LIABILITY AND LITIGATION

Liability litigation observations and trends 2023

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Overview

In May 2020 — when the world was facing unprecedented disruptions during the COVID-19 pandemic — Sedgwick published an analysis of liability claims litigation trends and practices. In March 2022, our team revisited the subject of liability litigation trends in a paper examining the impact of the pandemic and other factors. Today, over a year later, we assess the state of liability litigation trends once again, and share observations drawn from Sedgwick and industry data.

Key findings

- Economic inflation and supply chain disruptions are adversely impacting the costs of both litigated and non-litigated claims, but the costs of litigated claims include additional increases above and beyond the recent elevated levels of inflation and disruption.
- Attorney representation, a precursor to litigation, is occurring earlier in the claims process across both auto and general liability claims.
- While litigation remains an extremely small percentage of the overall claim volume, it has been increasing incrementally over the past several years.
- The cost of resolving litigated claims is significantly greater than that of non-litigated claims and continues to escalate.
- Social inflation is exacerbating the costs of litigation beyond normal economic factors and is both fueled by and includes:
  - Third-party litigation financing
  - Nuclear verdicts
  - Class action lawsuits

In 2022, a myriad of drivers impacted the cost of litigated liability claims. As already noted, this group of liability claims represents an extremely small percentage of the overall claim volume with less than 1% tried to a decision[1]. That said, the subset of litigated claims may account for as much as 50% or more of the total paid on all claims depending upon line of insurance and individual mix of insured risks. This paper will attempt to provide an examination of the drivers, as well as the impact and trends that may be derived from the outcomes of liability litigation.

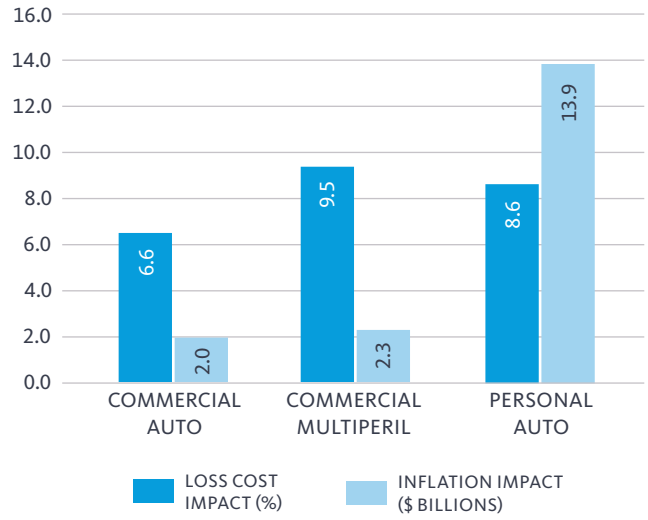
Economic conditions

Inflation

Economic inflation at the close of 2021 stood at 7%, approaching the highest it had been in four decades. During the course of 2022, inflation exceeded 9% by mid-year, closing out the year at 8%.

McKinsey and Company estimated that inflation alone increased U.S. property and casualty insurance loss costs over historical levels by $30B in 2021.[2] For auto damage claims alone, an estimated $9B in additional loss costs was seen because of price increases (motor vehicle parts and equipment up 22.8% and the cost of used vehicles up 14%) and other market factors.

U.S. inflation impact on loss costs[3]



Supply chain

A study conducted in June 2022 indicated that 95% of Fortune 1,000 companies were seeing significant supply chain disruptions. 75% of those businesses reported being negatively impacted by these issues.[4] After nearly three years of enduring wild swings and extremes, the system is slowly returning to pre-pandemic trajectories and getting back in sync — easing the pressure that was seen at the onset of the pandemic. These hardships were felt within the insurance industry throughout various aspects of the claim process. Consider the automotive repair environment. Supply chain delays impacted availability of replacement parts, leading to extended repair timetables by weeks if not months, which in turn extended rental car time periods — all factors contributing to a total cost increase for auto losses in 2022.[5]

