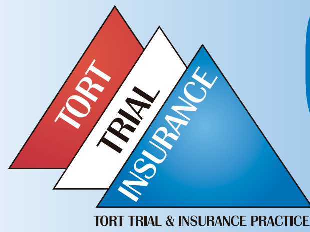

Committee News

ABA Defending Liberty Pursuing Justice

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Alternative Dispute Resolution Committee

BINDING ARBITRATION CLAUSES NO LONGER BIND POLICYHOLDERS IN WASHINGTON

By: Matthew J. Sekits and Daniel R. Bentson

It goes without saying that litigation is often expensive and unpredictable. To help curb these costs and risks, many businesses include mandatory arbitration provisions in their consumer contracts. And today, insurers are no exception. Insurance policies of all types frequently include arbitration provisions. For example, a typical arbitration provision in an insurance policy might read as follows:

> Should we and the insured disagree as to the rights and obligations owed by us under this policy, including the effect of any applicable statutes or common law upon the contractual obligations otherwise owed, either party may make a written demand that the dispute be subjected to binding arbitration.[1]

In Washington, however, such arbitration provisions are no longer enforceable in an insurance contract. In *Washington Department of Transportation v. James River Insurance*, the contractor on a state highway project named the DOT as an insured under the contractor's liability policy with James River.[2] After a car accident at the project site, representatives of those killed and injured in the accident sued the contractor and the DOT.[3] The DOT tendered the defense of the suit to James River and James River accepted under a reservation of rights.[4]

Later, due to a coverage dispute between James River and the DOT, James River attempted to enforce

Continued on page 8

1 *Wash. Dep't of Transp. v. James River Ins. Co.*, __ Wn.2d __, 292 P.3d 118, 120 (2013) (internal quotation omitted).

2 *Id.*

3 *Id.*

4 *Id.*

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MESSAGE FROM THE EDITORS

We welcome your contributions to the newsletter. If you have an article to submit or you know someone else who might like to submit an article, please contact one of the editors, Derek Lisk at dlisk@liskmediator.com or Timothy Penn at tpenn@travelers.com. ⚖

Derek Lisk and Timothy Penn
Newsletter Editors

The ADR National CLE Forum In Washington D.C. Was A Great Success!

Our full-day CLE program, co-sponsored by the TIPS Alternative Dispute Resolution and Excess, Surplus Lines & Reinsurance Committees, was comprised of five dynamic panel discussions on hot topics in arbitration and mediation:

Navigating Multi-Party ADR
Mediating the High-Profile Controversy
Innovations and Strategies for Complex Mediation
How to Lasso Run-Away Arbitration
How to Succeed in a Multi-National ADR

The program featured panelists from a wide variety of professional paths, including academia, private practice, and government work, and included ADR professionals, as well as in-house and outside counsel. Overall, it was very well attended, with a uniquely large contingency of government employees involved in ADR (capitalizing on the DC location). Ample audience participation – with questions, as well as practice observations – made for a very dynamic exchange and a highly engaging program all around. Renowned mediator Ken Feinberg gave the luncheon keynote address to a full house, and the day concluded with a cocktail reception hosted by Crowell & Moring overlooking Pennsylvania Avenue and the Capitol Building. It was a fantastic start to a historic 80th Anniversary weekend for TIPS.

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MAKING BRACKETS WORK AT MEDIATION

By: Steven N. Joseph, Esquire, Second Vice President, *Western World Insurance Group*

"I hate brackets." If you polled lawyers who mediate on a regular basis, a large number of them would give that response. And you can see why many would have strong feelings about brackets when they have had a bad experience with them. Here are three different scenarios, and these strong feelings become clear.

Scenario 1

Counsel represents an attorney in a legal malpractice action. The opening offer and demand are $50,000 and $2 million. At the end of the mediation, the parties are at $250,000 and $1 million respectively. The mediator declares an impasse, and the parties remain at their respective positions. After further discovery is completed which proves beneficial to the defense of the case, the parties return to mediation. The case gets resolved at $400,000.

