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Resolution of Commercial Insurance and Reinsurance Disputes

A Move Towards Mediation in the London Market?

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Contents

	page
1. The current climate	1
2. Drivers for change:	3
2.1 Commercial drivers	3
Dissatisfaction with current methods	3
Benefits of Mediation	3
2.2 Contractual drivers	4
2.3 Market custom and practice drivers	5
2.4 Judicial drivers	7
3. The international landscape	11
3.1 The use of mediation in America	11
Exxon Valdez, 1989	12
Recent examples: Hurricane Mediation Programmes	13
3.2 The use of mediation in Australia	14
4. The future for the London Market?	15

This article aims to set out how mediation is perceived currently, what drivers there are for change and how these drivers are likely to impact the use of mediation as a dispute resolution technique for London Market disputes in the future.

1. The current climate

Although facts and figures are hard to come by given the confidential nature of ADR solutions, it would appear from insiders that the London Market has strayed little from its very traditional roots when it comes to dispute resolution. Litigation and more recently arbitration are often seen to be the normal routes to the resolution of London Market disputes. That is not to say that settlement negotiations do not occur, but often against the backdrop of traditional proceedings and often at an advanced (nay protracted) stage.

While many of the historical North American London Market liabilities were resolved through settlement and/or mediation strategies largely as a result of the restructuring of old Lloyd's into Equitas and the numerous corporate insolvencies in the London Companies' Market, more recent catastrophic losses were litigated through final appeal, for example in the WTC coverage case.

Mediation is yet to be seen as an integral part of the dispute resolution process and is used in only a small percentage of commercial insurance disputes¹. It is, however, seen to be slowly increasing its acceptance and use.

¹ Unless the context otherwise dictates the term "insurance" includes "reinsurance" and the term "policyholder" includes both direct and reinsureds.

The use of mediation in this field may be hindered by the limited spread of specialised knowledge regarding the process, perceived disadvantages of mediation, as well as a lack of promotion of mediation.

There are five commonly branded arguments and misconceptions as to why mediation is not yet fully embraced in the UK:

- i. Mediation cannot guarantee resolution of the dispute ²;
- ii. Some carriers are yet to learn of the process and advantages of mediation;
- iii. Lawyers can be obstructive to the use of mediation as it conflicts with their interests in seeing disputes through to a fully litigated conclusion and/or appeal;
- iv. Carriers believe that their settlement processes are efficient enough;
- v. The judiciary is not fully apprised of, nor fully in favour of mediation. Accordingly, it is not encouraged “from the bench”.

Meanwhile, there is growing frustration amongst many participants in more traditional methods, which may explain the background behind various drivers to increased use of mediation in the insurance context.

² While there is some truth in this, the vast majority of mediations reach settlement “on the day”. In those that do not, the majority settle soon thereafter. Those that fail to reach settlement benefit from the process, which, by addressing areas of conflict and argument, narrows them; saving the duration and therefore cost of any subsequent trial.

2. Drivers for change:

2.1 Commercial drivers

Dissatisfaction with current methods

While traditional methods remain wholly appropriate to a large proportion of cases, there is seen to be increasing frustration regarding the drawbacks and limitations of both litigation and arbitration which is creating a driver for change.

Arbitration shares some of the widely acknowledged drawbacks of litigation, in terms of cost and time, transfer of control of the dispute to a fixed tribunal causing uncertainty and risk, the imposition of a narrow selection of remedies, limited rights of appeal from an imposed decision and the logistics of arbitrating, often in a foreign jurisdiction applying another country’s law (for example under the XL form – with a London arbitration clause and a New York choice of law provision). These drawbacks are sending both policyholders and carriers in search of other resolution techniques, including mediation.

Benefits of Mediation

There are many commercial benefits of mediation that create voluntary drivers to mediate. Insurance can best be described as a risk transfer business well understood by sophisticated policyholders and insurance companies alike. As a general proposition in risk management, is it better for those parties to control the risk transfer aspects associated with the claims handling process or to leave such decisions to an uncertain outcome?

