Mediation confidentiality and insurance bad faith

Don't let the law of mediation confidentiality keep your offer to settle out of evidence in a bad-faith action

By Alexander F. Stuart

Confidentiality is vital to mediation. It encourages open communication, the currency of successful compromise bargaining. The Legislature has instructed that confidentiality permeates the entire mediation process. California Evidence Code section 1119 provides that no statement made or writing prepared "for the purpose of, in the course of, or pursuant to, a mediation" is admissible in non-criminal proceedings as evidence or subject to discovery.

The Supreme Court has interpreted section 1119 broadly. It protects not only communications between parties to mediation, but even between parties and non-parties who participate in the mediation process.[1] A writing prepared for the purpose of, in the course of, or pursuant to mediation is inadmissible for any purpose.

Liability insurers sometimes assert mediation confidentiality as a shield to avoid bad-faith exposure when the opportunity to settle within policy limits arises.[2] What better way for an insurer to protect itself than to assert that a reasonable settlement demand was communicated "pursuant to" mediation, and thus inadmissible to prove bad faith?

This article examines the clash between mediation confidentiality and insurance bad faith, and begins with a brief history of an insurer's duty to settle.

Insurer's duty to settle

There once was a time when a liability insurer could gamble with its insured's money. An insurer could reject a reasonable settlement demand within policy limits, take the case to trial, and upon losing sums in excess of policy limits, counsel its insured to petition for bankruptcy protection. The Legislature made sure that certain injured plaintiffs (those suffering bodily injury or property damage) could still collect the insurance proceeds.[3] The poor insured, however, was forced to suffer bankruptcy's sting.

California's courts eventually altered the stakes, holding that insurers could only gamble with their own money when presented a reasonable settlement demand within policy limits. In *Comunale v. Traders & General Ins. Co.*, the Supreme Court held:

> When there is great risk of a recovery beyond the policy limits so that the most reasonable manner of disposing of the claim is a settlement within those limits, a consideration in good faith of the insured's interest requires the insurer to settle the claim. Its unwarranted refusal to do so constitutes a breach of the implied covenant of good faith and fair dealing.[4]

Comunale spawned broader protections for policyholders over the following decades. In *Johansen v. California State Auto. Assn. Inter-Ins. Bureau,* the Supreme Court held that an insurer may not consider coverage defenses in evaluating reasonable settlement demands within policy limits.[5] In *White v. Western Title Ins. Co.,* the Supreme Court held that an insurer cannot protect its settlement offers from admissibility in a bad faith lawsuit.[6]

White intimated that enforcing an insurer's duty to settle is paramount to all other rules governing settlement communications. But is that protection paramount to mediation confidentiality?

Mediation confidentiality

> In order to encourage the candor necessary to a successful mediation, the Legislature has broadly provided for the confidentiality of things spoken or written in connection with a mediation proceeding."[7] Sometimes incorrectly described as "the mediation privilege," mediation confidentiality is statutorily prescribed at sections 1115 through 1128 of the California Evidence Code.[8]

The Supreme Court has held that the statutory scheme is clear; the court "must apply the plain terms of the mediation confidentiality statutes . . . unless such a result would violate due process, or would lead to absurd results that clearly undermine the statutory purpose."[9]

No evidence of anything said, any admission made, or any writing prepared "for the purpose of, in the course of, or pursuant to a mediation" is admissible or subject to discovery in any arbitration, administrative adjudication, civil action or other non-criminal proceeding in which testimony can be compelled by law.[10] In construing whether a statement or writing is "for the purpose of, in the course of, or pursuant to mediation," courts must consider "the timing, context and content of the communication."[11] Communications are protected by mediation confidentiality if they are "materially related to" the mediation.[12]

Settlement communications occurring between mediation sessions are not always "materially related" to mediation.[13]

In *Wimsatt v. Superior Court,* an intermediate appellate court held that a settlement conversation, which occurred during a phone call to schedule expert depositions, was not protected by mediation confidentiality because the conversation took place "in the regular course of litigation."[14] The objecting party failed to present facts demonstrating that the settlement discussion "was anything other than a routine discussion, unassociated with mediation that routinely occurs in civil litigation."[15]

