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Using ADR to Resolve Insurance Coverage Disputes

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The continuing recession has created a dilemma for policyholders involved in insurance coverage disputes. The economy has made it critical for policyholders to pursue claims that have been denied by their insurance companies, as the outstanding funds may be essential to cash flow and perhaps even fiscal survival. Moreover, concerns over the financial health of some of the world's largest insurance conglomerates have resonated with policyholders who are not willing to be patient in exchange for a date with insurance insolvency.

The emphasis on pursuing claims is, however, offset by concerns that insurance coverage disputes can be both protracted and costly to pursue. ADR can be an effective method of insurance coverage dispute resolution for policyholders attempting to pursue claims in an expedited and economical manner, especially in a particularly challenging economic climate.

As an advocate for policyholders, I have found that certain unique characteristics of insurance coverage disputes can make ADR an alluring alternative to traditional litigation in certain circumstances. At the same time, features peculiar to both the arbitration and mediation processes should be recognized and evaluated by any party considering submitting a coverage dispute to ADR.

A CONCENTRATED FOCUS

Over the past few decades, insurance recovery efforts have spawned highly complex litigation throughout the United States. Disputes between policyholders and their insurance companies are not limited to discreet areas of the law, but instead often touch upon sophisticated matters such as environmental clean-up,

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products liability, mass torts, asbestos liability and directors' and officers' liability. Moreover, high-profile catastrophic events such as Sept. 11 and Hurricanes Katrina and Rita have involved billions of dollars in disputed insurance coverage.

The magnitude and value of such claims, combined with the sophisticated subject matter often central to coverage disputes, render such disputes among the most hotly contested, protracted and costly matters.

In some cases, the litigation process does have certain advantages, including requiring meaningful participation by both sides as well as the availability of full discovery. In the current economic climate, however, the protracted and expensive nature of insurance coverage disputes often neutralizes such advantages. As is often true in any dispute, ADR can offer a concentrated focus on one or two key issues central to a coverage dispute that will serve as pressure points for resolution.

In the process, ADR can minimize or altogether eliminate the toll that litigation can take on the parties' resources, including the enormous time spent by personnel who become involved in the litigation process by way of assisting in discovery efforts or participating in depositions. Consequently, ADR can be a useful vehicle in avoiding the all-out war that is often inherent in insurance coverage claims.

THE RIGHT ADR MECHANISM

A policyholder considering ADR must determine whether arbitration or mediation is best-suited for the dispute and, in the case of arbitration, must also appreciate the potential pitfalls that accompany arbitration. In addition, policyholders must carefully evaluate the timing of when to submit a coverage dispute to ADR.

Insurance policies are increasingly requiring policyholders to arbitrate, rather than litigate, their coverage disputes. While arbitration is usually advantageous for insurance companies, there are aspects of arbitration that may also be beneficial to cost-conscious policyholders.

Arbitration offers less formal procedures than litigation, yet maintains frequently desired or necessary elements of the adversarial system such as abbreviated presentations and limited evidence. This allows the arbitrator or panel to not only focus their attention upon the interpretation of the essential policy language or exclusions at issue, but also affords the parties an opportunity to educate the arbitrator on the complexities of the underlying dispute or facts, which, as noted previously, can often involve highly sophisticated issues such as long-tail liabilities in the environmental or asbestos context.

Arbitration nevertheless presents significant concerns for policyholders. Discovery is often essential to a policyholder's case, particularly for cases involving claims of bad faith against an insurance company. Typical arbitration provisions found in insurance policies may limit the scope of discovery. In addition, other restrictions in an insurance policy, such as choice of law, can further restrict the scope of discovery.

If a policyholder is negotiating either

arbitration language in a policy or an agreement to arbitrate an existing dispute, one of the key policyholder advantages of litigation — the discovery process — must be addressed and preserved if possible.

