Mediation of Reinsurance Disputes[(1)]

by Robert M. Hall[(2)]

Arbitration is the traditional means of resolving disputes between ceding and assuming insurers. Arbitration clauses in reinsurance contracts often specify that the arbitration will take place before a panel of current or former insurance or reinsurance company executives pursuant to relatively relaxed rules of procedure and evidence. With some exceptions, arbitrations resolve disputes faster and at less cost when compared to litigation and allows panelists more creativity in terms of remedies. On balance, arbitration has proved to be an effective means of having a third party (the panelists) resolve reinsurance disputes for parties who are unable to negotiate their own solutions.

As a prelude to arbitration, ceding and assuming companies should consider non-binding mediation of certain types of dispute. In this context, "non-binding" means that the mediator has no power to impose a result on the parties. The mediator facilitates the efforts of the parties to solve their own dispute. Should such efforts be fruitless, other remedies remain, such as arbitration.

I. **Types of Disputes Appropriate for Mediation**

Not every dispute is a likely candidate for mediation. Those which are better candidates for mediation tend to have one or more of the following characteristics.

• The cost of a full scale arbitration or litigation would be onerous;

• There is considerable uncertainty as to the outcome of arbitration or litigation;

• One or both parties cannot tolerate the risk of a complete loss;

• There is a willingness to compromise;

• There are incentives to an on-going relationship; and

• There are opportunities for joint gains.

Mediation is not likely to be successful if one or both of the parties perceive no need to compromise, wish to establish legal precedent or can communicate with each other only in terms of ultimatums.

II. **Potential Benefits of Mediation**

For appropriate disputes, mediation offers a number of benefits.

A. Control

With mediation, control of the dispute remains with the parties. They retain the power to formulate and consider various settlement proposals and to accept or reject them. The mediator has no power to impose a settlement. Thus, the parties retain the ability to accept the results of the mediation process or to reject them and proceed to other methods of dispute resolution. Since the mediation process is more akin to a business negotiation than a legal proceeding, the parties are not relegated to the largely passive role they assume in arbitration and litigation.

B. Costs

Mediation is considerably less expensive than arbitration or litigation. Usually there is no discovery which can consume months of time reviewing documents and deposing witnesses. There is no hearing which can tie up busy executives for many days in preparation and testimony. Most mediations require a day or two to complete and do not require a host of representatives from each party. One cost that the parties should not forego is advice of counsel. Objective legal advise is very important to understand: (i) the legal issues involved in the dispute; (ii) the possible or likely result of arbitration or litigation; and (iii) the ramifications of various settlement alternatives. In addition, counsel is necessary to help structure and document an appropriate compromise.

C. Confidentiality

Litigation is a public event. Even arbitration results may become public if a panel order is appealed. Since mediation usually does not involve discovery, there is little to become public except the dispute itself. The objective of mediation is to facilitate an agreement by the parties so there is no appeal of a solution imposed on the parties by panel or judge. Mediations typically are conducted pursuant to confidentiality agreements and state law often imposes confidentiality on the mediation process.

D. Focus

The entire focus of the mediation is on a successful resolution of the dispute by the parties. This encourages a higher degree of creativity in finding a mutually acceptable solution. In addition, mediation encourages the parties to focus realistically on the strengths and weakness of their relative positions before the dispute is delegated to a third party (a panel or court) for resolution. Moreover, mediation requires parties to consider areas of compromise before discovery and motion practice costs are incurred. The proverbial settlement on the courthouse steps sometimes occurs because one or both parties did not truly evaluate the strength of their cases and alternative solutions until faced with the immediacy of a trial. By that time, most litigation expenses, and a substantial portion of arbitration expenses, have already been incurred.

E. Flexibility

While mediations have stages, as noted below, there is no mandated structure or procedure to the mediation process. The mediation can be structured around the nature of the dispute involved and the best route to resolution of the dispute. For instance, the role of the mediator may vary. He or she may simply act as a facilitator offering no personal opinion on the dispute itself. The mediator may play an evaluative role privately making observations on the strengths and weaknesses of the positions of each party. The mediator may propose possible compromises and draft the compromise agreed upon. In addition, the mediator may focus the negotiations simply on the issues involved in the dispute or may broaden the discussions to focus on the relationship of the parties and their long-term goals.

F. Relationships

Litigation and arbitration often damage the relationship between the ceding and assuming company because they lock the parties into adversarial positions in a process designed to produce a winner and a loser. Mediation presents a better opportunity to preserve the working relationship since it is a cooperative effort to achieve a compromise short of an adversarial proceeding.

III. Reinsurance as a Subject Area for Mediation

Most mediations involve considerable bargaining. There are two basic types of bargaining: distributive and integrative. Distributive bargaining assumes a relatively fixed pie to be divided between the parties. If one party is selling a car for $20,000 and the other offers to buy it for $15,000, the pie is $5,000. Over an extended period of time, the parties could be expected to edge toward a middle figure of $17,500 assuming relatively equal bargaining power and the wherewithal to sell and buy at $17,500. Should the buyer attempt to short-cut the process by offering $17,500 at an early stage that may become the floor for further negotiations. The pie becomes $2,500 and a sales

price in excess of $18,000 is more likely. As a result, distributive bargaining presents an incentive to extended bargaining with incremental changes in position.