Scenario 2

Same case. The parties move to the $250,000 and $1 million offers and demand. The mediator then suggests a bracket between $400,000 and $800,000. Before the bracket, counsel had provided an evaluation of the settlement value of the case to be somewhere between $300,000 and $400,000. Plaintiff's counsel accepts the bracket proposed by the mediator, and with added pressure employed by the mediator, defense counsel, the client, and insurance company representative reluctantly accepts the bracket. Negotiations continues, and the case settles at $650,000.

Scenario 3

Again, same case. The parties have the same initial offers at $50,000 and $2 million. The $50,000 offer is in response to the $2 million demand. Plaintiff's counsel then proposes a bracket of $1.95 million and $1.25 million. The parties on the defense side rejects that bracket, and proposes a competing bracket of $100,000 and $500,000. Since the brackets are far apart, both sides want to declare an impasse. The mediator then tries to save the mediation (and keep his success ratio intact) and proposes a bracket of $500,000 and $1.2 million. Defense counsel had provided the same evaluation for settlement as in Scenario 2. They reluctantly agree to negotiate in the bracket proposed by the mediator, and the case ultimately settles for $850,000.

In both Scenarios 2 and 3, the introduction of the brackets changed the dynamic of the negotiation. The cat is out of the bag. In both Scenario 2 and 3, even if the defense side had rejected the proposed bracket, plaintiff and plaintiff's counsel will see this as a fall back position, even if they do not agree with the proposal. The defense side has lost credibility with their proposal, even if the numbers they had proposed were credible numbers from a liability vantage point.

The other problem for the defense with the above 2nd and 3rd scenarios is that the numbers represent a huge compromise in their negotiation position. If the defense attorney accepts a bracket on behalf of the client, a clear signal is being sent that the client has a willingness to go to the midpoint of the bracket. In scenario 2, though not verbalized, the offer moves from $250,000 to $600,000. In scenario 3, the unspoken new offer moves off of $300,000 to $850,000.

Any competent negotiator would not feel comfortable with such a drastic move off of their settlement position. Not only was this a huge move off of their negotiation position, but both numbers were well above the recommended settlement number. In scenario 3, it was more than double the amount that defense counsel had recommended for settlement. The case settles, but not without some hard feelings of having overpaid to settle the case.

This article discusses how to make brackets work at mediation. From a plaintiff's counsel's perspective, scenario 3 is exactly how to make brackets work for them. The first bracket proposed is a false bracket or a clever decoy. It is not being put out with any serious intent that the bracket will be accepted. In fact, plaintiff's counsel is 100% confident that the bracket will be rejected. But, the trap has been set. In scenario 3, the defense side put out a bracket that they viewed as the appropriate bracket. It represented a settlement range that they had in mind from the start. Defense counsel may not have been confident that the bracket would be accepted, but it was made with an honest intent on how they had seen the case.

Once the trap had been set, a third bracket is then proposed that is between the two original brackets. The plaintiff's attorney shows a deep reluctance to go into this bracket. It is represented that this is a grand

compromise on their part. The client is furious, and has very hard feelings over the process. They tell the mediator that because of this great sacrifice, they now want to see results. Because they are accepting this compromised third bracket, they make it clear that they want to end up at the top of the bracket.

However, this was their plan all along. They are exactly where they had intended to be. And, what is the mediator supposed to do? They put a significant amount of pressure on the mediator, and the mediator is compelled to show some results.

The case settles at $850,000. Crocodile tears are flowing from the plaintiff. No handshakes are exchanged once the deal was done. But, in private, smiles and hugs. The plan was executed to perfection.

From the defense side, this can be avoided. First, no one put a gun to their head to accept the bracketing process as the means for negotiation. Brackets can be rejected outright. In scenario 3, the defense team can simply point out that the plaintiff has an unrealistic view of the case, and "while we are willing to continue to negotiate based on a discussion of the issues, we are simply not willing to negotiate with brackets as the basis for the negotiation."

The problem that arises with bracketing is that too often, once the bracketing begins, the facts and the law leave the negotiation process. It becomes all about the bracket. In scenario 3, one is too cold, and the other too hot. So like in the story of Goldilocks and the Three Bears, the mediator becomes Goldilocks and selects the bracket that appears to be just right.

The key here is not to walk away from brackets, but rather, in a counterintuitive way, embrace them.

