

Memorandum 2014-27

Relationship Between Mediation Confidentiality and Attorney Malpractice and Other Misconduct: New Developments and Recent Communications

The Commission¹ has received several new comments relating to its study of the relationship between mediation confidentiality and attorney malpractice and other misconduct. Some of those comments concern a new case involving California’s statutory protection for mediation communications. The new comments, as well as pertinent excerpts from the new case, are attached to this memorandum, as follows:

	<i>Exhibit p.</i>
• Bonnie Fong (5/27/14)	1
• Ron Kelly, Berkeley (5/26/14)	2
• Thomas Lambie (Rio) (5/27/14)	3
• Jane V. Lee (5/27/14)	3
• Jim O’Brien, Conflict Resolution Center of Nevada County (5/27/14)	4
• Barbara Peyton, Sacramento (5/27/14)	4
• Jane Stallman, Oakland (5/24/14)	5
• Patricia Tweedy, Sacramento (5/27/14)	6
• Nancy Neal Yeend, Silicon Valley Mediation Group (5/13/14)	7
• Nancy Neel Yeend, Silicon Valley Mediation Group (5/22/14)	8
• Milhouse v. Travelers Commercial Ins. Co. (excerpts)	11

Those materials are discussed briefly below.

1. Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission’s website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission’s staff, through the website or otherwise.

The Commission welcomes written comments at any time during its study process. Any comments received will be a part of the public record and may be considered at a public meeting. However, comments that are received less than five business days prior to a Commission meeting may be presented without staff analysis.

COMMENTS THAT STRESS THE IMPORTANCE OF PROTECTING
MEDIATION COMMUNICATIONS

Many of the new comments are from mediators who stress the importance of protecting mediation communications. For example, Thomas Lambie, a Nevada County mediator, says “that weakening mediation confidentiality in any way would be a very big mistake.”² He believes that such a step “would be harmful to all of the stakeholders in mediations and benefit none of them.” *Id.* The comments from Bonnie Fong,³ Jane Lee,⁴ Jim O’Brien,⁵ Barbara Peyton,⁶ Jan Stallman,⁷ and Patricia Tweedy⁸ are similar.

COMMENTS RELATING TO *MILHOUSE V. TRAVELERS COMMERCIAL INS. CO.*

In separate comments, mediators Ron Kelly⁹ and Nancy Yeend¹⁰ alert the Commission to a federal district court opinion issued late last year: *Milhouse v. Travelers Commercial Ins. Co.*¹¹ In that case, a couple sued their home insurer for breach of contract and bad faith in handling an insurance claim. The case was tried and evidence from an unsuccessful mediation of the insurance claim was admitted on the issue of bad faith. The trial ended with a mixed result and both parties filed post-trial motions. Of note here, the plaintiffs filed a post-trial objection contending that admission of the mediation evidence violated California law.

The federal district court rejected the plaintiffs’ argument on two independent grounds:

First, the [plaintiffs] failed to raise the issue with the Court at or before trial, and therefore waived their right to claim any privilege. *Second, to find evidence of statements made at the mediation proceeding inadmissible at trial would violate the due process right of [the defendant insurer] to provide a complete defense to its alleged liability for bad faith and punitive damages.*¹²

2. Exhibit p. 3.

3. Exhibit p. 1.

4. Exhibit p. 3.

5. Exhibit p. 4.

6. Exhibit p. 4.

7. Exhibit p. 5.

8. Exhibit p. 6.

9. Exhibit p. 2.

10. Exhibit p. 7.

11. No. SACV 10-01730-CJC(ANx) (C.D. Cal. 2013).

12. *Milhouse* at 24 (footnote omitted; emphasis added) (Exhibit p. 18).

The court went on to explain its reasoning in some detail.¹³

The decision is apparently unpublished and is being appealed to the Ninth Circuit. The staff hesitates to say much about it at this point, because we do not want to interfere with pending litigation. We are grateful to Mr. Kelly and Ms. Yeend for bringing this matter to our attention.

FURTHER COMMENTS OF NANCY YEEND

In a separate letter with a cover email,¹⁴ Nancy Yeend makes some comments in response to Memorandum 2014-6, in which the staff provided a preliminary analysis of relevant policy interests. Among other things, she urges the Commission to follow the lead of jurisdictions that recognize a professional misconduct exception to protection of mediation communications:

I welcome the Commission's review of existing statutes for both UMA states and others that have created exceptions to confidentiality. As I have testified previously, speculation that an exception to confidentiality will lead to attorneys being plagued with malpractice lawsuits is not supported by the statistics.

The UMA exceptions to mediation confidentiality provide a reasonable mechanism, which supports confidentiality and protects the public from malpractice. As your research on this topic continues, please consider mediator malpractice as well. There is a major deficiency in the present California Evidence Code regarding confidentiality exceptions, and monitoring attorney and mediator conduct.¹⁵

Ms. Yeend also (1) encourages the Commission to "address confidentiality as it relates to non-legal forums, such as the Internet, 'pillow talk' and 'over-the-fence' conversations," and (2) provides input on specific aspects of the staff's preliminary policy analysis.¹⁶ The staff will hold these comments for later consideration, after the Commission has examined the laws of other jurisdictions and starts formulating a tentative recommendation.

Finally, Ms. Yeend describes some of her credentials, including mediating in Florida, serving as faculty of the National Judicial College for 20 years, and

13. *Id.* at 24-31 (Exhibit pp. 18-25).

14. Exhibit pp. 8-10.

15. *Id.* at 9.

16. *Id.* at 9-10.

having “a vast amount of experience with mediation statutes for all 50 states.”¹⁷ She offers to “be a resource for the Commission.”¹⁸

The staff is not sure what Ms. Yeend has in mind. As we made clear from the beginning of this study, the Commission welcomes and greatly appreciates hearing from persons like her, who have expertise in the topic under study. Such participation is invaluable in the Commission’s study process.

