CLM
FURTHERING THE HIGHEST STANDARDS OF CLAIMS AND LITIGATION MANAGEMENT
MARCH 2017

HOW 3-D IMAGING IS STEMMING THE GROWTH OF MEDICAL FRAUD

COVERAGE AND CLAIMS FOR PERSONAL VEHICLE SHARING PROGRAMS

WHY THE *SEBO* VERDICT SENT SHIVERS THROUGH PROPERTY INSURERS

Settling Into DEFEAT

Is an Unhealthy Aversion to Risk Keeping Insurers from Punching Back in Court?

Settling Into DEFEAT

Is an Unhealthy Aversion to Risk Keeping Insurers from Punching Back in Court?

Irwin R. Kramer and David A. Pisanic

Civil trials have become a rarity in recent years. The perception that defense costs have increased has placed a premium on settling cases that insurers previously used to defend. Rather than measure the impact of defense efforts on the value of a case, many claims professionals are evaluated on the speed with which they resolve cases and on the size of their "legal spend."

By placing a premium on fast settlements, however, the insurance industry may unwittingly be settling into defeat. Without taking cases to trial, we have undermined the value of verdict research that mines an insufficient sampling of claims. Left to speculate on the true value of a case, we focus only on that which we can control—legal expenses—and guess about the rest.

We may be avoiding catastrophic losses at trial, but our aversion to litigation also eliminates the benefits of a trial process that may favor carriers in the aggregate. Lacking a sufficient number of verdicts, we also deprive ourselves of the data needed to evaluate these claims on the basis of reliable information. For an industry that relies heavily on actuarial analyses, statistical trends, and projections, the speculation that surrounds claims evaluation and a myopic focus on the expense of defense may pose the biggest risk of all.

THE LITIGATION "EXPLOSION"

Although it is difficult to find credible data on the litigation "explosion," it isn't hard to find staggering statistics being cited without attribution. According to one blogger, "50,000 lawsuits are filed in this country every day." Another laments that "legal woes cost small businesses more than $100 billion a year."

These observations often end with scathing indictments of the legal profession as an unscrupulous enterprise founded on greed. "Contingency-fee law has made more overnight millionaires than just about any business one could name," wrote Walter K. Olson in his book *The Litigation Explosion: What Happened When America Unleashed the Lawsuit*.

A casual observer would read these headlines as a sign that jurors have gotten too generous with their verdicts, awarding millions of dollars in marginal cases. But most of these astounding contingency fees were paid out of cases that insurance carriers and other large corporations chose to settle.

In truth, the litigation explosion seems to have missed the courtroom. Less than five percent of all cases go to trial; far fewer are resolved by juries. When cases do reach a verdict, the awards often are below pretrial offers.

Does this trend confirm the industry's wisdom in deciding which cases to defend? Or does it challenge us to take more risks by taking more cases to trial?

TO TRY OR NOT TO TRY?

Although insurers complain of rising litigation costs, the percentage of cases going to trial has sharply declined in recent years. Nationally, studies from sources like the U.S. Department of Justice's Bureau of Justice Statistics show that more than 90 percent of all civil cases are settled, less than five percent are resolved at trial, and even fewer are decided by juries. When jurors do return verdicts, they rarely reward plaintiffs with more money than they could have settled for. So if fewer cases are going the distance, are litigation costs really rising? If they are not, then how can we explain what many trial lawyers believe is a greater reluctance to take defensible cases to trial? Let's take a look at three possibilities.

Changing Perspectives. Once part of a hawkish industry undeterred by the inflated demands of their adversaries, insurance carriers often took hard-line stances to develop tough reputations among plaintiffs' counsel. Such positions were thought to discourage litigation, increase the carrier's bargaining power, and reduce overall costs.

Exclaiming that "the best defense is a good offense," claims managers were more apt to take defensible claims to trial. Understanding the risks, litigation managers would tell their counsel that "if you aren't losing any cases, you aren't trying enough of them."

Times have changed. As their front-line soldiers prepare for battle, the generals in the home office now question the cost of ammunition. Where they once refused to pay "a penny for tribute," claims managers and their counsel must now pinch pennies on legal expenses.

Now that every case has a value, claims professionals are more inclined to pay a tribute on claims that their predecessors would have denied. Increasingly evaluated on the speed with which they resolve their cases, claims professionals may find little reason to celebrate a winning verdict that is the cause of a spike in legal spend.

Legal Costs or Case Investments. As industry attitudes toward litigation shift, the metrics by which carriers measure success have changed, as well. Using a microscope wielded by third-party auditors, the industry focuses intently on legal invoices, the duration of a given case, and other costs incurred in the litigation process. Unlike the savings realized through effective defense strategies, these "objective" factors are much easier to measure. Perhaps for that reason alone, they often command greater attention as a yardstick of a claims department's performance than the ultimate result achieved.