These benefits include:

- Savings as to transaction costs, both fiscal and core management time
- Reduction in time in the claims life cycle, thereby freeing capital for investment rather than for reserves, litigation costs and/or to fund any underlying claim
- Control over the process which is confidential and voluntary up to the point of any agreement
- Improved commercial relations between insurers and policyholders leading to enhanced commercial reputations
- A better understanding of those cases which may not result in a successful mediation leading to a more focussed plan where litigation or arbitration is required

2.2 Contractual drivers

As the benefits of mediation become more widely acknowledged, the use of mediation clauses in insurance contracts will increase. Mediation clauses have recently seen an increase in their usage in the international reinsurance arena and the benefits may well apply equally to direct insurance.

Such clauses are likely to be enforceable in their own right: *Cable & Wireless Plc v IBM* [2002] EWHC Ch 2059 per Colman J An agreement to mediate and participation in an agreed mediation procedure “are, in my judgment, engagement of sufficient certainty for a court readily to ascertain whether they have been complied with”.

Contractual provisions to mediate may take several forms, either in advance of adversarial proceedings or parallel thereto, but should adopt a clear process and will usually identify a model mediation procedure. It is noted that under English law, no party can seek to oust the jurisdiction of the court, but the court will usually stay any proceedings to allow parties to honour their agreement to mediate.

In addition to the commercial benefits highlighted above, contractual provisions to mediate may have the following benefits:

- Parties are prompted from the outset to explore a process which remains in their control
- The earlier parties seek to mediate the better the prospect for settlement with reduced costs and other savings, especially as positions are likely to be less entrenched
- Avoidance of a court imposed mediation process not upon agreed terms and the potential for costs’ sanctions: see below under judicial drivers.

2.3 Market custom and practice drivers

Enhanced awareness of some of the drawbacks to litigation and arbitration has led to an increasing call for other resolution avenues, with mediation becoming the tool of choice. Following consultations with leading companies and law firms in the London and American Insurance Markets, the International Institute for Conflict Prevention and Resolution (CPR) has issued the International Reinsurance Industry Dispute Resolution Protocol (“Protocol”), which:

“... offers best practices to encourage the early and efficient resolution of disputes between reinsurers and reinsureds. The Protocol consists of a statement of intent to follow particular procedures in the event of certain disputes arising between parties and a detailed account of the procedures to be followed.”³

The Protocol suggests four ways it may be used or incorporated:

- By reference or express incorporation into treaties and agreements;
- Unilateral adoption by a carrier as a statement of its own policies and practices;
- Adoption by parties to a particular dispute to assist in managing information exchange⁴; or
- Groups of insurers, market or other associations may use it as the basis for discussion of wider best practices in the London Market sector⁵.

In summary, the Protocol sets out procedures for the prompt identification of any dispute, the early exchange of information, direct inter-party negotiation **and the introduction of a “skilled, neutral third party to facilitate those negotiations through a mediation procedure”**⁶. [Emphasis added]

3 CPR Description of the Protocol: <http://www.cpradr.org/CPRStore/tabid/67/ProductID/96/Default.aspx>

4 The Protocol further suggests that parties may wish to modify it as applicable to the dispute

5 Protocol p3

6 6 *Ibid* p4

Although the Protocol is at present neither legally binding nor mandatory, its authors predict that it will bear commercial fruit in time:

*“The protocol is not a legally binding agreement. A company choosing to adopt it waives no right, defence or privilege, and no cause of action arises from a company’s declining to follow it. However it is anticipated that the industry’s adherence to the “best practices” set forth in the Protocol, in the exercise of good will and cooperation, will yield substantial economic benefits over time.”*⁷

It is further noted that the increased usage of Honourable Engagement clauses, especially in the reinsurance arbitration clause context may also increase the usage of mediation, since an arbitral panel is not constrained by the strict letter of the law but rather will consider any dispute in light of market practice and the general agreement of the parties⁸. Given this approach to a formal arbitration, the scope for a successful mediation prior to or in conjunction with such process should be enhanced.