If Ms. Yeend is suggesting a more formal role in the Commission’s study, that is a different matter. On the staff’s recommendation, the Commission previously decided not to select an expert advisor for this study.¹⁹ At the time, the staff explained:

In the current study, unlike the one in the ... 1990’s, a broad variety of knowledgeable sources have already contacted the Commission and expressed interest in the topic. It is clear from the outset that the Commission will receive abundant input from persons with expertise in the area. There is no need for the Commission to select a particular person as its expert adviser. Taking that step could be divisive and counterproductive.²⁰

Those points remain true. We believe the Commission **made a sound decision on how to proceed and should stick with it.**

Respectfully submitted,

Barbara Gaal
Chief Deputy Counsel

17. *Id.* at 8.

18. *Id.*

19. Minutes (Aug. 2013), p. 3.

20. See also First Supplement to Memorandum 2013-39, pp. 2-3.

EMAIL FROM BONNIE FONG (5/27/14)

Re: Mediation Confidentiality

Dear Ms. Gaal,

I recently heard about the CLRC's new study regarding mediation confidentiality. I am e-mailing you to express my concern over the possibility of a change in the CA Evidence Code that may decrease the confidentiality afforded in mediations.

As an attorney and mediator, I strongly believe that providing full confidentiality to all participants in a mediation is vital to create space for open communication. The current CA Evidence code allows the parties to feel safe to bring up issues or reveal facts that may otherwise be concealed. This openness afforded by our current Code is a big factor leading to successful mediations. I urge you to keep the importance of mediation confidentiality in mind during the study and review of the current CA Evidence Code.

Thank you very much for your attention.

Best regards,

Bonnie Fong

EMAIL FROM RON KELLY (5/26/14)

Re: Milhouse Case — Mediation Protections v Due Process

Dear Ms. Gaal,

A friend sent me this article about the federal Milhouse case. Have you reviewed this case?

<http://www.pgpmediation.com/blog/2014/05/is-there-a-bad-faith.shtml>

Due process is a centrally important right, but certainly open to wide interpretation after the fact.

Bright line predictability in advance was what we were trying to achieve in drafting our current mediation protections.

If the 9th Circuit were actually going to try to apply California law on this evidentiary question, I would think the following section of the CA Supreme Court decision in the Simmons case would be applicable.

In deciding whether a judicial exception was appropriate to carry out the Legislature's goals, we observed that with the enactment of the mediation confidentiality statutes, the Legislature contemplated that some behavior during mediation would go unpunished. (*Foxgate, supra*, 26 Cal.4th at p. 17.) The Legislature was also presumably aware that general sanctions statutes permit punishing bad faith conduct. Considering this, we reasoned we were bound to respect the Legislature's policy choice to protect mediation confidentiality rather than create a procedure that encouraged good faith participation in mediation. Thus, we held that evidence of a party's bad faith during the mediation may not be admitted or considered.

(Ibid.)

Simmons v. Ghaderi (2008) 44 Cal.4th [underlining added]

Best wishes,

Ron Kelly

EMAIL FROM THOMAS LAMBIE (5/27/14)

Re: Confidentiality in mediation

As a seven year mediator with more than 300 non-family mediations in Nevada County Superior Court, I have to say that weakening mediation confidentiality in any way would be a very big mistake. It would be harmful to all of the stakeholders in mediations and benefit none of them.

Thomas Lambie (Rio)

EMAIL FROM JANE V. LEE (5/27/14)

Re: Confidentiality in Mediation

Dear Ms. Gaal,

Thank you for taking public comment on the issue of confidentiality in mediation. As a mediator since 2005, I have repeatedly had the opportunity to inform people of the importance of confidentiality and their subsequent ability to reveal information that might otherwise have been withheld.

When mediation is scrutinized by persons unfamiliar with the process and the importance of confidentiality, or having a preference for a particular party where neutrality is compromised, the essence of mediation is also damaged.

Mediation ought to remain private and parties who facilitate mediation between disputants ought to remain neutral and without a stake in the outcome. To do otherwise is to lose what we call Mediation.

Thank you very much.

Sincerely,
Jane V. Lee
Mediator, MFTI

EMAIL FROM JIM O'BRIEN (5/27/14)

Re: Mediation Confidentiality

I believe that confidentiality is essential to successful mediation. Please don't change this aspect of a process that encourages participants to speak freely and openly.

Jim O'Brien, mediator
Conflict Resolution Center of Nevada County

EMAIL FROM BARBARA PEYTON (5/27/14)

Re: Confidentiality of Mediation

I strongly support keeping mediation as confidential as possible. I strongly oppose any efforts to erode that confidentiality. Please note my position on this issue and feel free to contact me if additional support for these positions is required.

Barbara Peyton
Attorney At Law
(196) 488-2701

**EMAIL FROM JAN STALLMAN, CENTER FOR STRATEGIC
FACILITATION (5/24/14)**

Re: Protections for Mediators

Mediators provide a needed service to our overburdened courts. For appropriate situations they help to keep conflicts at a more manageable and less costly level. I understand that the legislation protecting mediations is under review. I'd like to urge that the confidentiality that is currently protected be kept.

Thank you for paying attention to my comments,

Jane

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AICP CM units: 13.5 CM for ToP Facilitation Methods

MFT and LCSW CEUs: 14 for ToP Facilitation Methods

EMAIL FROM PATRICIA TWEEDY (5/27/14)

Re: Study K402 – Mediation Confidentiality

Dear Ms. Gaal,

I urge the Commission to make no recommendation to the legislature which would result in eroding the protections afforded to mediation communications.

Mediation participants, including lawyers and their clients, are urged to consider and discuss not only the strengths of their positions but the weaknesses of their case as well. The participants make these concessions with the confidence that their statements will not later be admissible against them. When participants admit to the difficulties of their cases, they begin to see the other side's points and start to negotiate freely. Complete confidentiality is, simply put, vital to the process of obtaining mediated agreements.

Thank you for your consideration. If you would like further input, please do not hesitate to contact me.

Sincerely,

Patricia Tweedy, Esq.
Mediator & Arbitrator
Member State Bar of California
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**EMAIL FROM NANCY NEAL YEEND,
SILICON VALLEY MEDIATION GROUP (5/13/14)**

Re: New Case

It would seem that this recent case would be worth reviewing in light of the commission's study. This is from a mediate.com communication.