Additionally, many insurance policies require the arbitration of a coverage dispute to be brought in foreign jurisdictions such as Bermuda or London. Foreign arbitrations force a policyholder to play a literal and metaphoric "away game," as insurance companies are far more familiar with foreign arbitrators. Furthermore, foreign arbitrations often cost significantly more than domestic litigation. Accordingly, it is critical for policyholders to appreciate these characteristics of arbitration at the time the policy is purchased and not merely when a dispute arises.

Mediation is well-tailored for disputes that do not require as paramount the interpretation of policy language or discovery on claims handling, particularly disputes that have been essentially reduced to a business decision of settlement amounts or ranges. Mediation may be the most efficient ADR mechanism if the dispute is centered upon the valuation of the loss or, in the business income or business interruption context, the period of restoration.

Because the interests and creativity of the parties and the mediator are the only limiting factors on the terms of the mediation process, any uniquely essential requirements mandated by the nature of the dispute are often negotiated at the outset of the mediation process.

Although mediation can provide a number of advantages in the context of coverage disputes, these benefits can only be realized if there is meaningful participation from both sides.

Insurance coverage mediation is particularly susceptible to being rendered useless if an insurance company fails to send the proper personnel — or any personnel other than counsel — with settlement authority. In such cases, the mediation becomes nothing more than a "free" opportunity for the insurance company attorneys to hear the policyholders' positions.

Consequently, it is imperative for policyholders and ADR professionals to insist or mandate that both parties bring to the mediation an individual with settlement authority. Making such a person available by phone is not good enough.

WHEN TO OPT FOR ADR

In addition to carefully evaluating the right ADR mechanism for a particular dispute, policyholders should analyze when the time is ripe to propose or initiate an arbitration or mediation. Voluntarily initiating arbitration when the dispute first arises may make sense if there are no enforceable contractual obligations to arbitrate contained in the insurance policy itself. This can be an attractive option when there is no real need for discovery or when no significant legal determinations are required.

A policyholder considering ADR must determine whether arbitration or mediation is best-suited for the dispute and, in the case of arbitration, must also appreciate the potential pitfalls that accompany arbitration. In addition, policyholders must carefully evaluate the timing of when to submit a coverage dispute to ADR.

In other cases, submission to ADR may make sense only after litigation is commenced and a limited amount of discovery is conducted or discreet legal issues such as the enforceability of an exclusion have been ruled upon.

While each individual dispute will have different considerations as to when the ADR process is ripe for introduction, the timing question is one that the policyholder should consider at the outset. By choosing the ADR mechanism that best fits the nature and posture of a particular coverage dispute, the parties can greatly improve the chances of success.

SPECIAL CONSIDERATIONS

The ADR process raises unique considerations to parties involved in an insurance coverage dispute. Often the relationship between the parties to an insurance coverage dispute is one that dates back some time. This is particularly likely to be true of claims involving an insurance broker who thoroughly knows the policyholder's business and insurance needs. In many instances, all parties involved have a strong interest in preserving the existing business relationships following resolution of the dispute.

Whereas the litigation process virtually guarantees that the relationship cannot be maintained, ADR is far more amenable to the preservation of such relationships, as it is geared toward a mutually satisfactory outcome.

Moreover, the private nature of arbitration proceedings can be a double-edged sword for policyholders. In certain circumstances, policyholders may benefit from the privacy of arbitration if they do not want the details of unresolved underlying claims made public. Conversely, the secrecy of arbitration is an incentive for insurance companies to advocate positions contrary to prior arguments since the position taken at arbitration cannot be subsequently used against them.

As the number of coverage disputes is likely to rise dramatically in the current economic climate, policyholders will be prone to explore and invoke ADR as a way to bring these disputes to an expedited, yet satisfactory, resolution. Although ADR can streamline an otherwise lengthy and costly process, cost-conscious policyholders should fully appreciate all aspects of the ADR process and not merely the potential economic benefits. •