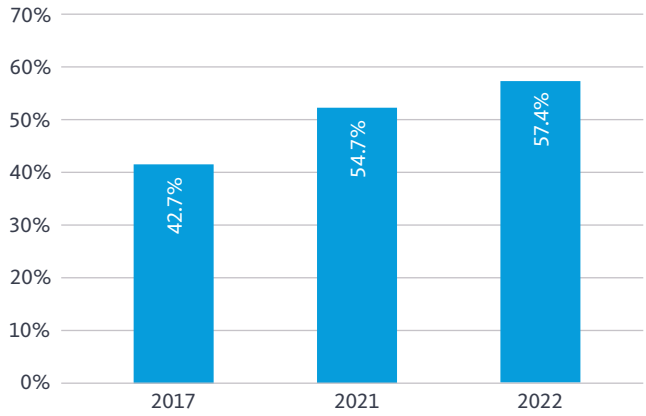
Litigation conditions

Attorney representation

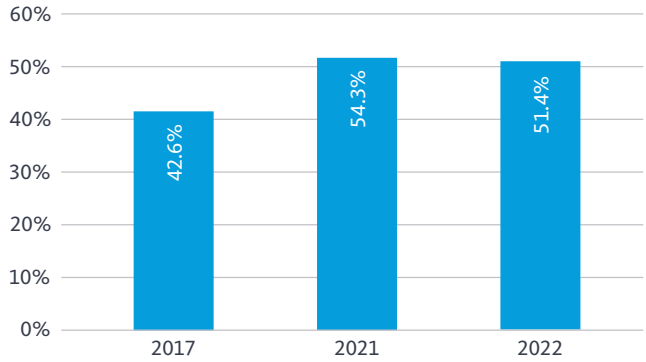
There is no question that a primary precursor to litigation in the general liability and auto arena is attorney representation at the claim level. **While the ligation rate for liability claims remains very low**, over the course of the last five years, we have continued to see an increasing number of claims being filed with an attorney representing the claimant at the time of first notice of loss.

In 2017, just under 43% of auto liability and general liability claims that ultimately would become litigated already had attorney representation in place within 24 hours of the claim being reported. By the end of 2022, the percentages had risen to over 57% for auto liability and 51% for general liability.

Percentage of all litigated auto claims with early representation



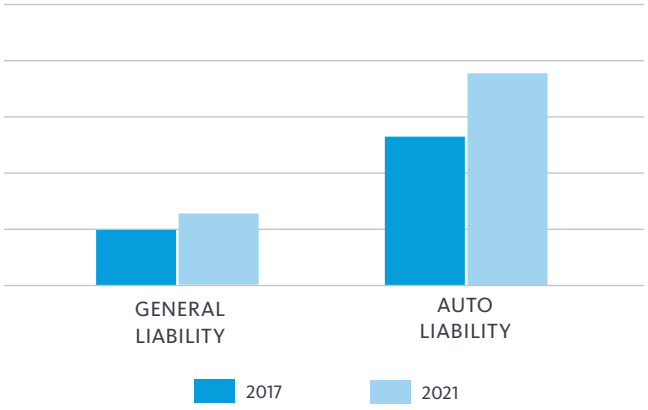
Percentage of all litigated general liability claims with early representation



Litigation rate

The overall insurance litigation rate across all lines has been reported by industry legal data expert, Lex Machina, to have spiked 47% between 2017 and 2021 — with 2021 accounting for the most federal case filings over that period at nearly 14,800.[6] Sedgwick data confirms an increase in the overall litigation rates for both auto and general liability claims over the same time period, although the **overall rate remains below 1%** of the total volume of claims received and actually decreased slightly in 2022.

Sedgwick litigation rates 2017 to 2021



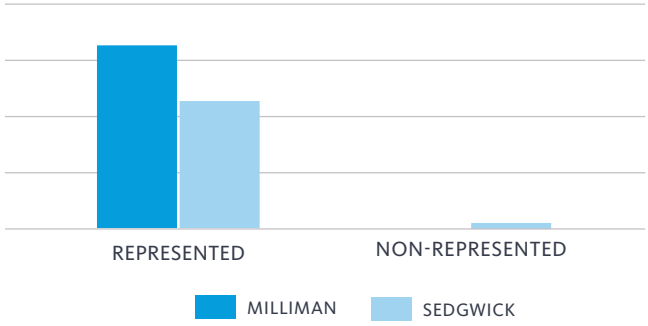
Litigation costs

As noted by Milliman in its report, *Trends in Attorney Representation: US Commercial Automobile Insurance*[7], claims with representation come with a cost. For claims closed in 2019:

- The average cost of claims with attorney representation was 14.3 times higher than the average cost of claims closed in 2019 without an attorney.
- The average cost to resolve a claim with an attorney was 34 times higher than the cost to resolve a claim without an attorney.
- The average total loss and ALAE for claims with attorneys was 15.3 times higher than claims without an attorney.

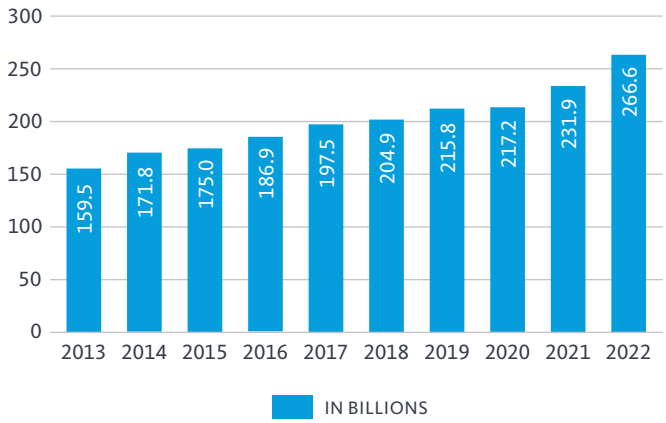
Sedgwick data shows a similarly large disparity between the cost of litigated claims and the cost of non-litigated claims, though less than the Milliman data. By the conclusion of 2022, the Sedgwick litigated auto claim data continued to reflect roughly the same ratio to non-represented claim costs as in 2019. However, the average cost of both litigated and non-litigated claims has continued to increase over that time as previously noted.

Cost of represented auto claim vs. cost of non-represented auto claim 2019



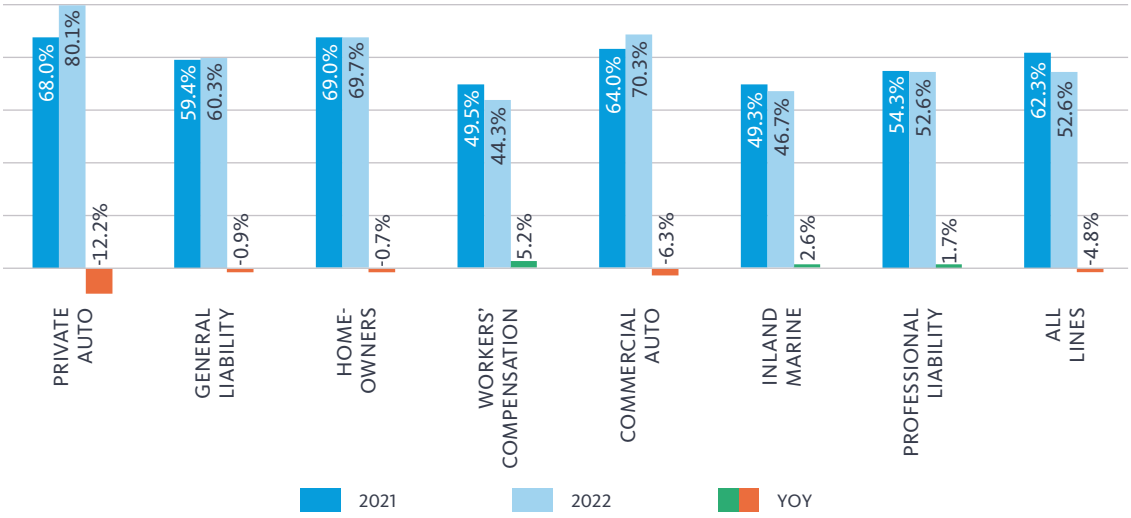
The net cost of claims is measured as net loss incurred plus loss adjustment expenses paid. To best understand changes affecting these costs, the aggregate data must be broken down further to separate out inflation, growth in policies in force, and other market cost influences. PropertyCasualty360's analysis of September 2022 shows emerging factors in insurance litigation.[8]

U.S. property/casualty insurance industry results[9]



Aggregate data on year-over-year metrics can give clues to developing shifts, as in the view below of loss ratios deteriorating across all lines specifically driven by private and commercial auto last year. But again, layers need to be peeled back to more clearly quantify root causes.