The Reasonable Home Run

While you spend time with the mediator in the private caucus room, while a single number may be put out as offers, all the discussions revolve around brackets. The obvious first bracket is exactly what can happen at trial. Plaintiff's counsel suggests that the jury will come back with a very large number. Defense counsel will suggest that they will get a defense verdict.

However, if the defense side spends the entire time in the private caucus session talking about a zero award, they lose credibility, and from a risk management perspective, they cede power to the mediator to act as the risk manager. To avoid this scenario, the defense side has to direct the conversation to what would termed as a "reasonable home run." I call it "reasonable" because it presumes that the plaintiff's counsel will ask for a very high number and there is also a chance for a defense verdict. The reasonable home run presumes that plaintiff's counsel will do an excellent job on behalf of his or her client. It also presumes that defense counsel too will do a superb job before a jury. We want to get away from a negotiation that literally suggests that the plaintiff's attorney is wonderful, and defense counsel just passed the bar and can't find the courtroom. Unless defense counsel truly just passed the bar, this is a very easy concession to come by at mediation.

Now, because we can agree that defense counsel actually knows how to try a good case, we can move the negotiation away from the astronomical numbers that plaintiff's counsel may suggest. The jury award number gets a bit lower. Then, if defense counsel factors in the time and cost that plaintiff will incur to get to trial, the "reasonable home run" is further reduced.

So, getting back to the scenarios above, I want to be clear that because this is a mediation, I do not want to simply go up to the pitcher's mound, and suggest that the pitcher gives up a home run intentionally. The number needs to be a compromise number. I can represent that, in this case, the "reasonable home run" is $500,000. I just created a bracket of $0 and $500,000. I backed it up by who the players are, the type of case we have, and the facts as well as law. I hope to have made a compelling case that, during the course of the mediation, it would no longer be credible to even suggest a bracket of $400,000 and $800,000, or $500,000 and $1.2 million. I used brackets without ever offering a bracket to the other side.

Multiple Brackets

Just in the same way that plaintiff's counsel used "multiple" brackets to their advantage, defense counsel can use the same strategy. There is one big difference here. In the above scenario, the defense side settled that case after being put in an awkward situation by the mediator, and walked away with the feeling that they were beaten and taken advantage of by the mediator, the plaintiff's counsel or both.

However, from the defense side, we want to create the impression that the plaintiff won the battle at mediation. Instead of thinking of a "reasonable home run" as a single number, the thought process going into a mediation is that there is a certain dollar range in which the "reasonable home run" resides in. You would present the "low range" number to the mediator,

and it is important that this number be a credible number because you want to maintain credibility with the mediator. The "high range" number is not for general consumption, but you have that in mind in your preparation for the mediation.

Let's get back to the original scenario posed. But, we will change the evaluation from the defense side. The exposure at trial is $2 million. The settlement range is between $800,000 and $1.2 million. But, because of the defenses raised, a good faith presentation can be made that the "reasonable home run" would be $600,000. You also know that a more conservative "reasonable home run" can be as high as $1.2 million, the high end of the settlement value you have placed on the case.

The initial demand is $2 million, and an offer of $100,000 is made. After a few rounds of back and forth, the parties are far apart. Plaintiff's demand is $1.75 million, and the last offer is $250,000. The mediator (or any of the parties negotiating) suggests that each party proposes a bracket. Plaintiff's counsel suggests a bracket of $1.2 million and $1.6 million. The defense side then proposes a bracket of $300,000 and $600,000.

Plaintiff's counsel may be infuriated. They read the defense bracket as a signal to go up to the midpoint at $450,000, and draw a fair conclusion that the defendant would pay up to $500,000 to settle the case.

Now, where do we go from here? The key is that you came prepared and did an excellent job presenting to the mediator that the "reasonable home run" as being the $600,000 number. If you have successfully convinced the mediator of your position, you can then get a lot of effort from the mediator to work in your corner by confiding that "to get the case settled today," you would consider going beyond even the $600,000 number that you convinced the mediator would be a likely outcome at trial.

Two things can then happen here. The midpoint between the two high numbers (of $600,000 and $1.2 million is $900,000. The mediator logically maybe considering the $900,000 as a good compromise between the numbers and direct the parties to go to that number. The mediator proposes a "mediator's bracket" of $600,000 and $1.2 million, and the case settles at $900,000.

