

FREQUENCY OF SEVERITY:

The New Reality for Excess Casualty

By:

Dana Alden Fox, Partner, Lewis Brisbois Bisgaard & Smith LLP

Christopher G. Kopser, President, Excess Casualty, Chartis

Steven E. Lessick, Vice President, Issue Management, Chartis

Bruce D. Margolin, Senior Vice President, Issue Management, Chartis

Richard C. Woollams, Senior Vice President and Chief Claims Officer, Chartis U.S.

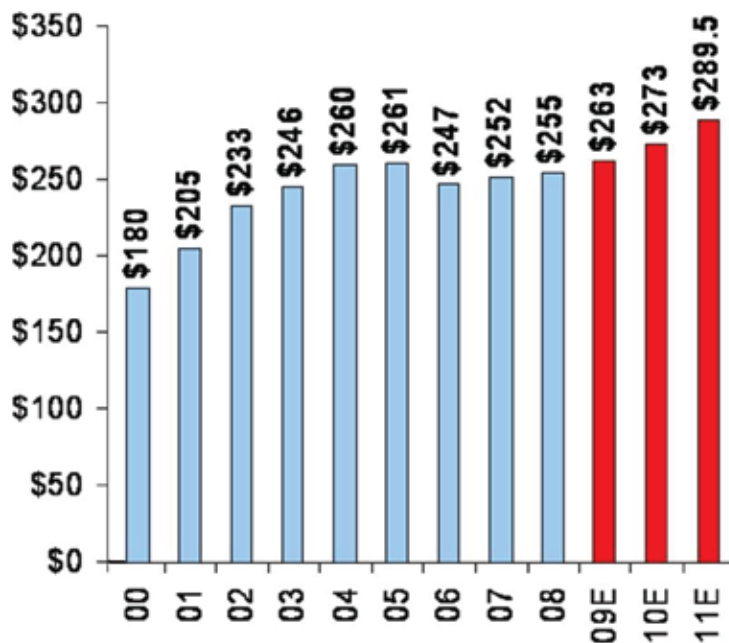
Tort Costs Rising

Tort costs are no longer on the decline. Diverse evidence suggests that any benefit derived from the long struggle for civil justice reform in the U.S. at state and federal levels may have reached its apex. The pendulum swing toward a fair and equitable litigation environment that gathered steam since the turn of the millennium is now poised for a push in the opposite direction. A review of the latest statistics is a warning flare signaling this development.

A View from the Top

Most current studies using broad measures of litigation trends and costs point to a distinctive climb in dollars spent in the tort arena. Tillinghast, the insurance consulting arm of Towers Watson, in its *2009 Update on U.S. Tort Cost Trends* succinctly illustrates the point. The study looks at three components to arrive at its figures: losses measured as monies paid or expected to be paid, defense costs and administrative expenses attendant to these losses. Tillinghast finds that tort costs have risen steadily, at times dramatically over the past twenty years. However, after two short years of stagnant or decreasing tort costs from 2004 through 2006, the culmination of many years of reform efforts, the dollars are again on the rise:

COST of U.S. TORT SYSTEM (in billions)



Source: Tillinghast-Towers Perrin, *2009 Update on US Tort Cost Trends*; Insurance Info. Institute.

