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Mediation Matters

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What Happens When Co-Defendants Hold Divergent Interests?

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This article addresses some of the issues that can arise when parties at a mediation are co-defendants but are not fully aligned because some or all of their interests conflict with one another. These competing interests can include (1) a potential settlement where one defendant would be required to cooperate with the plaintiff in pursuing claims against the other defendant, and/or (2) the exhaustion of an insurance policy through a settlement that could adversely affect the nonsettling defendant's ability to defend the ongoing litigation.

Summary of Variables

In a multi-defendant mediation, it is not uncommon for defendants to be in vastly different positions for a variety of reasons, including the nature of their claims, defenses and economic wherewithal. The validity and merits of the claims against each defendant could be disparate from the plaintiff's perspective and/or even based on the facts of the underlying case. While several defendants may be sued in one action because there is a factual connection among the claims, this does not mean that the predicate facts for each of them are equally well established. In addition, each defendant could hold different views as to the merits and value of the claims being asserted against them.

While one defendant could believe that it has potentially significant liability, another defendant could believe that the complaint has absolutely no merit and is an attempt by the plaintiff to extort money from a deep pocket. Of course, both defendants could be equally misguided in their views or evaluation of the facts and law, but nevertheless their perceptions are part of the reality of the process itself.

Further, the defendants could each hold different defenses, and the strengths of those defenses could also vary. For example, in an avoidance action, one defendant could be an initial transferee, while the other defendant could be a subsequent transferee.[1] Alternatively, in an action with potential insurance coverage, one defendant could be a major player in the alleged wrongdoing, while the other defendant could have played a minor role. Further, one defendant could have deep pockets and the other might be judgment-proof — all of which could have a significant impact on each party's evaluation of settlement posture and negotiation strategy.

Differences will not only arise from the defendants' disparate views of the case and their own defenses, but could also be impacted by their own interactions with plaintiff's counsel or even their experiences with mediations from other cases. Unfortunately, not everyone has good experiences with mediation. These factors could lead to one defendant believing that mediation is a waste of time and the other being invested in the process.

These variables will play a role in the manner in which each defendant and their counsel approach the overall mediation process. It is fair to say that co-defendants' interests are not always aligned, which can have a significant impact on the process. At mediation, a lack of alignment can reveal itself at varying points in the process where one defendant is open to the construct of mediation in general, or where one defendant is amenable to a settlement that has a potential negative effect on the nonsettling defendant.

It is important to highlight that this potential conflict is not always clear at the onset of the mediation — certainly not always to the mediator, or at times even the parties themselves. The facts of the case, defenses and positions can take time to develop, especially in early-stage pre-

1 *See* § 550 of the Bankruptcy Code.

discovery mediation. The trajectory or outline of a settlement will also take time to flesh out and take shape. So how do these potential conflicts impact a mediation?

Sharing of Information

Particularly when mediation is conducted at an early pre-discovery stage, the sharing of information by and among parties will be affected by the number of parties, the different claims and the varying approaches taken by each defendant. In a two-party mediation, the focus is typically on a set of alleged facts and claims and a discrete "two-way street" to share information.

However, in a multi-defendant mediation, the focus can be different for each defendant. Thus the plaintiff might share certain information with one defendant but not with others. This can create concerns regarding the extent of information-sharing and might lead to conflicts among the parties. Defendants may even have different motivations for sharing information. For example, one defendant might have an interest in sharing with the plaintiff financial information pertaining to the defendant's inability to satisfy a judgment or information concerning the liability, but might not want that information revealed to the other defendant.

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Cooperation

So what happens if a potential settlement requires one defendant to cooperate with the plaintiff against the other defendant? In a multi-party mediation, it is not uncommon for only one party to settle with the plaintiff at an early stage and the others to either settle later or not at all. Clearly, there is an ongoing confidentiality obligation that will govern parties' conduct concerning information-sharing happening in connection with the mediation or at the mediation table. However, the fact that not all parties may end up with equal access to information or be able to fully share information in general can create a level of discomfort for all parties concerned. We recognize that this might not be any different if the parties had been sued separately, but the fact is that once the parties are in a "room" together, issues are highlighted front and center, so all impacted parties are made aware of them.

Unlike litigation, the mediation conference and settlement process is happening in a compressed time frame, with all the parties sitting together at a "table" (or in a Zoom room). Any negotiations and agreements reached are, so to speak, in everyone's face. While good mediators are especially careful not to disclose the parameters or terms of a potential settlement to the nonsettling party, they cannot hide the fact that settlements are occurring as parties drop out of the negotiations or process. Again, we reiterate that in litigation, co-defendants settle out and reach agreements to cooperate with a plaintiff all the time, but the difference is that it often happens over a greater expanse of time, much more quietly and privately, and not in "the room where it happens."[2]

Insurance Policy Exhaustion

Insurance often plays a role in litigation — and even more so in mediation. Insurance can be funding the cost of defense and can contribute significantly to a potential settlement. However, insurance has its limits, and such limits can be tested where one defendant would like to use such proceeds to settle, while the other defendant would instead prefer to use such proceeds to continue to litigate.[3]

In addition to plaintiff and co-defendants attending mediation with their counsel, the insurance company (and counsel) may also have an active role in the mediation. The mediator might need to address not only the claims by the plaintiff against the defendants, but also claims by one defendant against the insurer, as well as the obligations of the insurer as to both defendants.