Federal Court Concludes that Insurer's Due Process Rights Trump California's Mediation Confidentiality Statute

A federal trial court concluded that California's strict mediation confidentiality provisions were not applicable in a bad faith claim by homeowners against their insurer, as the insurer needed to be able to show that its failure to settle the case was the result of the homeowners' excessive demands in mediation. The court relied on the seminal California Supreme Court case, *Cassel v. Superior Court*, in which due process is recognized as a limit on the mediation confidentiality statute, even though the Supreme Court was not concerned about shielding legal malpractice when only civil damages were at issue. Here, however, the federal court concluded that the insurer's due process right to defend itself outweighed confidentiality, where the homeowners initially demanded \$7 million in mediation for a house the court found to be worth about \$1 million. While the parties also had signed a confidentiality agreement covering the mediation, it was never presented to the court and thus could not exclude testimony about the mediation. The decision is being appealed to the Ninth Circuit. *Milhouse v. Travelers Commercial Ins. Co.*, No. SACV 10-01730-CJC (U.S.D.C. C.D. Cal., November 5, 2013)

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Silicon Valley Mediation Group
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Email: nancy@svmediators.com

**EMAIL FROM NANCY NEAL YEEND,
SILICON VALLEY MEDIATION GROUP (5/22/14)**

Re: Comment on Memo 2014-6

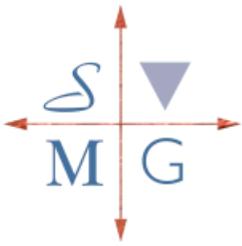
Please find attached my letter regarding your recent report. In it I mention the fact that I have actually mediated in Florida, am very familiar with their rules and how the DRC operates. I am approved by the Florida Supreme Court as a trainer, and both my Civil Mediation (40-hour) and Appellate Mediation courses are approved by the Supreme Court. Florida is one of the few states that provides credentials for mediators (5 different categories), trainers and courses.

Also, I have taught Mediation, Advanced Mediation and Appellate mediation for many years, and just completed my 20th year as faculty at the National Judicial College, so have a vast amount of experience with mediation statutes for all 50 states. My work, *State Appellate ADR: National Survey and Use Analysis with Implementation Guidelines*, was the first study of appellate ADR, which also provided me with a national perspective.

If you think that I can be a resource for the Commission, please let me know.

Nancy

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SILICON VALLEY MEDIATION GROUP

May 22, 2014

California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739

Re: Memorandum 2013-39 (Study K-402)

Dear Commissioners:

The Commission's Memorandum 2014-6 provided a useful summary of the primary evaluation factors being considered in crafting an exception to mediation confidentiality. I welcome the Commission's review of existing statutes for both UMA states and others that have created exceptions to confidentiality. As I have testified previously, speculation that an exception to confidentiality will lead to attorneys being plagued with malpractice lawsuits is not supported by the statistics.

The UMA exceptions to mediation confidentiality provide a reasonable mechanism, which supports confidentiality and protects the public from malpractice. As your research on this topic continues, please consider mediator malpractice as well. There is a major deficiency in the present California Evidence Code regarding confidentiality exceptions, and monitoring attorney and mediator conduct. I would hope that the Commission concludes that California must establish a program, much like Florida's. I am one of the few California mediators, who actually mediated in Florida, and am more than willing to share that insight with the Commission.

Another area the Commission might wish to consider is expanding and clarifying confidentiality. Presently the statute only addresses confidentiality in administrative and legal proceedings. A recent CNN report, www.cnn.com/2014/03/02/us/facebook-post-costs-father, covered the impact of violating confidentiality in other forums. California statutes do not appear to address confidentiality as it relates to non-legal forums, such as the Internet, "pillow talk" and "over-the-fence" conversations.

Finally, I would like to share some observations relating to the section of the Memorandum entitled *Factors Favoring Mediation Confidentiality*. The focus of items (1) and (2) is on candor between and among the disputing parties. The key point—it is the *parties'* dispute and *their* negotiations. As the Commission illustrates later, an attorney who promises to reduce fees, is not a part of the *parties'* negotiations. Those attorney/client discussions should not be shielded. On page 6, it may be prudent to clarify that there is a significant difference between "blunt advice" and malpractice. Advice is one thing, but making false promises is very different.

On page 7 another example is provided, and in that scenario the justification for confidentiality mentions an admission to the mediator: "... a stupid mistake the attorney once made, to help *persuade* the mediator..." My concern is that some may view *persuasion* as an attempt to manipulate the mediator to serve as an advocate or to help pressure the client. In either instance, I am not sure the *example* supports keeping the statute in its present form.

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EX 9

The section entitled *Factors Favoring Disclosure of Mediation Communications* traces the attorney/client relationship back to the *Cox v. Delmas*, 1893 decision, and then moves forward to Justice Chin's concerns that confidentiality may be a "high price to pay." These examples support the argument for creating an exception. Further, on page 13 there is a reference to *Glass* and "...honesty is fundamental in the practice of law." It is fascinating that as the Commission explores confidentiality, the California State Bar is proposing a rule relating to attorney truthfulness in negotiations. With Formal Opinion Interim No. 12-0007 and other existing rules addressing attorney conduct, how can the Bar hold any meaningful hearings, when mediation confidentiality protects any discussion of what happened? Creating an exception would greatly enhance the Bar's ability to evaluate and respond to claims based on attorney malpractice.

Mediation confidentiality is a complex topic, and the protection it affords is for the *disputants'* *discussions*, not attorney conduct. Creating an exception does not diminish the benefits of mediation. On the contrary, it strengthens it and instills public confidence that confidentiality in mediation is not a shield protecting malpractice.

Sincerely,

Nancy

Nancy Neal Yeend

nny:dlg

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**UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
SOUTHERN DIVISION**

**CRAIG MILHOUSE; PAMELA
MILHOUSE,**

Plaintiffs,

vs.

**TRAVELERS COMMERCIAL
INSURANCE COMPANY,**

Defendant.