But, I want the mediator to be considering something else. By having my high number in the first bracket at $600,000, and indicating some "hesitant" willingness to move even above that, the mediator has to guess where I would likely go. Not too high, and not too low. Even though I never mentioned any number, the mediator believes that I would go up to $750,000.

The mediator also has been given sufficient ammunition that the $600,000 number is a very possible outcome at trial, and that the folks on the defense side firmly are entrenched in that belief. The mediator suggests a bracket between $600,000 and $1 million. After a few more rounds, the case settles at $800,000. This is the low point of the original settlement range. The defense side is happy because that is where they wanted to end up. The plaintiff's side is happy, but less so, because they believe they got $300,000 more than they thought the defense side was prepared to pay.

Conclusion

The reason that many attorneys "hate brackets," as the beginning of this article suggested, is that they have a misguided belief that if they propose a bracket, it will be embraced by the opposing side, or at the very least, there will be overlapping brackets that the parties can try to find a middle ground. Those attorneys will always be disappointed, and end up with a worst result than if they negotiated in a straight dollar amount negotiation. The key to making brackets work, whether you are representing the plaintiff or the defendant, is first set up a bracket of likely outcomes at trial (e.g., $0 to $600,000) in the private caucus, even before a bracket negotiation begins, and then, understand that you will likely need to propose at least two brackets to get the case in a desired range.

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BINDING ARBITRATION...

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the policy's arbitration provision.[5] The DOT resisted arbitration and sued James River in state court, seeking a declaration that the policy's binding arbitration provision was unenforceable.[6] The trial court ruled in favor of the DOT.[7] James River appealed and the Washington Supreme Court granted direct review.[8]

1. Arbitration clauses deprive a court of jurisdiction over the original action.

The first issue on appeal concerned the proper interpretation of a Washington statute governing insurance policies—that is, did the statute prohibit mandatory arbitration clauses? The relevant statutory text said:

> (1) No insurance contract delivered or issued for delivery in this state and covering subjects located, resident, or to be performed in this state, shall contain any condition, stipulation, or agreement
>
> * * *
>
> (b) depriving the courts of this state of the jurisdiction of action against the insurer . . . .[9]

The DOT and James River disagreed regarding the meaning of this statutory language. The DOT argued that the legislature intended the language as an anti-arbitration provision but, according to James River, the legislature only intended to prohibit forum selection clauses.[10]

The Washington Supreme Court sided with the DOT. The court distinguished between a court's jurisdiction over an "original action" and its jurisdiction over a "special proceeding to confirm an arbitration award."[11] Although arbitration did not deprive courts of the latter, it impermissibly deprived them of jurisdiction over the original action. According to the court, "binding arbitration agreements deprive our state's courts of the jurisdiction they would normally possess in an original action by depriving them of the jurisdiction to review the ***substance*** of the dispute between the parties."[12] The court, therefore, held that the policy's binding arbitration provision was unenforceable under Washington law.[13]

2. The Federal Arbitration Act does not preempt state laws prohibiting binding arbitration provisions.

Because the Washington Supreme Court found that the state statute prohibited the policy's arbitration provision, it next addressed whether federal law preempted the state statute. The court noted that the Federal Arbitration Act ("FAA") generally preempts state statutes prohibiting arbitration agreements.[14] But there is an exception to this general rule.

Under the McCarran-Ferguson Act, state laws "regulating the business of insurance" are saved from preemption.[15] Under that act, federal law does not preempt a state law if: (1) the federal statute does not specifically relate to the business of insurance; (2) the state law was enacted for the purpose of regulating the business of insurance; and (3) the federal statute operates to invalidate, impair, or supersede the state law.[16] The parties did not dispute that the FAA does not specifically relate to insurance and the court had already determined that the FAA would invalidate the state anti-arbitration statute if applied.[17] The only issue remaining, then, was whether the state statute regulated the business of insurance.[18]