But viewing legal spend as a line item that ought be slashed may be shortsighted. If, as defense counsel often argue, an effective litigation strategy may eliminate or mitigate the liability of an insured, these same costs may be viewed as an investment in overall savings.

To measure the return on investment, carriers must crunch more numbers than litigation costs alone. They must look at the numbers on the indemnification side of the equation, attempting to correlate legal expenses with litigation outcomes. This requires a data dive to see if there is, in fact, an inverse correlation; whether there is a significant ROI; and, if not, what variables may be adjusted to change the equation in the carrier's favor.

Impact on Litigation Management Decisions. Figures don't lie, but they can be deceptive. To determine the true costs and benefits of litigation, we must crunch the numbers with care.

Many carriers fail to do this when reviewing litigation outcomes. Measuring their ROI with defense-cost-to-indemnity ratios, some carriers compare their total defense costs with the overall value of a case. That seems sensible if one values the case appropriately. But many carriers take a flawed approach to measuring a case's value by assuming that the ultimate indemnification cost is the case value.

Take a catastrophic loss for which ABC Insurance set reserves at \$250,000. After 10 months of litigation at a cost of \$50,000, the case settled on the eve of trial for \$75,000. In total, ABC Insurance disposed of this case for a total expenditure of \$125,000, or half of the projected exposure.

An outstanding result? Not under a defense-cost-to-indemnity analysis. Legal expenses constituted a whopping 67 percent of the $75,000 "value" of the case. Although the payout was only 30 percent of potential exposure, claims professionals who reserved $250,000 on this claim are more likely to be chastised for reserving too much than they are to be hailed a hero for saving that much.

In this example, comparing legal spend with the ultimate cost of indemnification would make sense only if ABC Insurance could have settled early for less than $125,000. But the real world is not that simple. In most cases, one must invest in litigation and case investigation to obtain the leverage required for outstanding results.

When carriers attend to the wrong metrics or crunch numbers without understanding the litigation process, they undervalue the work of claims professionals and their counsel. Ignoring their impact on the value of claims that would cost significantly more without them, these carriers second-guess the litigation management decisions of their staff and foster an unhealthy aversion to risk.

SETTLING INTO DEFEAT?

In an industry that is built on the calculus of risk, are we calculating risk correctly?

The trial process puts our risk tolerance to the test. The only certainty in taking a case to trial lies in the legal fees and costs incurred to get there. Few cases may be characterized as "slam dunks," and those that are often may be dismissed on preliminary or pretrial motions.

By avoiding protracted litigation, carriers may spare expenses and avoid unpleasant surprises. Their claims managers will not be taken to task for exercising the courage to litigate cases that ultimately fail to produce the desired outcome.

That's a safe approach to litigation and claims management. But is it a wise approach? Are we tolerating enough risks to achieve optimal results for policyholders and for shareholders?

If carriers engage in a trend of overpaying claims, then using settlement costs as a measure of value will only perpetuate a flawed formula. Yet if we are not sending a sufficient sampling of cases to trial, verdict research will not accurately reflect the value of these cases, either.

To be sure, trying more cases will create a statistical increase in awards at trial. But it may be the only way to gain a true measure of value. The problem now is that we have insufficient trial data on which to do any more than speculate as to the real value of cases.

The lack of reliable data contrasts sharply with the approach of an industry that relies so heavily on statistical analyses and actuarial studies. With all the industry discussion about the importance of big data, where are the statistics to confirm the litigation explosion, the runaway verdicts, or the increase in litigation expense? If we only measure defense costs and do nothing to obtain an accurate evaluation of claims exposure, then do we continue to assume that defense costs are the crux of the problem?

If there is a trend toward defense friendly verdicts, then perhaps we should try more cases. Others may disagree and argue that this "trend" reflects the wisdom of claims managers in determining with which cases to go the distance. With less than five percent of civil cases going to verdict, we lack a sufficient sample size to resolve this debate.

Devoid of data, a statistics-oriented industry must set reserves and settle cases on the basis of fear rather than fact. Are we evaluating cases as jurors would? Or are we settling cases and setting reserves based on a fear of what they might do?

Unless we try, we may never know. ■

Irwin R. Kramer is the managing attorney at Baltimore's Kramer & Connolly. He can be reached at irk@kramerslaw.com.

David A. Pisanic is president of David A. Pisanic & Associates and branch owner of AmeriClaim, a property and casualty adjusting firm. He can be reached at dapandassoc@comcast.net.