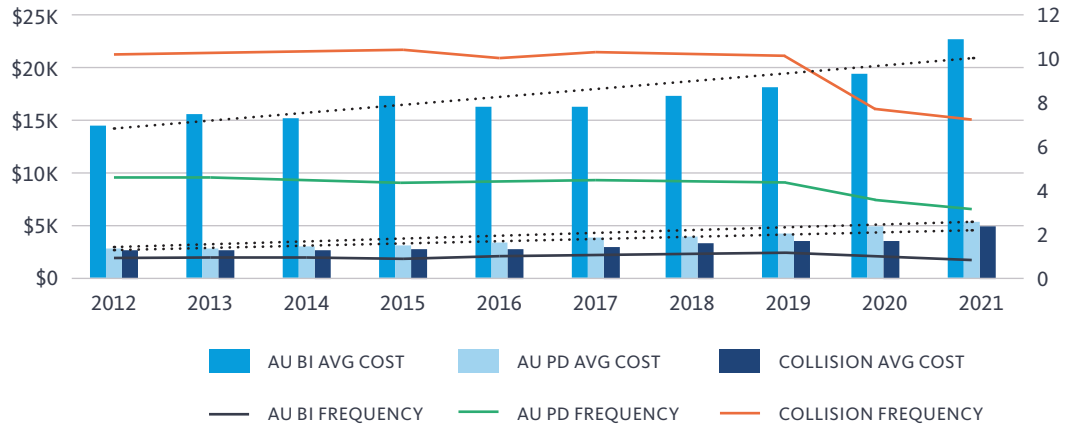
Loss ratios by line of business



Line of business results begin to offer a filtered view. Industry data reflects a 4.8% deterioration in the overall combined loss ratio year-over-year from 2021 to 2022 driven predominantly by increased losses in private and commercial auto.

A closer examination of auto results focused on frequency and severity can better illustrate trends and deviations. The chart below tracks frequency and severity across 10 years for personal auto. Relatively flat frequency can be seen up until the disruption due to reduced driving as a result of COVID-19 and consequent shifts to working from home. Over the same period, a progressive increase in severity can by tracked across auto bodily injury (AU BI), auto property damage (AU PD) and collision losses, particularly in bodily injury. The increases can be further dissected, revealing that they are outpacing normal inflation and marked influences. A notable larger annual increase can be seen in 2021 in both collision and bodily injury claims likely due to social inflation.

Personal auto claim frequency and severity trended[10]



Conspicuously missing is data for 2022 which was not available at the time of this publication. However, Sedgwick data suggests that a marked increase in both frequency and severity in 2022 data will be seen particularly in auto, and that primary drivers are supply chain disruptions for property damage and increased litigated claim costs for property damage and bodily injury — particularly due to significant increases in the number and cost of the largest litigated cases.

Social inflation

Social inflation is a term that has been adopted to describe a phenomenon increasing the frequency and severity of litigated claims beyond the influences of pure economic inflation. This factor is derived from changes in societal beliefs and expectations of increasingly higher compensation for injuries in liability litigation.

Juries continue to dictate that when someone is injured, "someone" must pay. And the "someone" is inevitably a person perceived to have deep pockets. A corporate tortfeasor who has (or who can be painted to have) acted with disregard can be a target for inflated awards. Corporate mistrust leads the list of suspected causes. A Pew Research survey published in November 2022 found that 71% of those surveyed feel corporations negatively affect the country.[11]

It is difficult to determine an actual percentage impact of social inflation on litigation. In a recent article, "Social inflation increases in med mal losses" (January 23, 2023 – Judy Greenwald), Business Insurance noted a study from The Doctors Co. which made such an attempt. The article stated, "In the decade ended in 2021, between $2.4B and $3.5B, or 8-11%, of all medical malpractice losses incurred by physician-focused insurers stemmed from social inflation…"[12]