Case No.: SACV 10-01730-CJC(ANx)

**ORDER GRANTING DEFENDANT'S
MOTION FOR REMITTITUR OR IN
THE ALTERNATIVE A NEW TRIAL,
DENYING DEFENDANT'S MOTION
FOR JUDGMENT AS A MATTER OF
LAW, DENYING PLAINTIFFS'
MOTION FOR A NEW TRIAL, AND
DENYING PLAINTIFFS' MOTION
FOR PRE-JUDGMENT INTEREST**

INTRODUCTION AND BACKGROUND

Plaintiffs Craig Milhouse and Pamela Milhouse owned a home in Yorba Linda, California. Their home was insured by Defendant Travelers Commercial Insurance Company ("Travelers"). In November 2008, the Yorba Linda Freeway Complex fire swept through Dr. and Mrs. Milhouse's neighborhood and consumed their home. A total loss resulted, with the structure of the home itself and the personal property contained

1 within it all lost in the blaze. Dr. and Mrs. Milhouse tendered a claim to Travelers on
2 their homeowner's insurance policy to be compensated for their loss. Unable to settle
3 their claim with Travelers out of court, in October 2010, the Milhouses filed suit against
4 Travelers, alleging breach of contract and breach of the covenant of good faith and fair
5 dealing. The Milhouses additionally sought punitive damages. On August 13, 2013, this
6 Court empaneled a jury and commenced a two-week trial of the Milhouses' claims. After
7 considering the evidence and testimony presented by both parties, the jury returned a
8 verdict in favor of Dr. and Mrs. Milhouse on their breach of contract claim, awarding
9 them \$1,949,634 in damages, or \$974,817 each. The jury also found, however, that in
10 breaching its contract with the Dr. and Mrs. Milhouse, Travelers did not act in bad faith,
11 and that the Milhouses were not entitled to punitive damages. Before the Court are
12 competing post-trial motions filed by both parties.

13
14 Dr. and Mrs. Milhouse move for a new trial on only their cause of action for
15 breach of the covenant of good faith and fair dealing, or alternatively, for a new trial on
16 both of their causes of action. (Dkt. No. 372 ["Pls.' Mot. for New Trial"].) They
17 additionally move to alter the judgment to account for pre-judgment interest. (Dkt. No.
18 365.) Travelers moves for judgment as a matter of law, (Dkt. No. 380 ["Def.'s Mot. for
19 JMOL"]), or for remittitur of the damage award or a new trial on the Milhouses' breach
20 of contract cause of action, (Dkt. No. 378 ["Def.'s Mot. for New Trial"]). For the reasons
21 stated herein, Travelers' motion for a remittitur, or in the alternative a new trial, is
22 GRANTED. Its motion for judgment as a matter of law, and the Milhouses' motion for a
23 new trial on breach of the covenant of good faith and fair dealing or on all causes of
24 action, are DENIED. Additionally, the Milhouses' motion to alter the judgment to
25 include pre-judgment interest is DENIED.¹

26
27
28 **EX 12**

¹ The Milhouses additionally move to augment the trial record. (Dkt. No. 377.) That motion is unopposed by Travelers, (Dkt. No. 391), and is hereby GRANTED.

1 The Court finds that the jury faithfully discharged its duties and, with one limited
2 exception, returned a reasonable verdict supported by the evidence presented. The jury
3 only overestimated the damages recoverable by Dr. and Mrs. Milhouse for breach of
4 contract. The Court therefore upholds the jury's verdict in all other respects, and reduces
5 the contract damages award to the maximum amount supportable by the evidence.

6 7 ANALYSIS

8 9 ~~I. Travelers' Motion for Judgment as a Matter of Law~~

10
11 Under Federal Rule of Civil Procedure 50(a) and (b), a court may enter judgment
12 as a matter of law if "a reasonable jury would not have a legally sufficient evidentiary
13 basis to find for the [prevailing] party" as to an issue on which that party has been fully
14 heard during trial. A party seeking judgment as a matter of law has a "very high"
15 standard to meet. *Costa v. Desert Palace*, 299 F.3d 838, 859 (9th Cir. 2002). The jury's
16 verdict must be upheld if, viewing the facts in the light most favorable to the nonmoving
17 party, there is sufficient evidence for a reasonable jury to have found in the nonmoving
18 party's favor. *Johnson v. Paradise Valley Unified Sch. Dist.*, 251 F.3d 1222, 1227 (9th
19 Cir. 2001).

20
21 In its motions for judgment as a matter of law and for renewed judgment as a
22 matter of law, (Dkt. No. 336; Def.'s Mot. for JMOL), Travelers argues that it was not in
23 breach of contract by naming the IRS as a co-payee on a benefits check issued to the
24 Milhouses, that the policy's Additional Replacement Cost Protection ("ARCP")
25 Endorsement was not triggered, and that the Ordinance or Law coverage of the policy
26 was not triggered. It additionally argues that the Milhouses cannot establish through the
27 evidence presented that Travelers was in breach of its dwelling, alternative living
28 expenses, or loss of use coverage obligations. As described more fully in the context of

1 ~~Millhouses for special damages beyond the policy limits is \$402,000, or payment of~~
2 ~~\$6,700 per month for 60 months.⁸~~
3

4 **C. Total Contract Damages**

5
6 Based on the above, the Milhouses were entitled to \$674,634 for damages on the
7 policy itself, and an additional \$402,000 in special damages. Therefore, the maximum
8 damage award supportable by proof is \$1,076,634. The Milhouses may accept this
9 remitted amount, or otherwise, the Court will hold a new trial on the issue of breach of
10 contract.
11

12 **III. Dr. and Mrs. Milhouse's Motion for a New Trial on Bad Faith**

13
14 Dr. and Mrs. Milhouse move for a new trial on the issue of bad faith, arguing first
15 that the Court erred in not charging the jury on several issues of law, including the
16 legality of naming the IRS on payments to the Milhouses, and Travelers' definition of
17 "actual cash value" in its insurance policy. The Milhouses also argue that as a result of
18 admission of testimony at trial regarding a mediation proceeding between the parties,
19 they were prejudiced as to the issue of bad faith.
20

21 //

22 //

23
24 ⁸ The Milhouses argue that the jury could have found that the Milhouses were entitled to special
25 damages for additional living expenses of \$144,000 per year for between five and eight years.
26 (See Dkt. No. 388 ["Pls.' Opp'n to Def.'s Mot. for JMOL"] at 7.) The \$144,000 figure is
27 unsupported by the evidence presented, and moreover, appears to include damages for living
28 needs other than rent. While the Court finds that the Milhouses are entitled to special damages
to pay their rent on another home while their lost home is being rebuilt, it does not find that the
necessity of payment for other, non-rent-related expenses can be considered a foreseeable harm
resulting from Travelers' breach.