One means of obtaining more of the pie in distributive bargaining is to signal inflexibility in the bargaining process *i.e.*, a final offer. This tends to generate a similar reaction from the other party. Once "final" offers are made, it is difficult to compromise further without seeming to be losing the negotiation. While distributive bargaining is a necessary part of negotiation with certain types of disputes, it can be quite contentious and time consuming.

Integrative bargaining seeks to expand the pie by focusing on the various interests of the parties that lie beneath the positions they have taken. In this way, the parties can identify their larger goals and find ways to achieve these goals, both with respect to past events and future opportunities, without exacting maximum toll on the other party. In this way, the negotiation process becomes less of a war of attrition and more of a collaborative effort.

With certain exceptions (*e.g.*, companies which are in runoff or insolvent), reinsurance presents an ideal subject for integrative bargaining. The parties are sophisticated and creative. The transactions often are multi-faceted with many opportunities to restructure. There is an emphasis on long-term relationships. This provides fertile ground for a mediator to facilitate an approach which allows the parties to move past distributive bargaining to integrative bargaining in order to resolve the dispute and do business in the future.

For instance, a reinsurer may be less concerned with a sum claimed by a cedent than: (a) timing of payments; (b) financial statement impact; (c) categorization of the payment; (d) impact on aggregate limits; (e) establishment of a course of dealing; (f) ability to collect from retrocessionaires; (g) adjustment of sliding scale commissions or retrospective rates; (h) future rates; or (i) access to other business. Such a situation provides considerable room to compromise.

Anecdotal evidence, however, indicates mixed results for mediations in the reinsurance context. In some cases, experienced industry executives have been used as mediators, however, they did not have the training necessary to properly perform the facilitator role. In other cases, experienced mediators were retained, however lack of insurance industry knowledge hampered their ability to understand, evaluate and articulate various compromise alternatives. Mediation will become a more successful dispute resolution process in the reinsurance arena when those with industry experience obtain the training necessary to develop the knowledge and skills appropriate to a successful mediator.

IV. Stages of Mediation

While mediations may vary considerably in structure, many have the following stages.

A. Convening

In this stage, the parties to the dispute discuss the use of mediation and select a mediator. The parties, with the assistance of the mediator, set the terms of the mediation *e.g.*, the parties and issues, location, time period for the mediation, use of pre-mediation briefs, confidentiality and compensation.

B. Opening

In this stage, the parties are brought together and the mediator becomes acquainted with outside counsel as well as the party representatives. This assists in establishing a rapport which is often essential to a successful mediation. The mediator will confirm the issues present in the dispute and establish an agenda of matters to be resolved. In addition, the mediator will:

• Explain the mediation process;

• Explain his or her role as a facilitator rather than a decision maker;

• Answer questions;

• Confirm that the party representatives present have the authority to settle the dispute; and

• Have a confidentiality agreement signed by each party as well as the mediator.

C. Communicating

In this stage the mediator explores the parties' perception of the dispute as well as the underlying interests which have influenced the positions taken by the parties. Some mediators conduct much of the mediation through private discussions with each side in a sort of "shuttle diplomacy." This process is designed to explore matters which are to be kept confidential from the other party. During this stage the mediator will explore with each party:

• The perceived strengths and weaknesses of its position;

• The perceived expectations of the other party;

• Priorities and motivations;

• Hidden values and interests; and

• Avenues which may produce compromise.

D. Negotiating

In this stage the mediator assists the parties in formulating, presenting and evaluating compromise proposals. The mediator may need to serve as a reality check for those with unreasonable expectations concerning a resolution of the dispute and to remind the parties of the cost and uncertainty involved in a solution imposed by a court or arbitration panel. In this way the mediator gradually eases the parties to a resolution.

The most valuable mediator is one who can assist the parties in expanding the solution alternatives beyond those previously considered through integrative bargaining. This promotes a shared "ownership" of the compromise and increases the opportunity for a "win-win" solution.

It is at the negotiation stage that both industry knowledge and mediation training is most valuable. This combination allows the mediator to assist the parties in moving toward a solution which reflects the history and mores of the insurance industry as well as the interests of the parties themselves.

E. Closing

Organizations that promote mediation as a means of dispute resolution claim that approximately 80% of mediated disputes are settled. Some do not settle immediately but only after the parties have considered the results of the mediation. If a compromise is reached at the mediation, however, it is important for the mediator to detail it immediately while both parties are present. A written document signed by both parties is the desired methodology.

Some mediations are unsuccessful. If the parties have explored unsuccessfully various areas of compromise, they are free to engage in more formal methods of dispute resolution such as litigation or arbitration.

V. Conclusion

While reinsurance disputes seem to be fertile ground for mediation, this dispute resolution technique currently is being underutilized. Mixed results to date suggest that the utility of this technique will improve when mediators have both insurance industry experience and training in the skills appropriate to the mediation process.

Mediation is not a substitute for arbitration since there are some disputes which cannot effectively be compromised and some parties who seek the sort of win/lose alternative offered by arbitration or litigation. Mediation does, however, offer a less costly opportunity for the parties to compromise their dispute before expending the necessary costs and engaging in the uncertainties of arbitration or litigation.

Back to the Home Page of Robert M. Hall

ENDNOTES

1. This article was previously published by Mealey's Reinsurance Reports.

2. Mr. Hall practices insurance and reinsurance law, and is active in both arbitrations and mediations. The views expressed in this article do not represent the opinions of Mr. Hall's clients. Comments and questions can be addressed to *robertmhall@erols.com*.