2.4 *Judicial drivers*

In the UK, influential members of the judiciary have been outspoken in their comments about the settlement “versus” litigation debate. In a speech given in India

7 *Ibid*

8 For example, BRMA 6 H ARBITRATION “The arbitrators shall interpret this Contract as an honourable engagement and not as merely a legal obligation. They are relieved of all judicial formalities and may abstain from following the strict rules of law. They shall make their award with a view to effecting the general purpose of this Contract in a reasonable manner rather than in accordance with a literal interpretation of the language.”

in 2008 by the Lord Chief Justice, Lord Phillips betrayed both his alarm at the expense of litigation and support for mandatory mediation:

*“... It is madness to incur the considerable expense of litigation – in England usually disproportionate to the amount at stake – without making a determined attempt to reach an amicable settlement. **The idea that there is only one just result of every dispute, which only the court can deliver is, I believe, often illusory.** Litigation has a cost, not only for the litigants but for society, because judicial resources are limited and their cost is usually born – at least in part – by the state. **Parties should be given strong encouragement to attempt mediation before resorting to litigation. And if they commence litigation, there should be built into the process a stage at which the court can require them to attempt mediation – perhaps with the assistance of a mediator supplied by the court...**”*⁹

[Emphasis added]

Sir Anthony Clarke, Master of the Rolls, speaking at the Second Civil Mediation Council conference of increasing the use of mediation pointed out:

“It is of course a cliché that you can take a horse to water, but whether it drinks is another thing entirely. But what can perhaps be said is that a horse, even a very obstinate horse, is more likely to drink if taken to

*water. We should be doing more to encourage, and perhaps direct, the horse to go to the trough. The more horses approach the trough, the more will drink from it.”*¹⁰

Further, failure to demonstrate efforts to achieve settlement through negotiation pre-trial in line with the Overriding Objective of the Civil Procedure Rules¹¹ may have negative cost implications for the recalcitrant party. Under the Allocation Questionnaire, to be filled out pre-trial¹²:

“... parties should make every effort to settle their case before the hearing. This could be by discussion or negotiation (such as a roundtable meeting or settlement conference) or by a more formal process such as mediation. The court will want to know what steps have been taken. Settling the case early can save costs, including court hearing fees...

Your answers to these questions may be considered by the court when it deals with the question of costs: see Civil Procedure Rules Part 44.3(4).

1. *Given that the rules require you to try to settle the claim before the hearing, do you want to attempt to settle at this stage?* Yes No
2. *If Yes, do you want a one month stay?* Yes No

¹⁰ “Mediation grows as firms see the benefit of finding common ground” John Sturrock The Scotsman 07/07/08

¹¹ Inter alia, saving expense, dealing with cases proportionately to their monetary value, complexity and the financial positions of the parties: Civil Procedure Rule 1.1

¹² Form N150 Promulgated under the Civil Procedure Rules

⁹ “Alternative Dispute Resolution An English Viewpoint” India 29/03/08 pp1-15 at pp14-15: http://www.judiciary.gov.uk/docs/speeches/lcj_adr_india_290308.pdf.

3. *Would you like the court to arrange a mediation appointment?* Yes No
4. *If you answered No to question 1, please state below the reasons why you consider it inappropriate to try to settle the claim at this stage. Reasons: ...”*¹³

[Emphasis added]

In *Halsey v Milton Keynes General NHS Trust* [2004] EWCA Civ 576 the Court of Appeal listed the factors that could be relevant in deciding whether a party had acted unreasonably in refusing to agree to ADR. The factors included the nature of the dispute, the merits of the case, the extent to which other settlement methods had been attempted, whether the costs of ADR would be disproportionately high, whether any delay in setting up and attending the ADR would have been prejudicial and whether the ADR had a reasonable prospect of success. Where a successful party had refused to agree to ADR despite the court’s encouragement, it was a factor that the court would take into account when deciding whether his refusal was unreasonable and any implications as to the award of costs.¹⁴

The trend towards increased scrutiny and judicial management of parties’ conduct in the interests of the Overriding Objective also seems likely to take hold in the

¹³ Theoretically, it could be argued that a solicitor may refuse to answer a judge’s questions relating to discussions with his client about settlement at a costs hearing on the grounds of solicitor/client privilege. However, it is likely that any such refusal would, at best, provoke a negative reaction from the bench.