1 **A. Substantial Evidence of No Bad Faith**

2
3 Before reaching the substance of Dr. and Mrs. Milhouse's motion for a new trial
4 on bad faith, it is important to provide the contextual basis for the jury's finding.
5 Substantial evidence was presented at trial that while Travelers did breach its contract
6 with the Milhouses it did not act in bad faith in doing so. Instead, based on the evidence
7 presented, the jury reasonably could have found that Travelers did not unreasonably
8 delay in paying policy benefits.

9
10 Travelers presented significant evidence to show that its conduct in adjusting the
11 Milhouses claim was not unreasonable or undertaken without proper cause. (*See* Jury
12 Instr. No. 32.) For example, the jury heard testimony that by December 2008, within
13 weeks of the fire, Travelers was attempting to correspond with the Milhouses about how
14 best to send them an 80 percent advance on their dwelling coverage. (*See* Aug. 14
15 Transcript at 93:6–93:24 (Hunt).) The Milhouses did not respond to the inquiry. (*See*
16 *id.*) By May 2009, Travelers was still waiting for the Milhouses to provide them a
17 response to the inquiry and, moreover, to provide a response to a questionnaire that
18 would be necessary to determining the amount of money they were entitled to receive
19 under the policy. (*See id.* at 96:3–96:13 (Hunt).) The response was provided in June
20 2009, (*see* Aug. 16 Transcript at 32:6–34:20 (C. Milhouse)), though even after that
21 Travelers reported additional delays in obtaining follow-up responses. (*See* Aug. 14
22 Transcript at 96:3–96:13 (Hunt).) Similarly, with regard to settling the personal property
23 coverage, Travelers sent a contents adjuster to California to assist the Milhouses in
24 submitting their contents claim. (*See id.* at 103:15–106:2 (Hunt).) The Milhouses,
25 however, did not meet with the adjuster or send a final contents claim until March 2012.
26 (*Id.*)

1 The record is replete with other examples of Travelers' attempts to settle the claim,
2 as well as with evidence of the Milhouses' own contributions to the delay in the
3 adjustment process. While the evidence is certainly contested, after evaluating the
4 complete record and the competencies of each witness presented to it, the jury had ample
5 basis upon which to find that while Travelers did breach its contract with the Milhouses,
6 the breach was not in bad faith.

7
8 **1. Jury Instruction on "Actual Cash Value"**

9
10 As discussed above, Dr. and Mrs. Milhouse's dwelling coverage entitled them to
11 recover the "actual cash value" of their dwelling. (Policy at 38.) The policy further
12 defines actual cash value as "the amount it would cost to repair or replace covered
13 property . . . subject to a deduction for deterioration." (*Id.* at 38.) The Milhouses argue
14 that such a definition of actual cash value violates California law, and that the jury should
15 have been instructed to that effect. The Court declined to offer the Milhouses' proposed
16 instruction, and the Milhouses now argue that that decision constituted prejudicial error
17 as to their bad faith claim. The Court disagrees.

18
19 The California Insurance Code provides that where a total dwelling loss has
20 occurred, as happened to the Milhouses' property, actual cash value is determined by the
21 fair market value of the structure — that is, the value of the property excluding the land
22 on which the dwelling structure is situated — or the policy limits, whichever is less. Cal.
23 Ins. Code § 2051(b)(1). The Insurance Code does not further define "fair market value."

24
25 Relying on the California Supreme Court's opinion in *Jefferson Insurance Co. v.*
26 *Superior Court*, Dr. and Mrs. Milhouse argue that while the Insurance Code is silent on
27 the definition of "fair market value," California courts have held that it can only be
28 defined as "the price that a willing buyer would pay a willing seller, neither being under

1 ~~define actual cash value, see (Policy at 38) (“Actual cash value is calculated as the~~
2 ~~amount it would cost to repair or replace covered property . . . subject to a deduction for~~
3 ~~deterioration . . .”), closely mirrors that language suggested by California courts as the~~
4 ~~appropriate means by which to contract around the *Jefferson* default definition. See~~
5 ~~*Cheeks*, 61 Cal. App. 4th at 130 (noting that insurers can contract around the *Jefferson*~~
6 ~~default definition “by using words such as ‘actual cash value, with proper deduction for~~
7 ~~depreciation’ ”).~~

8
9 Because California law does not explicitly preclude parties to insurance contracts
10 from contracting to define actual cash value in terms of replacement cost less
11 depreciation, and because Travelers and the Milhouses contractually agreed to use the
12 replacement cost less depreciation formula to define actual cash value, it would have
13 been improper for the Court to instruct the jury as the Milhouses requested. It was for the
14 jury to decide (1) whether in adjusting the Milhouses’ claim, Travelers determined the
15 appropriate actual cash value of the Milhouse home for breach of contract, and (2)
16 whether in using the method that it did, Travelers acted in bad faith. Based on the
17 evidence presented, the jury reasonably returned a verdict answering both questions in
18 the negative.

19
20 **2. Failure to Exclude Testimony Regarding Mediation Proceedings**

21
22 At trial, evidence was presented regarding statements made during the course of
23 the mediation proceeding between Dr. and Mrs. Milhouse and Travelers. In particular,
24 testimony was presented that at the mediation, the Milhouses made a \$7 million demand
25 of payment and that they asked for nearly a million dollars of attorney’s fees when their
26 attorney had only worked on the case for a few weeks. (See, e.g., Aug. 13 Transcript at
27 170:22–173:9 (Ballinger).) The Milhouses now challenge the admissibility of such
28 evidence, and argue that it resulted in prejudicial error that warrants a retrial on the issue

1 of bad faith. The Milhouses' argument fails on two independent grounds. First, the
2 Milhouses failed to raise the issue with the Court at or before trial, and therefore waived
3 their right to claim any privilege.⁹ Second, to find evidence of statements made at the
4 mediation proceeding inadmissible at trial would violate the due process right of
5 Travelers to provide a complete defense to its alleged liability for bad faith and punitive
6 damages.