5 *Id.*
6 *Id.*
7 *Id.*
8 *Id.*
9 RCW 48.18.200(1)(b).
10 *James River*, 292 P.3d at 121-22.
11 *Id.* at 122. The court cited *Price v. Farmers Ins. Co. of Wash.*, 133 Wn.2d 490, 946 P.2d 388 (1997) in support of this distinction. The court, however, did not address *Price*'s apparent approval of binding arbitration provisions in the insurance context. *See Price*, 133 Wn.2d at 498 ("Although an arbitration clause could submit coverage questions to arbitration, that is not our case . . . ."). *See also Godfrey v. Hartford Cas. Ins. Co.*, 142 Wn.2d 885, 892 and n. 3, 16 P.3d 617 (stating that the parties could agree by contract to resolve their disputes over UIM coverage by arbitration).
12 *James River*, 292 P.3d at 123 (emphasis in original).
13 *Id.* In a previous unpublished opinion, a federal district court in the Western District of Washington reached the exact opposite conclusion, holding that RCW 48.18.200(1)(b) did not deprive the courts of jurisdiction. *Boeing Co. v. Agric. Ins. Co.*, 2005 WL 2276770 at *5 (W. D. Wash. 2005).
14 *James River*, 292 P.3d at 123.
15 *Id.* at 124 (quoting 15 U.S.C. § 1012(b)).
16 *Am. Bankers Ins. Co. of Fla. v. Inman*, 436 F.3d 490, 493 (5th Cir. 2006).
17 *James River*, 292 P.3d at 124.
18 *Id.*

The court held that the state statute regulated the business of insurance and, thus, it was saved from preemption.[19] In arriving at this holding, the court cited to a previous Washington Supreme Court opinion saying that, in the insurance context, the McCarran-Ferguson Act saved prohibitions on arbitration agreements from preemption.[20] And the court cited numerous out-of-state cases that reached the same conclusion.[21] Because federal law did not preempt the statutory anti-arbitration provision, the binding arbitration provision in the James River policy was unenforceable.[22]

3. Statutory text controls the future of binding arbitration in the insurance context.

With respect to federal preemption, *James River*'s holding is consistent with the decisions of most federal courts.[23] Its more controversial holding, however, is that arbitration deprives courts of their jurisdiction over an "original action."

Courts take different views on whether arbitration deprives courts of jurisdiction. For example, in *Macaluso v. Watson*,[24] a Louisiana statute provided that a policyholder had the option to enforce an arbitration provision contained within a UIM policy; an arbitration provision, however, could not purport to deprive the Louisiana courts of jurisdiction.[25] The policyholder's UIM insurer sought to enforce a binding arbitration provision in his UIM policy but the court held that the binding arbitration provision deprived the Louisiana courts of jurisdiction and, thus, violated the statute.[26]

Alternatively, in *DiMercurio v. Sphere Drake Insurance*,[27] the First Circuit addressed a Massachusetts statute, much like the statute at issue in *James River*, which generally prohibited insurance policies from depriving courts of jurisdiction. The court reviewed the history and development of the weakening of judicial hostility towards arbitration and, in line with the modern view, held that the insurance policy's binding arbitration provision did not deprive courts of jurisdiction.[28] Thus, the arbitration provision was enforceable.[29]

DiMercurio follows the modern view that arbitration does not deprive a court of jurisdiction. In that case, historical arguments about changing judicial attitudes towards arbitration ultimately persuaded the First Circuit that binding arbitration did not deprive the Massachusetts courts of jurisdiction. According to the court, historically, both British and American courts refused to enforce arbitration agreements, based on the view that such agreements "ousted" courts of their jurisdiction.[30] The court determined that the traditional view has now lost most, if not all, of its legitimacy.[31] Under *DiMercurio*'s reasoning, then, an agreement to arbitrate is just a contractual provision, which courts should enforce like any other terms in the contract.[32]

James River, however, demonstrates the continuing vitality of the traditional view. There, the insurer made the same historical arguments regarding the judiciary's evolving acceptance of arbitration.[33] Nevertheless, the court sided with the traditional view, holding that an arbitration provision that deprives a court of the ability

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19 *Id.*

20 *Id.* (citing *Kruger Clinic Orthopaedics, LLC v. Regence Blueshield*, 157 Wn.2d 290, 138 P.3d 936 (2006)).

21 *Id*. at n. 5 (cases cited therein).