¹⁴ See also section 61 of the Arbitration Act 1996 Award of costs “(2) Unless the parties otherwise agree, the tribunal shall award costs on the general principle that costs should follow the event except where it appears to the tribunal that in the circumstances this is not appropriate in relation to the whole or part of the costs.”

Commercial Court. In the face of criticism that hearings in the court were too complex, long in duration and expensive, a Working Party produced a report recommending procedural and substantive reforms, designed to simplify litigation, reduce cost and bolster the Commercial Court against attacks that it is too expensive. Such criticism led to concern that some, particularly international, litigation is moving to other jurisdictions or methods of dispute resolution such as arbitration.

The trial period ran from February to November 2008 and, most notably, contained provisions widening the court’s discretion to consider conduct when allocating costs. The court was effectively encouraged to make more use of its power to award costs to discourage the parties from behaving unreasonably.

Accordingly, although the UK courts’ stick and carrot encouragement of pre-trial settlement and ADR options is perhaps less polarised than in jurisdictions such as the USA and Australia, there is a distinct and increasing danger of incurring costs in circumstances where settlement and mediation options are bypassed en route to trial.

3. The international landscape

While we cannot just assume that what is happening elsewhere will necessarily happen in the London Market, it is useful to look at examples and trends outside of the UK and consider the likely impact on the London Market.

3.1 The use of mediation in America

For a long time it had been recognised that litigation is not the only technique required:

“Our system is too costly, too painful, too destructive, too inefficient for a truly civilized people. To rely on the adversary process as the principal means of resolving conflicting claims is a mistake that must be corrected.”

Former United States Chief Justice Warren E. Burger, 1984 ¹⁵

There are also widespread examples of the successful use of mediation in insurance and reinsurance disputes:

Exxon Valdez, 1989

Arguably the leading authority for mediation’s suitability to complex LM disputes is that of the Exxon Valdez environmental disaster of 1989.

Shortly after the disaster, Exxon lawyer Dick Clinton echoed a familiar and perhaps regrettable sentiment:

“If people want to litigate, we’ll have to litigate and use all the vehicles we have” ¹⁶

In the coverage litigation between Exxon and around 250 carriers, which ran until 1996, Exxon argued that its carriers were liable for over \$490 million plus interest of \$161 million. The carriers countered that the total award should be limited to \$335 million ¹⁷. Exxon had originally sought over \$2 billion from its carriers.

In January 1996, a partial settlement was reached whereby the carriers would pay Exxon \$300 million. In June 1996, a Houston jury awarded Exxon \$250 million.

Facing the significant costs of a prolonged appeal, the carriers and Exxon began mediation resulting in a settlement of \$480 million payable to Exxon. The mediation also resolved Lloyd’s pending claim against Exxon in New York federal court.

Recent examples: Hurricane Mediation Programmes

In the wake of hurricane Katrina in 2005, total LM and capital market losses totalled between \$39.9 and \$54.6 billion ¹⁸. With Rita in its wake, these disasters were to become one of the costliest disasters in the history of the USA.

