 262, 270 (Fla. 4th DCA 2012). In California, Section 1119 of the California Evidence Code prohibits the admission of "evidence of anything said or any admission made for the purpose of, in the course of, or pursuant to, a mediation or a mediation consultation." Houck Const., Inc. v. Zurich Specialties London Ltd., 2007 WL 1739711, at *2 (C.D. Ca. June 4, 2007) (applying California law) (quoting California Evidence Code section 1119 and finding that Section 1119 encompasses communications between an insurer and its insured).

2. *See, e.g.*, Kan. Att'y Gen. Op. No. 2010-9 (Mar. 29, 2010); Kan. Stat. Ann. §§ 5-501–5-516.

3. *See, e.g.*, Wash. Rev. Code Ann. § 5.60.070(1).

4. *See, e.g.*, Mich. Comp. Laws Ann. § 691.1557; Va. Code Ann. § 8.01-581.22.

5. Nev. Rev. Stat. Ann. § 48.109; Fla. Stat. § 44.405.

6. Fed. R. Evid. 408.

7. Folb v. Motion Picture Industry Pension & Health Plans, 16 F. Supp. 2d 1164, 1171 (C.D. Cal. 1998).

8. Fed. R. Evid. 501.

9. Olam v. Congress Mortgage Co., 68 F. Supp. 2d 1110, 1124-25 (N.D. Cal. 1999).

10. No. CV-07-3101-FVS, 2008 WL 4330313, at *3 (E.D. Wash. Sept. 16, 2008).

11. *Id.* at *1.

12. *Id.* at *2.

13. *Id.* at *3 (quoting Wash. Rev. Code Ann. § 7.07.010(1)) (emphasis in original).

14. *Id.*

15. *Id.*

16. No. 8:10-CV-156-T-24TBM, 2010 WL 5092721, at *1 (M.D. Fla. 2010).

17. *Id.*

18. A "mediation participant" is defined under Florida statutes as "a mediation party or a person who attends a mediation in person or by telephone, videoconference, or other electronic means." Fla. Stat. § 44.403(2).

19. "Mediation communication" means an oral or written statement, or nonverbal conduct intended to make an assertion, by or to a mediation participant made during the course of a mediation, or prior to mediation if made in furtherance of a mediation. Fla. Stat. § 44.403(1).

20. *Id.; see also* Allied World Assurance Co., Inc. v. Lincoln General Ins. Co., 280 F.R.D. 197 (M.D. Penn. 2012) (Florida's Mediation and Privilege Act was inapplicable where both primary and excess insurers were mediation participants and there had been no effort to disclose the communications to persons other than mediation participants; additionally privilege may not be invoked as to communications that occurred outside the mediation process).

21. 161 P.3d 406 (Wash. Ct. App. 2007).

22. *Id.* at 411.

23. *Id.* at 424.

24. *Id.* at 419.

25. *Id.*

26. *Id.* at 417-8.

27. 790 N.E.2d 653 (Mass. 2003).

28. *Id.* at 658, n.11.

29. *Id.*

30. *Id.*

31. 605 F. Supp. 2d 1234 (M.D. Fla. 2009).

32. *Id.* at 1242.

33. *Id.* ■

MEALEY'S LITIGATION REPORT: INSURANCE BAD FAITH
edited by Mark Rogers
The Report is produced twice monthly by

1600 John F. Kennedy Blvd., Suite 1655, Philadelphia, PA 19103, USA
Telephone: (215)564-1788 1-800-MEALEYS (1-800-632-5397)
Email: mealeyinfo@lexisnexis.com
Web site: http://www.lexisnexis.com/mealeys
ISSN 1526-0267