As any claim a defendant has against the insurer could then impact the plaintiff, and since the vast majority (or all) of the proposed settlement proceeds could be coming from the insurance policy, mediation could entail a dialogue directly between the plaintiff and insurance company. This could lead to the mediation likely including not just your standard caucuses with the plaintiff and each defendant, but with numerous variations of caucuses, including the insurance company. A mediator will have to be extremely careful to keep information learned in a specific caucus separate from information learned in another, especially if one defendant opts to settle and potentially exhaust insurance funds to the detriment of the other defendant. As the existence of applicable insurance policies is typically known in advance, these issues can be anticipated and thus planned for ahead of time, at least in terms of sufficient number of conference rooms and time set aside for the mediation.

Mediation Confidentiality

When one defendant in a mediation is interested in settling but the other defendant is not, you are obligated to keep such information confidential.

2 "The Room Where It Happens," *Hamilton* (2015), *available at* en.wikipedia.org/wiki/The_Room_Where_It_Happens (unless otherwise specified, all links in this article were last visited on Jan. 17, 2023).

3 *Compare In re Sept. 11 Prop. Damage Litig.*, 650 F.3d 145, 153 (2d Cir. 2011) (stating that under New York law, insurer has no duty to pay out claims ratably and that insurer may "settle with less than all of the claimants under a particular policy even if such settlement exhausts the policy proceeds"), *with Kinder v. W. Pioneer Ins. Co.*, 231 CA2d 894 (Ca. 1965) ("[A] carrier, faced with multiple claims, must, with due regard for the interests of its insured, attend to [the insured's] best protection against all of these."); *Exec. Risk Specialty Ins. Co. v. Rutter Hobbs & Davidoff Inc.*, 2012 WL 12878754 at *5 (C.D. Cal. Sept. 12, 2012), *aff'd sub. nom., Exec. Risk Specialty Ins. Co. v. Rutter Hobbs & Davidoff Inc.*, 564 Fed. App'x 887 (9th Cir. 2014) (collecting cases and stating that "as this Court clearly explained ... California does not recognize a 'first to settle' rule. In fact, the opposite is true. Under numerous California cases, an insurer may be liable on a claim of bad faith made by other insureds with competing claims if it pays the entire policy limit on behalf of fewer than all insureds").

This can certainly add a new layer of complication to the mediation. However, most local court rules contain provisions confirming or governing mediation confidentiality, and the parties can often enter into separate agreements requiring confidentiality of certain unique information exchanged at the mediation table.

Ordinarily, any information exchanged that is not otherwise public or that has been previously shared and is labeled confidential for mediation purposes is considered to be confidential; however, there have been recent decisions that have affected confidentiality, so parties do need to be mindful of the scope and extent of these cases.[4] In general, there are overarching protections afforded ordinary settlement communications pursuant to Rule 408 of the Federal Rules of Evidence, as made applicable to bankruptcy proceedings by Rule 9017 of the Federal Rules of Bankruptcy Procedure. The confidentiality rule governing settlement communications under Rule 408 is well known and provides effective guidance in protecting against the admissibility of communications focused on settlement. As discussed at length in a recent ABI article,[5] only the Sixth Circuit has adopted and recognized the existence of a mediation privilege in *In re Lake Lotawana Community Improvement District*.[6]

When there are co-defendants involved in a mediation at the outset, the parties and mediator should consider providing additional language or provisions on continuing confidentiality for exchanged information, documents and negotiations in the event one party settles and the other does not. This would be no different than in a situation where one firm is representing multiple parties in a litigation and an engagement letter is being negotiated. This way, regardless of how the mediation twists and turns, there is a written document governing the parties that binds them going forward. Parties' counsel should be the first to address having a binding document, not the mediator or the courts, as the counsel who represents these parties (the co-defendants) will be most keenly aware of the varying degrees of risk, analysis, and strengths and weaknesses (real or perceived) of the parties' positions, and, most importantly, will be responsible for protecting them.

Conclusion

Confidentiality, disclosure and the sharing of information can be readily addressed with some clarity at the outset of the mediation process, ideally in a written and signed agreement. The rest may only be dealt with as the facts and issues unfold, and could lead to or warrant the splitting up of the process and the creation of separate mediation sessions on different days and times with the various parties (not just the simple creation of breakout rooms) in order to provide some buffer. These potential concerns should be considered by a plaintiff when deciding whether to bring claims against multiple parties in one action or separate actions, or whether to have a global mediation session or separate mediations for each defendant. Where there is a global mediation session, defense counsel should consider these issues when deciding what cards to put on the table at what point — and their overall strategy approaches to the process. abi

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4 *See, e.g.*, Leslie A. Berkoff & John G. Loughnane, "Limitations on Confidentiality," XLI *ABI Journal* 9, 26-27, 47, September 2022, *available at* abi.org/abi-journal.
5 *Id.*
6 563 B.R. 909 (Bankr. W.D. Mo. 2016).