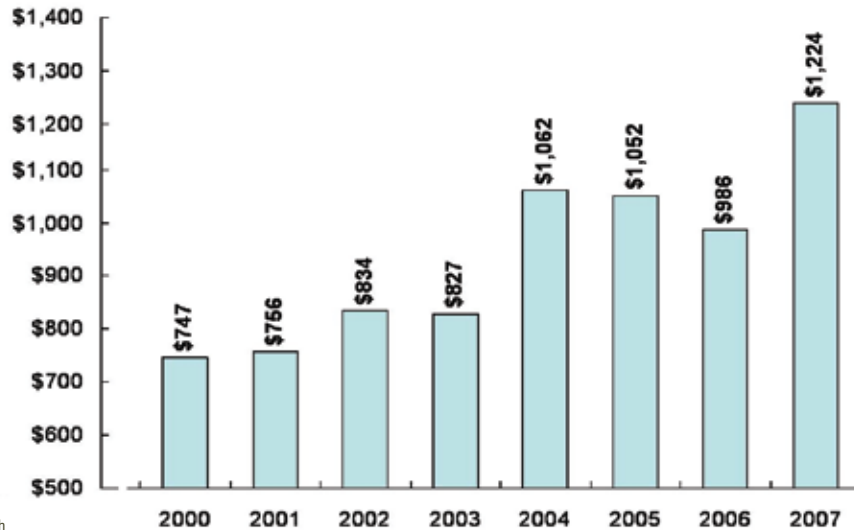
When the final tally is in, Tillinghast predicts a 3% increase in tort costs for 2009, larger than each of the previous four years. Moreover, the forecasts for 2010 and 2011 are even higher—4% and 6%, respectively.

A study by the Pacific Research Institute, a free-market think tank entitled “Jackpot Justice: The True Cost of America’s Tort System”¹ estimates the cost of our tort liability system to be even greater - \$865.37 billion per year, amounting to an annual “tort tax” of \$9,827 for a family of four.

¹ For the complete report, visit www.pacificresearch.org.

Jury Verdict Research (JVR) provides an alternative methodology that similarly supports the view that tort costs are trending upward. JVR maintains a nationwide database of plaintiff and defense verdicts and settlements in personal injury claims. Based on the latest available data, JVR's results are consistent with Tillinghast. After a steady rise in reported awards and settlements, there is a slight dip from 2004-2006, shown below, followed by the resumption of a rising arc in 2007:

Average Jury Awards 2000 – 2007 (in thousands)

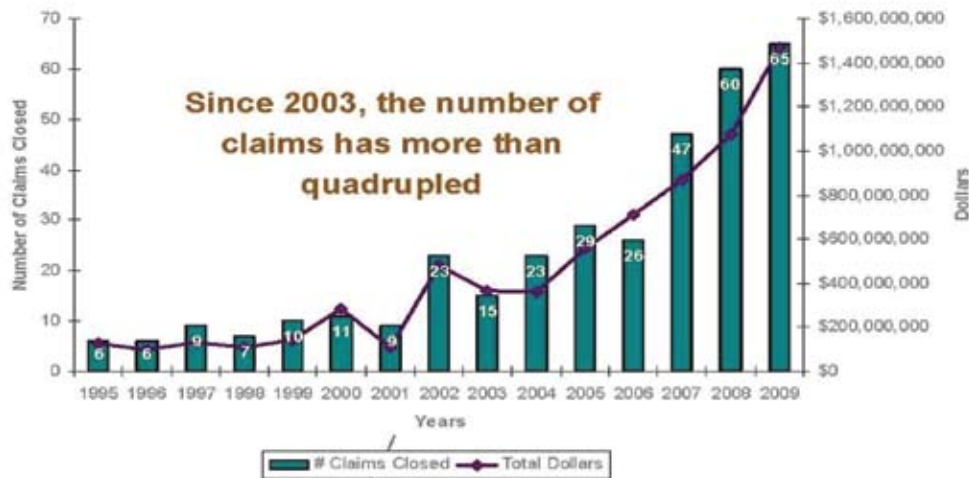


Source: Jury Verdict Research

In addition, in 2007 seventeen percent of all personal injury cases reported to JVR had awards or settlements of one million dollars or more, an increase from fifteen percent in 2005 and thirteen percent in 2003.

Finally, a picture of costs from Chartis' own excess claims book tells the same story. As illustrated below, the number of claims resolved by Chartis exceeding \$10 million quadrupled from 2003 to 2009. After a relatively flat period from 2004-2006, the number of high dollar claims resolved and the dollar amounts continue their ascent:

**Claims \$10M and Up
(Calendar Year 1995-2009)**



These different perspectives—a macro view of tort costs, jury awards and settlements and Chartis' own experience—all show a distinct movement from a flat or even decreasing tort cost environment to one resuming an upward climb.