Although the Supreme Court has cited *Wimsatt* with approval, the court has yet to decide "the precise parameters" of the triggering phrase "for the purpose of, in the course of, or pursuant to a mediation."[16] Anyone asserting mediation confidentiality has the burden to prove that the statutory protection applies.[17]

Resolving competing interests

Assume Peter sues Dan for injuries suffered in a car accident. Dan tenders his defense to Insurer, who agrees to defend the lawsuit. The matter proceeds to mediation. Insurer is invited to, and participates in, the first of two scheduled mediation sessions. In advance of the first session, Peter delivers a mediation brief analyzing liability and damages, and concluding there is a substantial likelihood of a judgment exceeding Dan's policy limits. The mediation brief demands payment of the limits.

Insurer rejects the demand at the first session, and counters with an unreasonably low offer that infuriates Peter. The first mediation session ends, and the second mediation session is cancelled. The case proceeds to trial, Peter recovers twice the limits of Dan's policy, and Dan later sues Insurer for bad-faith failure to settle.

May Dan offer evidence of Peter's settlement demand in his bad-faith lawsuit against Insurer?

There is no case law directly on point. Evidence Code section 1119 provides that any writing prepared "for the purpose of, in the course of, or pursuant to a mediation" is inadmissible. Peter's settlement demand was set forth in a writing prepared for the purpose of mediation; it was materially related to a mediation. Insurer had no notice that Peter or Dan intended to use the demand as evidence of insurance bad faith. Unless the parties agree to waive mediation confidentiality, the demand most likely cannot be offered to prove Insurer breached the duty of good faith and fair dealing.

Assume Peter and Dan waive mediation confidentiality as the only "parties" to the mediation. The result should be the same. Insurer has its own right to assert confidentiality as a "participant" in the mediation.[18] While an argument can be made for applying the Supreme Court's *White* analysis to settlement demands presented to an insurer in mediation proceedings, it is likely that courts will hold section 1119 protects all writings materially related to mediation. To hold otherwise would potentially open the door to admissibility of mediation discussions, undermining the "open communication" purpose of mediation confidentiality.[19]

So what could Peter and Dan have done differently before the personal injury lawsuit was tried?

For starters, they could have agreed that Peter would deliver another written demand after the first mediation session ended, labeling the demand "outside mediation" and intended for admissibility in a bad-faith lawsuit. Dan could then deliver the written demand to Insurer. Peter's demand would need to specify a reasonable time for Insurer to communicate acceptance.[20] Depending on the level of Insurer's knowledge of liability and damages (based on information obtained outside of mediation), the period could be short or long. Erring on the side of fair time is advisable.

What could Peter and Dan expect from this "outside mediation" process?

Depending on Insurer's attitude, they could receive anything from (1) a simple acknowledgement letter, to (2) an "inside mediation" letter challenging admissibility of the subsequent settlement demand on grounds that it was communicated between mediation sessions. Since delivery of the demand is itself a communication, Insurer might claim that there is no agreement between Peter and Insurer or Dan and Insurer that mediation confidentiality is waived. While such a position would be technically accurate, there is no evidence that the Legislature intended to immunize insurers from the effect of written demands "outside mediation" where the demands are silent relative to anything said or done at mediation.[21]

Indeed, if written demands "outside mediation" were still cloaked with mediation confidentiality, the same could be said of statutory offers under Code of Civil Procedure section 998. Litigants could use the mediation process to thwart the consequences of an otherwise effective 998 offer made by any party to the action. It is doubtful the Supreme Court would sanction such assertion of mediation confidentiality. Taken one step further, insurers could never issue effective reservation of rights letters between mediation sessions were all communications between sessions deemed inadmissible under Evidence Code section 1119.[22]

The better view is that written demands "outside mediation," like 998 offers and reservation of rights letters, are not "prepared for the purpose of, in the course of, or pursuant to, a mediation," and thus are not protected by mediation confidentiality. Even where the parties agree to return to mediation, the purpose of a written demand "outside mediation" is simply to communicate a settlement position that triggers important legal rights and duties. Unless a written demand comments on something said or done at mediation, it should be considered "routine" to civil litigation and thus admissible to prove breach of the implied covenant of good faith and fair dealing later.

So what else could Peter and Dan have done differently before the personal injury lawsuit was tried?