7
8 **a. Waiver**

9
10 Under Federal Rule of Evidence 103, "[a] party may claim error in a ruling to
11 admit or exclude evidence only if the error affects a substantial right of the party and[,] if
12 the ruling admits evidence, a party, on the record[,] timely objects or moves to strike; and
13 states the specific ground, unless it was apparent from the context." Fed. R. Evid.
14 103(a)(1). An objection is untimely unless it is "made as soon as the ground of it is
15 known, or could reasonably have been known to the objector, unless some special reason
16 makes its postponement desirable for him and not unfair to the offeror." 21 Charles Alan
17 Wright & Kenneth W. Graham, Jr., *Federal Practice and Procedure* § 5037.1 (2d ed.
18 2005) (citing John H. Wigmore, *Code of Evidence* 25 (3d ed. 1942)). Rule 103's timely
19 and specific objection requirement "serves to ensure that the 'nature of the error [is]
20 called to the attention of the judge, so as to alert him [or her] to the proper course of
21 action and enable opposing counsel to take corrective measures.'" *Jerden v. Amstutz*,
22 430 F.3d 1231, 1236 (9th Cir. 2005) (quoting *United States v. Gomez-Norena*, 908 F.2d
23
24

25
26 ⁹ In their post-trial motions, the Milhouses attempt to establish that testimony about mediation
27 communications should not have been admitted because Travelers and the Milhouses had signed
28 a confidentiality agreement regarding the proceedings. (*See* Pls.' Mot. for New Trial at 8.) The
argument obfuscates the fact that the Milhouses never presented their confidentiality agreement
to the Court, and incorrectly assumes that the Court can exclude testimony on the basis of a
confidentiality agreement it has never seen.

1 497, 500 (9th Cir.1990)), *opinion amended on denial of reh'g*, 04-35889, 2006 WL
2 60668 (9th Cir. Jan. 12, 2006).

3
4 The Milhouses now contend that California's mediation privilege barred the
5 admission of the mediation statements. Their post-trial objection, however, is not
6 timely.¹⁰

7
8 The Milhouses argue that their objection was timely because the issue of the
9 admissibility of the parties' mediation statements was raised by the parties at the pre-trial
10 conference on August 12, 2013. (*See* Dkt. No. 359 ["Aug. 12 Transcript"] at 37:9-39:12
11 (Pre-Trial Conference).) But the evidentiary question raised by the parties at the pre-trial
12 conference was limited in scope to whether Travelers would be allowed to discuss that it
13 offered to mediate the Milhouses' claim. The Milhouses took the position that Travelers
14 should not be able to present such a fact to the jury. (*Id.* at 37:9-14 (Pre-Trial
15 Conference).) After hearing brief argument, the Court held that "the fact that Travelers

16
17 ¹⁰ The Milhouses' untimely objection presents a seemingly rare, but serious tension between the
18 dictates of Federal Rule of Evidence 408 and Rule 501. Under Rule 501, in civil cases, "state
19 law governs privilege regarding a claim or defense for which state law supplies the rule of
20 decision." Because the Court exercises its diversity jurisdiction to apply California substantive
21 law regarding breach of contract and bad faith, Rule 501 seemingly requires the application of
22 California Evidence Code section 1119, the state's strict mediation privilege. *See Foxgate*
23 *Homeowners' Ass'n, Inc. v. Bramalea Cal., Inc.*, 26 Cal. 4th 1, 15 (2001) ("To carry out the
24 purpose of encouraging mediation by ensuring confidentiality, the statutory scheme . . .
25 unqualifiedly bars disclosure of communications made during mediation absent an express
26 statutory exception."). However, where, as here, a party to a diversity action in California seeks
27 to introduce mediation statements for a purpose other than to prove or disprove the validity of a
28 claim — for example, to show that its conduct was not taken in bad faith — there is a conflict
between section 1119, applied through Rule 501, and Rule 408, which allows evidence of
settlement negotiations to be admitted where offered not to prove liability, but to refute a claim
of undue delay or bad faith. No court has considered this conflict in the context of an action
brought solely through diversity jurisdiction. While the Court harbors doubts that the Federal
Rules of Evidence intended themselves to be subordinated to the application of state evidence
law, the question need not be resolved here given the Milhouses' waiver, and given the due
process ground for the statements' admissibility, discussed below.

1 offered mediation in their handling of this claim is not inadmissible.” (*Id.* at 39:8–9 (Pre-
2 Trial Conference).) The Milhouses’ attorney acknowledged the scope of the Court’s
3 ruling, stating that he “understand[s] the Court’s inclined to let the mention of the
4 mediation take place. That’s fine.” (*Id.* at 39:10–12 (Pre-Trial Conference).)

5
6 The Milhouses now suggest that the Court’s remarks during the August 12 pre-trial
7 conference that the Rules of Evidence “seem[] to suggest even statements made and
8 offers made which are inadmissible can be admissible if to rebut a claim of undue delay,”
9 (*id.* at 39:4–6 (Pre-Trial Conference)), constituted an affirmative ruling on the issue of
10 whether statements made *during* the mediation would be admissible at trial. (Dkt. No.
11 402 [“Pls.’ Reply in Supp. Mot. for New Trial”] at 3–4.) That broader question,
12 however, was not before the Court. The Milhouses’ objection was limited to whether
13 Travelers would be allowed to present evidence that it offered to mediate the Milhouses’
14 claim. In fact, at the pre-trial conference, the Milhouses never presented to the Court
15 their objection that the California mediation privilege could make the parties’ mediation
16 statements inadmissible, nor was their objection apparent from the context. The
17 Milhouses cannot now expand the scope of the Court’s ruling to encompass an objection
18 which they did not raise.

19
20 Broadly interpreted, the Milhouses’ second ground for argument is that they
21 moved the Court *in limine* to exclude testimony regarding the parties’ mediation
22 statements. (Pls.’ Mot. for New Trial at 6; *see* Dkt. No. 98 [“Pls.’ Mot. in Limine”].)
23 However, the motion *in limine* to exclude testimony regarding mediation statements was
24 voluntarily withdrawn by the Milhouses themselves, before the Court provided any ruling
25 on the matter. (Dkt. No. 187.) Travelers’ own motion *in limine* on the issue was
26 similarly withdrawn. (Dkt. No. 193.) Neither party refiled a motion *in limine* on the
27 subject, and any agreement they may have reached as to the admissibility of mediation
28

1 statements was not presented to the Court. The Milhouses' voluntarily withdrawn motion
2 *in limine* cannot then constitute a timely objection for purposes of Rule 103.