A View from the Trenches

A look at individual cases and litigants' experience further supports the rise in tort costs. One such measure, the top ten verdicts of 2009 published by Lawyers Weekly, is particularly enlightening. The reported verdicts are for individual plaintiffs, defined as a single person or small group involved in a single incident tried in one case. Consistent with the data above, the average of the top ten verdicts increased substantially to \$145 million, up from \$112 million in 2008 and an almost threefold rise from the \$51 million average in 2007. The increase reverses several years of decline in the country's largest verdicts from mid-decade. Two verdicts exceeding \$300 million and five exceeding \$70 million were included among the top awards.

Also, for the second consecutive year, more than half of the top ten verdicts were awarded in personal injury cases—a significant change from previous years in which no one claim category predominated. While the top verdict was slightly lower in 2009 (\$370 million versus \$388 million in 2008), the cumulative value of the awards rose to \$1.511 billion, up from \$1.344 billion in 2008 and more than double the \$615.5 million total in 2007. The top ten provide further confirmation that verdicts, particularly those involving catastrophic loss, are on the rise.

2009 Top Ten Verdicts:

\$370 Million	Defamation	California
\$330 Million	Personal Injury (Drunk Driving)	Florida
\$300 Million	Personal Injury (Tobacco)	Florida
\$89 Million	Personal Injury (Drunk Driving)	Missouri
\$79 Million	Personal Injury (Pharmaceutical)	New Jersey
\$77 Million	Personal Injury (Medical Malpractice)	New York
\$71 Million	Conversion and Breach of Fiduciary Duty	Texas
\$70 Million	Workers' Compensation	Texas
\$65 Million	Personal Injury (Auto)	Florida
\$60 Million	Personal Injury (Medical Malpractice)	New York

What do corporate counsel think of the current litigation environment? The *6th Annual Litigation Trends Survey* published by Fulbright & Jaworski in 2009 provides some clues:

- Forty percent of those surveyed believe litigation against their company will increase in the coming year, including fifty two percent of respondents from large companies (\$1 billion or more in revenue). Most of the remainder thought levels would be about the same as last year. Only seven percent predicted a decrease.
- Companies facing at least one high dollar lawsuit (\$20 million or more at issue) increased to twenty seven percent from twenty four percent in 2008.
- Fifty three percent of survey responders say they spend over one million dollars annually in litigation costs (excluding settlements and judgments) up from forty five percent in 2008 and less than forty percent in 2007.

Whether from objective statistical analysis or the subjective concerns of those in the daily fight, a clear consensus has formed—expect more litigation, larger jury awards, additional high dollar claims and greater expense.

After several years of flat or decreasing tort costs and relative stability in frequency, particularly in catastrophic claims, the trajectory has reversed. Civil justice reform has been blunted and a new wave of tort litigation is upon us. Some principal reasons are discussed below.

The Altered Political Landscape

Civil justice reform proponents held their collective breath last January awaiting the arrival of a new administration whose policies and approach to governance was anticipated to be at odds with those of its predecessor. Among the optimists, the prevailing wisdom held that President Obama's administration was less likely to advocate efforts to expand liability or pro-plaintiffs' bar positions, instead reviewing each piece of legislation solely on its merits. The pessimists were concerned the Obama administration would routinely rubber stamp legislation expanding recovery rights put forward by a newly confirmed, Democrat-controlled Congress.

Who proved to be correct? A review of legislation passed with Administration support, as well as the Administration's reaction to certain U.S. Supreme Court decisions recently handed down, suggests that the pessimists' view was closer to reality.