They could have ended the mediation before Peter delivered his written

demand "outside mediation." Evidence Code section 1125 provides that mediation is deemed to conclude ten days after the last communication between a party and the mediator. Section 1125 also provides that mediation ends when the mediator provides the mediation participants with a writing signed by the mediator stating that the mediation is terminated, "or words to that effect."

The statutory termination procedure has practicality for Peter and Dan, who never returned to mediation. However, it does not have practicality for parties to complex litigation where mediation often stretches months or years over a multitude of sessions, and where mediators frequently engage the parties in settlement discussions between sessions. Unless all parties to such a mammoth mediation agree to conclude the proceedings, or the mediator delivers a writing formally ending them, a matter could remain in mediation indefinitely. It makes no sense that insurers can take advantage of the logistical impediment to terminating such mediations as a ruse to cloak an "outside mediation" settlement demand with mediation confidentiality.

The "precise parameters" of the Legislature's directive to protect communications "for the purpose of, in the course of, or pursuant to a mediation" remain judicially unresolved. It is possible that courts will lean toward protecting all settlement communications, requiring that parties end mediations entirely before delivering written settlement demands that are truly outside the mediation process. It is more likely that courts will examine cases on their unique factual merits, requiring that insurers prove a written demand labeled "outside mediation" is truly material to a mediation and not a routine process of civil litigation.

Unless a substantial mediation relationship can be shown, written demands to settle within policy limits labeled "outside mediation" should always be accorded their *outside mediation* purpose.

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Endnotes

[1] *Cassel v. Superior Court* (2011) 51 Cal.4th 113,130-131 [communications between non-party lawyer and his party client are confidential].

[2] See *Johansen v. California State Auto. Assn. Inter-Ins. Bureau* 15 Cal.3d 9, 12 [insurer assumes risk of judgment exceeding policy limits when it rejects a reasonable settlement demand within those limits].

[3] Insurance Code section 11580 [judgment creditor may sue the judgment debtor's insurer for the amount of the judgment up to policy limits, even when the insured files for bankruptcy relief].

[4] *Comunale v. Traders & General Ins. Co.* (1958) 50 Cal.2d 654, 659.

[5] *Johansen, supra,* 15 Cal.3d at 19 [insurer's reasonable, but erroneous, belief that claim is not covered furnishes no defense].

[6] *White v. Western Title Ins. Co* (1985) 40 Cal.3d 870, 887 [Evidence Code section 1152 precluding admissibility of settlement offers to prove liability does not apply to "lowball" settlement offers made by an insurer].

[7] *Cassel, supra,* 51 Cal.4th at 117.

[8] "[T]he mediation confidentiality statutes do not create a 'privilege' in favor of any person." *Id.* at 132.

[9] *Id.* at 119.

[10] Evidence Code section 1119.

[11] *Wimsatt v. Superior Court* (2007) 152 Cal.App.4th 137, 160.

[12] *Cassel, supra,* 51 Cal.4th at 135; *Wimsatt, supra,* 152 Cal.App.4th at 160 [communications are protected if they are "materially related to, and foster, the mediation"].

[13] *Wimsatt, supra,* 152 Cal.App.4th at 160-161.

[14] *Id.* at 161.

[15] *Id.* at 161.

[16] *Cassel, supra,* 51 Cal.4th at 136-137.

[17] *Wimsatt, supra,* 152 Cal.App.4th at 160.

[18] *Cassel, supra,* 51 Cal.4th at 130-131.

[19] In holding that communications between a party and its non-party lawyer are protected by mediation confidentiality, the Supreme Court observed that the Legislature might have determined such communications require protection to give "maximum assurance that disclosure of an ancillary mediation-related communication will not, perhaps inadvertently, breach the confidentiality of the mediation proceedings themselves, to the damage of one of the mediation disputants." *Id.* at 136.

[20] See *Critz v. Farmers Ins. Group* (1964) 230 Cal.App.2d 788, 798.

[21] See, e.g., Evidence Code section 1122 permitting disclosure of a writing prepared by "fewer than all of the mediation participants" where "those participants" agree to the disclosure, and the writing does not reveal anything "said or done or any admission made in the course of the mediation."

[22] The insurer, of course, must be careful not to comment on anything said or done at mediation.