The Insurance Research Council[13], the Center for Insurance Policy and Research[14] and others attribute multiple drivers to the advance of social inflation, including:

- Changes in attitudes towards liability and responsibility and a willingness to punish those who cause injury.
- Increased plaintiffs' attorney advertising and narrative shaping.
- Weakening of previously enacted tort reforms and statutes of limitations and caps on punitive damages.
- Growing societal distrust of large corporations.
- Normalization of disproportionate awards by both traditional news outlets and social media.
- Emerging risks like COVID-19 and harmful substances.
- The proliferation of third-party litigation funding.
- Increasing numbers and reporting of large jury verdicts.

Third-party litigation financing (TPLF)

Litigation funding enterprises provide financial backing to plaintiffs' attorneys in exchange for a share of the award. The funding is most often made available in commercial litigation, particularly litigation involving mass torts. As a result, plaintiffs' lawyers can more easily develop involved trial preparations, retain experts, and have lessened incentive to reach a compromise settlement. According to a study by Swiss Re, litigation funding reached an estimated $17B worldwide in 2020 and is contributing to social inflation.[15] Defending against venture capital-funded plaintiffs' attorneys, their experts and sophisticated presentations is causing defendants to take new approaches to counter them, resulting in an increase in defense costs.

Third-party litigation financing remains unregulated and there have been numerous reports of predatory lending practices and allegations of conflicts of interest in cases involving TPLF. The interest rates effectively charged have been challenged in some states under usury laws while other states have refused to establish any guidelines. In 2021, the U.S. Congress reintroduced the Litigation Funding Transparency Act aimed at identifying funders and exploitive terms in funding agreements, although no additional action has been taken since that time.[16]

An ongoing case in the U.S. District Court for the Northern District of Illinois exemplifies challenging aspects of litigation funding. Sysco, the funded plaintiff, sued its funder, Burford Capital, Ltd., alleging the funder is meddling in the company's attempts to settle cases in which it is the plaintiff. Burford obtained a restraining order prohibiting Sysco from consummating settlements to resolve price-fixing lawsuits asserting that the settlements were too low given their assessment of the value of the claims. Burford invested $140M in the price-fixing and related cases. Facts are disputed as to the application of the terms to the agreement, but the dispute itself highlights some concerns inherent to non-party financial investment in litigated disputes.

Nuclear verdicts

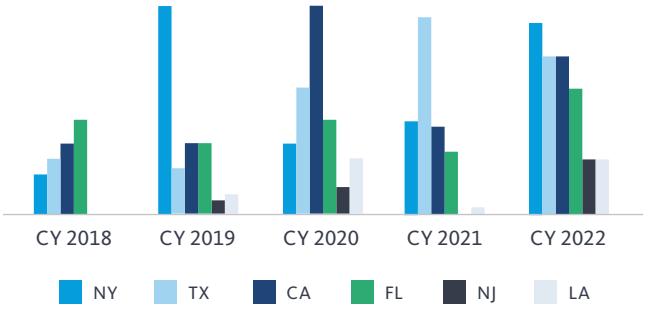
Jury trial results in 2022 continued to exhibit some of the highest plaintiff verdicts in history. In Virginia this past year, for example, a personal injury plaintiff recovered $47.5M, the largest sum ever recovered by a single personal injury plaintiff there. The previous record had been $30M, making the award 58.3% greater than any prior award in Virginia.[17]

Notable larger nuclear verdicts in 2022 include medical malpractice awards of $97.4M in Iowa[18] and of $111M in Minnesota[19], a dram shop case award of $96M in Florida[20] and a $1.14B exemplary damages award in a wrongful death case in Texas[21] (which was reduced from the jury award of over $7B by the judge in the case, following the $375M awarded in actual damages), to cite a few, and show no signs of slowing in 2023. Nuclear verdicts are most prevalent in products liability (23.6%), auto liability (22.8%) and medical liability (20.6%).[22] Georgia rose to the top of the judicial "hellholes" list recently after a string of nuclear verdicts including a $1.7B award against Ford Motor Company for failing to recall or disclose a perceived design deficiency with the roof of a F-250 pickup truck that crushed two occupants in a 2014 rollover. Prior to that, Florida and New York led the list of states with the most nuclear verdicts per capita between 2010 and 2019.[23]