- The first piece of legislation signed by President Obama, the Lily Ledbetter Fair Pay Act, which theoretically restarts the statute of limitations for unequal pay employment claims with each paycheck, was certainly unwelcome news in business circles.
- In another blow to business interests, the U.S. Supreme Court in *Wyeth v. Levine*² disallowed federal preemption defenses in some pharmaceutical claims. Taking its cue from *Wyeth*, the Obama administration further eroded the previous administration's widespread application of federal preemption by publishing an official White House memorandum ordering review of all regulations containing preemptive language issued within the past 10 years. In order for the regulation to remain in force, justification for federal preemption must be demonstrated.
- In December 2009, President Obama signed the Department of Defense Appropriations Act for 2010. Section 8816 of the Act, known as the "Franken Amendment", dramatically restricts the use of mandatory arbitration clauses in employment contracts between defense contractors and their employees or independent contractors. The provision was opposed by the Defense Department, Republicans and business interests.
- In the recent U.S. Supreme Court decision *Citizens United v. Federal Election Commission*³, the Court held that the government may not ban political spending by corporations in candidate elections. This was generally viewed by the business community as a step towards leveling the playing field with the plaintiffs' bar's outsized campaign spending. During his State of the Union address, however, President Obama tellingly remarked that the decision was "a major victory for big oil, Wall Street banks, health insurance companies and the other powerful interests that marshal their power every day in Washington to drown out the voices of everyday Americans."
- Despite the Administration's comprehensive efforts to overhaul healthcare and the legislation's passage into law, medical liability reform was virtually absent from the final product notwithstanding the public's overwhelming support for its inclusion.

Most pundits and experts agree Congress and the current Administration will continue to support legislation providing new or expanded opportunities for recovery. Few doubt that they will use their power to chip away or eliminate rules and regulations which limit individual recovery rights, especially those enacted during the previous administration. At the federal level, at least in the short term, civil justice reformers are once again forced onto the sidelines.

Unfortunately, the political landscape at the state level provides a similar view as 2009 saw a continuation of the pro-plaintiff legislative trends seen throughout 2007 and 2008. With Democrats in control in a majority of state legislatures, the plaintiffs' trial bar—a major party supporter—continued its full court press in statehouses nationwide to roll back existing reforms and pursue new opportunities for expansion of liability and recovery.

Looking ahead, the presence of a strong Democratic influence in many state legislatures clearly suggests that bolder, more pro-plaintiff legislation will continue to be proposed. Civil justice reformers will face tremendous challenges defeating or diluting the impact of such efforts. Few, if any, comprehensive reform efforts are likely to be mounted in the short term. Rather, the pattern of the last five years—seeking modest gains, vigorously opposing pro-plaintiff legislation and overturning of existing reforms—are likely, at least in the near-term, to remain the hallmarks of the political landscape.

² See *Wyeth v. Levine*, 129 S. Ct. 1187 (2009).

³ See *Citizens United v. Federal Election Commission*, 130 S. Ct. 876 (2010).

In September 2007, the action was dismissed. The thrust of the court's decision was that California's claim was a non-justiciable political issue that must be resolved through the legislative and executive branches rather than through litigation. Specifically, the Court found that in order to adjudicate the dispute, it would be required to make policy determinations that are best left to the other branches of government. The Court also found that interference by courts generally could undermine the political branches' foreign policy determinations "regarding the United States' role in the international concern about global warming." The appeal to the Ninth Circuit was ultimately dismissed.

Despite the trial court's refusal to hear California's claims, new climate change litigation continues to be filed as the plaintiffs' bar and public interest groups attempt to find a theory of liability that will survive the inevitable motion to dismiss for failure to state a valid cause of action.

In late 2009, two U.S. Circuit Courts of Appeal reviewed U.S. District Court opinions dismissing cases claiming that greenhouse gas emissions created a public nuisance. Both circuit courts reversed the dismissals and remanded the cases for further proceedings in district court, surprising some who considered public nuisance a waning if not discredited theory of recovery.