Predictably, coverage litigation on issues such as coverage for wind-driven water and flood damage was to follow. Nonetheless, Florida rapidly established mediation programmes to settle claims, such as the Claims Mediation for Condo Associations Program ¹⁹, whereby associations could request mediation of claims. Florida CFO Tom Gallagher stated that the programme would spur settlements and avoid insurance lawsuits:

“Many condominium communities in our state have not yet started to rebuild because they are struggling with their insurance companies to get their claims paid,” Gallagher said in a statement. “My goal is to

15 The State of Justice, A.B.A.J. 04/1984 p62 at 66

16 Anchorage Daily News 16/08/89 “Exxon Responds to 140 Lawsuits”: <http://www.adn.com/evos/stories/EV360.html>

12 17 Anchorage Daily News 01/11/96 “Exxon, Lloyd’s Settle”: <http://www.adn.com/evos/stories/EV417.html>

18 “Hurricane Katrina: Analysis of the Impact on the Insurance Industry” Tillinghast, October 2005

19 “Florida Unveils Hurricane Claims Mediation Program for Condo Associations” Best’s Insurance News, 07/12/05

*offer them a no-cost alternative to resolving their claims and help them successfully recover from catastrophic losses.”*²⁰

Similarly in Mississippi, the Hurricane Katrina Mediation Program, which within one year responded to 3,827 mediation requests; more than 2,600 reaching settlement.²¹ Louisiana responded in kind, setting up a Hurricane Mediation Program to:

*“... help resolve claims disputes between insurers and Louisiana policyholders arising from damages to residential property caused by Hurricanes Katrina and Rita.”*²²

It is testament to the effectiveness of a structured commercial approach to the settlement of claims that these programs, together with those of California and North Carolina, were considered as a starting point for the formation of a scheme in Texas in late 2008 to settle claims arising out of hurricane Ike.²³

3.2 *The use of mediation in Australia*

ADR has an entrenched position in Australia, “conciliation” being referenced in the federal constitution as a legislative power for the resolution of disputes and its popularity has two main drivers. The first is the perceived benefit of using flexible negotiation processes to address complex technical issues. In fields such as

²⁰ *Ibid*

²¹ “Insurance Mediation Milestone” Mississippi Business Journal 26/02/07

²² James J. Donelon, Commissioner of Insurance State of Louisiana: http://www.lidi.state.la.us/whats_new/Hurricane%20Mediation%20Program%20brochure%20Revised.pdf

14 ²³ “State looks at mediation on Ike claims” Houston Chronicle 29/12/08.

insurance, this is an important motivator because it reduces the risk involved in submitting fine factual disputes to the rather blunt remedies available at law. In commercial markets, where there are increasingly few significant players following a decade of mergers, mediation also has the advantage of preserving relationships for the future and minimizing publicity.

4. *The future for the London Market?*

Litigation and arbitration will continue to be valid and widely used methods of dispute resolution in the London Market. However, there is substantial evidence of drivers that will increase the use and acceptance of mediation, often parallel to more traditional proceedings.

The significant use of mediation as a tool internationally will mean that it is increasingly requested for use in international disputes involving the London Market by parties residing in areas where it is already accepted and more widely utilised.

The main barriers to the increased use of mediation will have less impact as the process becomes more widely used and accepted, the commercial benefits more widely acknowledged, the judicial and legislative influence increases, market practices change and contractual requirements come into force.

Those policyholders, insurers and their counsel who recognise the benefits as well as the increasing pitfalls in not so doing are likely to be best placed to achieve optimum commercial benefit from its application.

David Stern

David Stern is a barrister and an accredited commercial mediator specialising in the resolution of domestic and international insurance disputes through highly developed negotiation and mediation strategies. He is also a creative litigator and has acted in a number of arbitrations, particularly under the Bermuda form. Prior to his associate tenancy with 11 Stone Buildings, he founded Settlement Counsel in 2000. David has acted in some of the most prominent domestic and international insurance coverage matters of recent times, including the WTC coverage case. David regularly leads international teams of multi-disciplinary professionals tasked to negotiate settlement of high-value and complex commercial disputes. An acknowledged expert on the London and North American Insurance Markets, David's understanding of commercial realities and highly developed negotiation and mediation skills have led to commercial settlements totalling several billion pounds. David is regularly asked to author and present keynote speeches for several international organisations, including the American Bar Association.



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