22 *Id*. at 124,

23 *See*, *e.g.*, *Inman*, 436 F.3d at 493; *McKnight v. Chicago Title Ins. Co.*, 358 F.3d 854, 858 (11th Cir. 2004); *Standard Sec. Life Ins. Co. of N. Y. v. West*, 267 F.3d 821, 823 (8th Cir. 2001); *Stephens v. Am. Int'l Ins. Co.*, 66 F.3d 41, 45-46 (2d Cir. 1995); *Mut. Reinsurance Bureau v. Great Plains Mut. Ins. Co.*, 969 F.2d 931, 935 (10th Cir. 1992).

24 171 So.2d 755 (La. Ct. App. 1965).

25 *Id*. at 756. The statute was not in effect at the time of the policyholder's initial lawsuit but the court applied the statute retroactively. *See id*. at 755-56.

26 *Id*. at 757. The Louisiana Supreme Court later approved of *Macaluso*'s holding in *Doucet v. Dental Health Plans Mgmt. Corp.*, 412 So.2d 1383, 1384 (La. 1982).

27 *DiMercurio v. Sphere Drake Ins., PLC*, 202 F.3d 71 (1st Cir. 2000).

28 *Id*. at 81. *DiMercurio* is not alone in holding that arbitration provisions do not deprive courts of jurisdiction. *See, e.g.*, *Cranston Teachers Ass'n v. Cranston School Comm.*, 386 A.2d 176, 178 (R.I. 1978).

29 *DiMercurio*, 202 F.3d at 81.

30 *Id*. at 76 n. 5 (quoting H. R. Rep. No. 96, 68th Cong., 1st Sess., 1-2 (1924)).

31 *Id*. at 26 (citing *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626-27, 105 S. Ct. 3346, 87 L. Ed. 2d 444 (1985)).

32 *See id*. 202 F.3d at 76 ("Agreements to arbitrate are now typically viewed as contractual arrangements for resolving disputes rather than as an appropriation of a court's jurisdiction."); *see also Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219, 105 S. Ct. 1238, 84 L. Ed. 2d 158 (1985) ("The House Report accompanying the [FAA] makes clear that its purpose was to place an arbitration agreement 'upon the same footing as other contracts, where it belongs[.]'") (quoting H. R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924)).

33 *See James River*, 292 P.3d at 122.

to decide the merits of a case deprives the court of jurisdiction and is, therefore, unenforceable.[34]

Although judicial hostility towards arbitration may be declining, coverage counsel should be aware that persuasive arguments against the enforceability of such arbitration provisions may still carry the day. Together, *DiMercurio* and *James River* make clear that the enforceability of arbitration provisions now turns largely on the construction of both state and federal statutes.

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34 *See id.* at 122-23. *James River* expressly stated that "even if we accepted James River's argument that arbitration does not deprive the courts of this state of 'jurisdiction,' this determination does not end our inquiry." *Id.* at 122. But the court ultimately concluded that binding arbitration provisions violated the Washington statute because they deprived courts of "jurisdiction to review the *substance* of the dispute between the parties." *Id.* at 123. Moreover, the court approved of the Louisiana Court of Appeals' analysis in *Macaluso*. *Id.* *James River*, thus, despite its statements to the contrary, appears to side with the traditional view that arbitration ousts a court of jurisdiction.

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October 2013

8-13 **TIPS Fall Leadership Meeting** — **Minneapolis Marriott Hotel, Minneapolis, MN**
Contact: Felisha A. Stewart – 312/988-5672
Speaker Contact: Donald Quarles – 312/988-5708

13 **Symposium: Animal Shelter and Rescue Law** — **Hyatt Regency Jacksonville, Jacksonville, FL**
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17-18 **Aviation Litigation Fall Meeting** — **Ritz-Carlton, Washington, DC, Washington, DC**
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November 2013

6-8 **Fidelity & Surety Committee Fall Meeting** — **The Fairmont Copley Plaza, Boston, MA**
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January 2014

16-18 **40th Annual Midwinter Symposium on Insurance Employee Benefits** — **The Driskoll, Austin, TX**
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21-25 **Fidelity & Surety Committee Midwinter Meeting** — **Waldorf~Astoria Hotel, New York, NY**
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February 2014

5-11 **ABA Midyear Meeting** — **Swissotel Chicago, Chicago, IL**
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