In *Connecticut v. American Electric Power Co.*, a suit filed by eight states—California, Connecticut, Iowa, New Jersey, New York, Rhode Island, Vermont and Wisconsin, along with New York City and three land trusts—against six electric power companies, sought "abatement of defendants' ongoing contributions to a public nuisance" under either federal or state common law. The complaint alleged that the defendants were the largest emitters of carbon dioxide in the United States and among the largest in the world. As relief, the complaint sought to permanently enjoin the power companies to abate the nuisance by capping carbon dioxide emissions and then by reducing emissions by a specified percentage each year for at least 10 years.

The district court dismissed the complaint by applying the political question doctrine, finding that plaintiffs' causes of action could not be decided "without an initial policy determination of a kind clearly for nonjudicial discretion." The court rejected plaintiffs' argument that this was a simple pollution-public nuisance case and instead noted that none of those cases "touched on so many areas of national and international policy."

On appeal, the U.S. 2nd Circuit Court of Appeals allowed the public nuisance claims to proceed. The panel held that the case did not present a non-justiciable political question, that the claims were sufficiently pled under the federal common law on nuisance and that the claims were not preempted by federal law.

In reversing the district court, the 2nd Circuit panel found the political question doctrine inapplicable, noting:

"Nowhere in their complaints do plaintiffs ask the court to fashion a comprehensive and far-reaching solution to global climate change, a task that arguably falls within the purview of the political branches. Instead, they seek to limit emissions from six domestic coal-fired electricity plants on the ground that such emissions constitute a public nuisance that they allege has caused, is causing and will continue to cause them injury."

The 2nd Circuit panel applied a six-factor test to determine whether the matter was a political question, ultimately finding that judicial resolution of the matter would not interfere with congressional or executive branch policymaking or violate the doctrine of separation of powers. The court also rejected the argument that existing federal statutes, specifically the Clean Air Act and Global Climate Protection Act of 1987, displaced the federal common law on nuisance as it applies to emission of greenhouse gases. The court noted that federal common law may be preempted by an act of Congress or the EPA, but at present no such preemptive legislation concerning greenhouse gas emissions exists.

On October 22, 2009, the U.S. 5th Circuit Court of Appeals in *Comer v. Murphy Oil USA*, allowed fourteen private actions against oil, coal and chemical companies to proceed in a district court finding that the plaintiffs had standing to sue, and as in *American Electric Power*, did not present a non-justiciable political question. In this case, landowners along the Mississippi Gulf coast alleged that defendants' operations contributed to global warming through emission of greenhouse gases. Plaintiffs alleged the warming from their emissions caused a rise in sea levels, adding to the ferocity of Hurricane Katrina which destroyed their property.

The 5th Circuit panel found that the plaintiffs had standing because they alleged a series of scientific facts which, if true, traced the damages caused by Hurricane Katrina to defendants' greenhouse gas emissions. The court relied on the U.S. Supreme Court's decision in *Massachusetts v. EPA*, which held that Massachusetts had standing to challenge the EPA's decision not to regulate greenhouse gases since:

- 1) The Supreme Court had already embraced a causal link between climate change and greenhouse gas emissions; and
- 2) Standing was proper even if plaintiffs alleged only that defendants' emissions contributed to their injury but were not the sole or material cause thereof.

As in *American Electric Power*, the 5th Circuit panel also held that the plaintiffs did not present a political question because defendants could not identify any federal law or constitutional provision that committed the issue of climate change to the executive branch or Congress. On February 26, 2010, however, the entire 5th Circuit bench took the rare step of ordering a rehearing of the panel's ruling, opening the decision to reexamination.

For now, the cases will have an impact on several fronts. On a broad level, the decisions will surely encourage similar greenhouse gas emission, nuisance-based suits by private parties, municipalities and other governmental entities. The cases could also impact other climate change litigation such as *Native Village of Kivalina v. Exxon/Mobile, et al.*, in which an Inuit village in Alaska is suing major oil companies claiming the companies' contribution to global warming has caused melting ice that threatens to flood their village. The district court in *Kivalina* dismissed the case on September 30, 2009, citing lack of standing and the political question doctrine. An appeal to the 9th Circuit, a traditionally liberal bench, has been filed.