3
4 Finally, the Court notes that even during trial, when the contents of the mediation
5 proceedings were first directly inquired about by Travelers on the cross-examination of
6 Joseph Ballinger, the Milhouses objected first on hearsay grounds, and then on grounds
7 that the testimony lacked foundation. (*See* Aug. 13 Transcript at 168:14–169:3
8 (Ballinger).) Because adequate foundation had been laid for the testimony, and because
9 the statements were offered for their effect on the listener, the Court overruled the
10 Milhouses' objections. At no point during trial did Plaintiffs object on grounds that the
11 contents of the mediation proceeding were privileged, nor was such an objection apparent
12 from the context at the time of the Milhouses' speaking objections. (*See id.*) The same
13 was true every other time Travelers sought to introduce testimony revealing the parties'
14 mediation statements. The Milhouses' argument that raising such an objection would
15 have been "futile" because the "Court advised counsel that these inadmissible statements
16 could be presented at trial" is unavailing. (*See* Pls.' Reply in Supp. Mot. for New Trial at
17 5). As noted above, the issue of privilege was never raised with the Court. *See* Fed. R.
18 Civ. P. 103(a)(1)(B) (providing that a party must state the *specific* ground for their
19 objection to the admissibility of evidence, or it must be apparent from the context of their
20 timely objection). The Milhouses' failure to object to disclosure of the parties' mediation
21 statements, either at or before trial, therefore waived their ability to raise the objection
22 post-trial.

23 24 **b. Admissibility of Mediation Statements**

25
26 Even if the Milhouses had timely objected to the admissibility of the parties'
27 mediation statements, the Court would have overruled their objection. Due process
28

1 demanded that the Court allow the jury to hear the testimony regarding the parties'
2 mediation statements.

3
4 The Milhouses argued extensively at trial that Travelers, "unreasonably or without
5 proper cause, failed to pay or delayed payment of policy benefits." (See Jury Instr. No.
6 33.) More specifically, the Milhouses contended that Travelers acted in bad faith by
7 refusing to settle their claim. This bad faith theory was asserted at the very beginning of
8 the trial. In his opening statement, the Milhouses' attorney stated:

9
10 The parties go on for a period of years trying to settle the case. Nothing is getting
11 done. In June of 2010, Travelers is put on notice by the Milhouse's lawyer . . . that
12 it's time to pay the claim. A letter is sent to [Travelers] saying . . . pay the policy
13 limits. Send the check with interest for what you owe. [The Milhouses] don't
14 want to sue. . . . Settle the claim. You'll find that this was met with resistance and
15 an insistence on using an improper system. So the Milhouses met with Travelers,
16 tried mediation. That failed. They sued Travelers. And when they sued Travelers,
17 Travelers didn't say they were sorry. They didn't offer to pay the money.

18 (Aug. 13 Transcript at 64:18-65:6 (Milhouse Opening).) During the trial, the Milhouses'
19 attorney aggressively questioned Travelers' witnesses on the issue. For example, on
20 direct examination, Travelers' general adjuster Mr. Ballinger, the first witness at the trial,
21 was asked several questions by the Milhouses' attorney that suggested Travelers was
22 unreasonably refusing to settle the Milhouses' claim:

23
24 The only person that had authority to settle the claim, according to the folks [the
25 Milhouses] have talked to so far, was Richard Sweeney. . . . [D]id you ever see any
26 indication that Mr. Sweeney ever attempted to meet with the Milhouses or their
27 representatives to settle this claim? . . . Did you ever see anybody do that until after
28 October 2010 when we had the mediation and the lawsuit?

29 (Aug. 13 Transcript at 117:23-118:9 (Ballinger).) At one point, the Milhouses' attorney
30 pointedly asked Mr. Ballinger:

31
32 [I]s it unreasonable for Travelers not to have someone with authority to sit down
33 with the Milhouses? . . . The reasonable thing to do would have been to do that,
34 right? To meet with the Milhouses to try to settle the claim?

1 (*Id.* at 203:8–17 (Ballinger).) The Milhouses’ attorney was relentless in his questioning.
2 (*See, e.g.*, Aug. 14 Transcript at 13:18–17:20 (Hunt); Aug. 15 Transcript at 11:13–15
3 (Schaeffer); Aug. 16 Transcript at 224:5–226:9 (P. Milhouse); Aug. 19 Transcript, Vol. 1
4 at 168:2–170:3 (McKinnon).)

5
6 Then, in closing arguments, speaking of the need to impose punitive damages upon
7 Travelers, the Milhouses’ attorney emphasized to the jury the premise underlying the
8 Milhouses’ claim for bad faith:

9
10 “Cooperation. . . . With who? Working with Travelers is the sound of one hand
11 clapping. They’re not here. Cooperation is a two-way street. And the one with no
12 hand up is Travelers. The one with the obligation under the [C]ode to have a hand
13 up and help you out.”

14
15 (Aug. 22 Transcript, Vol. 2 at 88:2–8 (Milhouse Rebuttal).)

16 For the Milhouses, the case was one about a despicable insurance company that
17 had a policy of not fairly and reasonably cooperating with its insureds to settle their
18 claims after tragic loss. They now argue that the Court erred by allowing the jury to hear
19 the parties’ mediation statements. The Milhouses are wrong. Travelers needed to present
20 the parties’ mediation statements to provide a complete defense of its actions and to avoid
21 paying millions of dollars in bad faith and punitive damages for wrongfully refusing to
22 settle the Milhouses’ claim.