As the plaintiffs' bar and public interest groups continue to probe the climate change landscape for additional avenues to claim injury and damage from business activity, more litigation is expected.

Can It Be Managed?

A carefully crafted and appropriately high tower of excess liability insurance remains an effective way for companies to shield their assets and their shareholders against the potentially catastrophic financial impact of U.S. civil liability lawsuits. However, the insurance purchase itself can be risky business. Selecting an insurer that is financially solvent to take on the risk long-term is an important consideration—even more so in long-tail lines of business like excess casualty, since claims can emerge years, even decades, down the road.

There is also widespread uncertainty over what level of coverage is enough to adequately address such an unpredictable tort system. What constitutes “reasonable” terms and conditions of coverage, is another question. Some of the most pressing issues to consider when buying excess liability insurance are examined here.

How much liability coverage is enough? The decision is more art than science. Requisite limits vary widely depending on a company's circumstances. However, it is generally safe to say that even the most benign operations should purchase primary liability insurance, plus at least \$50 million in excess limits. Companies that perceive even a low level of liability risk should count upwards from there.

A buyer should consider the size of its company's operations, its geographic spread, inherent industry hazards and vulnerability to mass claims. It should also benchmark limits against peers in its industry and keep abreast of recent settlements and verdicts. Many buyers keep a close eye on the annual listing of the year's *Top 10 Verdicts* as a barometer of worst case scenarios. Ask, could these happen to you?

In addition, buyers should be cognizant that coverage is not only needed to pay potentially catastrophic judgments or large settlements, but will also serve as the collateral required to post an appeal bond, which is typically the full value of a verdict or more. Many large awards are reduced or reversed on appeal. Without the ability to post bond, a company is powerless to mitigate a loss on appeal.

What claim and litigation resources support the policy? An insurer that has extensive institutional expertise and resources to help insureds respond to liability crisis events and to handle large liability claims can contribute invaluablely to protecting the policyholder’s interests—from the immediate aftermath of an incident through claims and litigation. The importance of assessing these resources before signing on with a carrier cannot be overstated.

Are terms reasonable? If a carrier is overly generous with policy terms and conditions in the current U.S. liability environment, potential buyers should beware. Undisciplined underwriting cannot be sustained. Insurers that lack discipline will likely subject their insureds to an abrupt change in underwriting strategy and pricing and/or non-renewal not far down the road.

Can limits be eroded by third parties? A company’s tower of excess liability insurance is precious, finite and should be defended vigorously, lest it be depleted when it is needed most. Critical to defending the tower is anticipating indemnity agreements or transactions that might necessitate granting additional insured status to third parties. Losses arising from indemnity contracts will erode policy limits. Insureds have even seen unlimited indemnification agreements evaporate limits available to them—paying instead for liability arising out of the conduct of others. Extending coverage in this manner should be done cautiously and should be considered when assessing the limit to buy.

.....

Summary

Whether recent tort cost increases ultimately prove an aberration or the vanguard of a new, long-term cycle of rising costs can only be surmised. What is predictable, however, is the protection and financial security afforded by a high tower of liability insurance provided by an insurer able to weather the storm. Chartis is such an insurer.

.....

About The Authors

Dana Alden Fox is a Partner at Lewis Brisbois Bisgaard & Smith LLP based in the Los Angeles office. Dana is experienced in all phases of practice with emphasis on civil litigation, including cases involving public entity liability, police civil rights, trucking and transportation, catastrophic injury, construction defect, and product liability.

Dana is a graduate of the California State University at Los Angeles and obtained his J.D. with distinction from McGeorge School of Law, University of the Pacific. He is admitted to practice in California and Colorado as well as U.S. District Court, all Districts of California and the U.S. Court of Appeals, Ninth Circuit. Dana is a member of The American Board of Trial Advocates (ABOTA).

Christopher G. Kopser is President of the Excess Casualty Division of Chartis. He is responsible for driving executive-level strategies, including profitability and growth initiatives, new product development, broker and client relationship management and ensuring effective coordination with Chartis U.S.'s other casualty units.

Chris joined the organization in 2001 as a Business Development Manager, and has since held increasingly senior roles in underwriting and marketing, including Senior Vice President of Field Operations, Strategic Relationship Group; Senior Vice President of National Accounts, Chartis U.S.; and Executive Vice President of National Accounts, Risk Management Group. Most recently, he had responsibility for the Greater New York Region as Regional President.

Previously, Chris held senior management positions at Metcalf & Eddy, a prominent global environmental engineering firm and Zenon Environmental, a publicly-traded environmental equipment company, where he headed the Defense division.

Chris is a graduate of Purdue University where he earned Bachelor of Science degrees in Chemical Engineering and Chemistry.

Steven E. Lessick is Vice President of Issue Management, one of the resource groups comprising the domestic claims organization of Chartis. Issue Management provides technical expertise and support across all claim areas, including tracking emerging claims-related issues, legislative and tort reform efforts and coordination of appellate issues, amicus briefs and appellate counsel. The group also serves as a resource for technical bankruptcy claims issues, acts as a liaison to underwriting units and provides inter-departmental committee coordination, including Medicare reporting and e-discovery issues.

Steve has over 24 years of claims and legal experience. He joined the organization in 1990 in the Environmental Claims Department, and has since held a series of claims technical and management positions in Domestic Claims, Litigation Management and Product Development. Previously, Steve served for 3 years as Deputy Attorney General for the State of New Jersey.

Steve earned a bachelors degree from Temple University and a law degree from Rutgers School of Law. He is admitted to practice law in New Jersey.

Bruce D. Margolin serves as Senior Vice President of Issue Management, one of the resource groups comprising the domestic claims organization of Chartis.

Bruce has over 22 years of claims and legal experience. He joined the organization in 1997 in the Toxic Tort Claims Department. Since that time he has held various claims technical and management positions of increasing responsibility in Litigation Management and Domestic Claims.

Prior, Bruce worked for 9 years as a defense attorney with a New York-based law firm and as a Senior Trial Attorney for Fireman's Fund Insurance Company.

Bruce earned a bachelors degree from the University of Massachusetts and a law degree from New York Law School. He is admitted to practice law in New York and Connecticut.

Richard C. Woollams is Chief Claims officer of Chartis U.S. In that capacity, he oversees the operation of Primary Claims, Property & Casualty (P&C) Severity Claims, Financial Lines Claims, Claims Resources & Solutions, Commercial Property Claims, Lexington Claims, Aviation Claims, Canadian Claims, Structured Settlements and Claims Operations & Systems.

Prior to assuming that role, Rick was President of P&C Severity Claims, Chartis, a position he held from 2002 to 2008. He has also served as Senior Vice President of the Excess Casualty Claims Department.

Rick began his insurance career in 1988, holding various claims positions with Travelers, including Vice President of Strategic Claims. Prior, he was an attorney in private practice in Ohio.

Rick is a graduate of Cleveland State University John Marshall School of Law. He is admitted to the Ohio Bar and is a current member of the Claim Committee for American Nuclear Insurers.

Chartis
175 Water Street
New York, NY 10038
www.chartisinsurance.com



Excess Casualty is a division of Chartis. Chartis is a world leading property-casualty and general insurance organization serving more than 40 million clients in over 160 countries and jurisdictions. With a 90-year history, one of the industry's most extensive ranges of products and services, deep claims management expertise, and excellent financial strength ratings, Chartis enables its commercial and personal insurance clients alike to manage virtually any risk with confidence.

Chartis is the marketing name for the worldwide property-casualty and general insurance operations of Chartis Inc. For additional information, please visit our website at www.chartisinsurance.com.

The information contained in this document is for general informational purposes only. The advice of a professional insurance broker and counsel should always be obtained before purchasing any insurance product or service. The information contained herein has been compiled from sources believed to be reliable. No warranty, guarantee, or representation, either expressed or implied, is made as to the correctness or sufficiency of any representation contained herein.