23 Up to the point of the mediation, the parties knew that they had differences in their
24 estimates of how much the Milhouses were owed under the policy. Throughout the trial,
25 the jury would hear about these differences, and the varying assumptions made by
26 Travelers and by the Milhouses about how to value their home, and about how to value
27 other coverages under the policy. What the jury could not understand without hearing the
28 parties’ respective mediation statements, however, was why, despite these differences,

1 the parties could not reach a reasonable settlement of the claim. The parties' mediation
2 statements provided an answer for the jury. It was not Travelers who acted unreasonably
3 in settling the claim. Sadly, it was the Milhouses. They demanded way too much money
4 to settle their claim.

5
6 On cross-examination, and in testimony that was, for the most part, not
7 substantively disputed by the Milhouses,¹¹ Mr. Ballinger explained to the jury that as
8 Travelers prepared for the mediation, it understood that they were about \$500,000 apart
9 from the Milhouses on settlement of the claim. (See Aug. 13 Transcript at 170:1-3
10 (Ballinger).) Travelers therefore offered "a couple hundred thousand dollars" to settle
11 the claim. (See *id.* at 171:15-18 (Ballinger).) The Milhouses' attorney had a very
12 different number in mind: \$7 million. (See *id.* at 169:3 (Ballinger).) Of that, \$800,000 to
13 \$1 million was accounted for by fees to be paid to the Milhouses' attorney, who at that
14 point had been on the case for about six weeks. (See *id.* at 170:22-173:9 (Ballinger); see
15 also Aug. 16 Transcript at 109:18-110:21 (P. Milhouse).) When the Milhouses' moved
16 from their demand, it insisted that Travelers commit to paying in a range between \$1
17 million and \$5 million. (See Aug. 13 Transcript at 170:8-10 (Ballinger).) Travelers
18 would not acquiesce to the Milhouses' demand. (*Id.* at 170:13-15 (Ballinger).)

19
20 Following the mediation, and throughout the trial, the parties remained several
21 millions of dollars apart on settling the claim. In his closing arguments, the Milhouses'
22 attorney summarized for the jury what he believed Travelers owed for not settling the
23 claim: "The amount of money you need to put for the bad faith damages on the jury
24 sheet . . . is \$8,325,860." (Aug. 22 Transcript, Vol. 1 at 62:2-8; 63:1-11) (Milhouse

25
26 ¹¹ At trial, both Dr. and Mrs. Milhouse testified that they did not have any specific recollection about the
27 settlement demands they made to Travelers at the mediation. (See Aug. 16 Transcript at 104:4-107:14
28 (P. Milhouse); Aug. 19 Transcript, Vol. 1 at 21:23-23:23 (C. Milhouse).) However, the "ball park"
estimations provided by Ms. Milhouse do not contest Mr. Ballinger's testimony. (See Aug. 16
Transcript at 106:20-107:14 (P. Milhouse).)

1 Closing Argument).) Then, he continued, because Travelers' conduct was so
2 reprehensible, punitive damages were required: "The very least you can award in punitive
3 damages for this company [is] . . . \$9,079,182." (*Id.* at 63:1-11) (Milhouse Closing
4 Argument).) The jury rejected the suggestions and recommendations of the Milhouses'
5 attorney, finding no bad faith on the part of Travelers and imposing no punitive damages
6 whatsoever.

7
8 It was entirely proper for Travelers to present the parties' mediation statements to
9 the jury. The evidence presented at trial clearly demonstrated that Travelers did not settle
10 the Milhouses' claim because of the positions that were taken during and after the
11 mediation by the Milhouses and their attorney. The jury therefore needed to hear all
12 about what happened during and after the mediation so it could determine whether
13 Travelers did in fact act unreasonably, maliciously, fraudulently, or oppressively by
14 refusing to settle the Milhouses' claim. To exclude this crucial evidence would have
15 been to deny Travelers of its due process right to present a defense. *See Cassel v.*
16 *Superior Court*, 51 Cal. 4th 113, 119 (2011) ("We must apply the plain terms of the
17 mediation confidentiality statutes to the facts of this case *unless* such a result would
18 violate due process, or would lead to absurd results that clearly undermine the statutory
19 purpose.") (emphasis added); *cf. Solin v. O'Melveny & Myers, LLP*, 89 Cal. App. 4th
20 451, 465-66 (2001) ("It strikes us as fundamentally unfair for a client to sue a law firm
21 for the advice obtained and then to seek to forbid the attorney who gave that advice from
22 reciting verbatim, as nearly as memory permits, the words spoken by his accuser during
23 the consultation. Simple notions of due process counsel against such a procedure.").

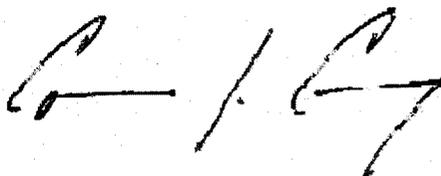
24
25 **CONCLUSION**

26
27 For two weeks, the jury sat and listened to testimony and viewed evidence
28 regarding Travelers' conduct in adjusting the Milhouses' insurance claim on the loss of

1 their home in a tragic fire. With the exception of the amount of damages awarded for
2 breach of contract, the verdict it returned was supported by substantial evidence. The
3 Court therefore upholds the jury's verdict that while Travelers did breach its contract
4 with the Milhouses, it did not act in bad faith in doing so. Travelers' motion for
5 judgment as a matter of law, and the Milhouses' motion for a new trial on bad faith are
6 therefore DENIED.

7
8 The Court does, however, GRANT Travelers' motion for remittitur, or in the
9 alternative a new trial. The jury's damage award was excessive with regard to the special
10 damages available to the Milhouses. The total damages award for breach of contract is
11 remitted to \$1,076,634. The Milhouses must notify the Court of their acceptance or
12 rejection of the remitted award by November 15, 2013. Should they reject the award, a
13 new trial will be held on breach of contract as soon as can be reasonably scheduled, in
14 consideration of the Court's and the parties' calendars.¹²

15
16
17 DATED: November 5, 2013



18
19 CORMAC J. CARNEY
20 UNITED STATES DISTRICT JUDGE

21
22
23
24
25
26
27 ¹² Because of the Court's grant of remittitur, or in the alternative a new trial on breach of contract, it is
28 unnecessary to reach the question of the Milhouses' entitlement to pre-judgment interest. That motion is
DENIED WITHOUT PREJUDICE. The Milhouses' may move for pre-judgment interest again after
judgment is re-entered in this matter.