Auto claims, and specifically the trucking industry, continue to be a prime target of nuclear verdicts. Other auto nuclear verdicts last year included an award of $35MM in California[24] to a plaintiff alleging back injury when rear ended by a tractor trailer, $45M to three plaintiffs in a trucking rear-end accident in California, $14M in NV[25] to a cyclist struck by a SUV, $80M to a family whose daughter died after being struck by a pickup truck in FL[26], and $25M to a man hit by a tractor trailer truck in IN[27] who has since recovered from the injuries received with an additional $5M awarded to his wife. And the awards show no sign of slowing this year with awards reported in March of 2023 of $75M in MO and $409M in Los Angeles to families of children killed in collisions.[28]

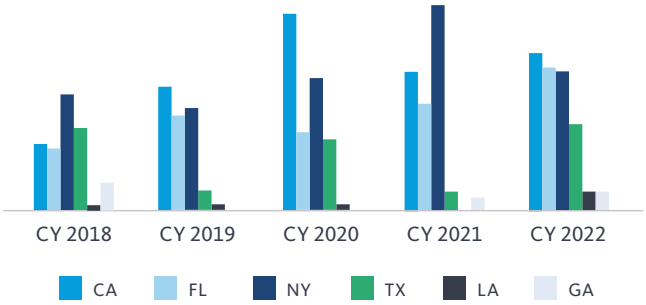
Although not representative of nuclear verdicts, Sedgwick data is consistent with the above litany of verdicts that certain states are worse than others when it comes to social inflation. For auto high-cost liability claims, the states of New York, Texas, California, Florida, New Jersey and Louisiana are most prevalent.

Auto body injury claim volume by incurred including outliers by top states



For high costs in general liability, the states of California, Florida, New York, Texas, Louisiana and Georgia are most prevalent.

General liability body injury litigated claim clause by incurred including outliers by top states



Class action lawsuits

Class action lawsuit size and frequency both increased while settlements decreased in 2022 and the number of class actions is expected to increase further in 2023. According to Carlton Fields[29],

- A record $3.5B was spent last year defending class actions.
- Labor and employment disputes made up nearly 35% and consumer fraud cases made up nearly 22% of the total.
- More companies (45.8%) had some coverage in place, up from 32.1% in 2021.
- The class action losses covered by insurance fell from 42.2% in 2021 to 30.4% in 2022.
- Active class actions related to COVID-19 have reduced by half year over year.
- Consumer fraud class actions challenging environmental, social and governance (ESG) corporate statements and involving data privacy are expected to continue to increase.

Among the more successful defenses remain demonstration that there is not a single issue of law or fact common to a class or that the claims of the class representatives are not typical of others of the class arising from substantially the same events. The number of dismissals for lack of actual injury has increased while failure to state a valid claim has declined but remains among the most pled and won defenses.

Avoidance and mitigation strategies

Companies should start at the beginning for avoidance and mitigation by cultivating an enterprise risk management culture that sets the highest expectations for safe and responsible practices and processes throughout the organization. Loss control consultation and assessments, using data and predictive analytics, and leveraging emerging technologies like telematics can all be useful in developing overall avoidance and mitigation plans. Adopting a cadence of regular reassessment of risks, adequacy of limits and retentions is crucial to understanding exposures and being prepared. Corporate ESG programs that establish an organization's documentable commitment to safe and responsible conduct of its operations bolster sustainability and help make companies less easy to paint as indifferent, profit-focused institutions.

Litigation avoidance at the claim stage must continue to be a focus. Advocacy — ensuring timely communication that promotes understanding of the claim process with a resolution focus — will help ensure that claims do not become litigated. Additionally, utilization of predictive modeling identifying claims likely to become litigated can prompt an aggressive workflow to push appropriate and timely resolution. Once a suit is at hand, seek to reach an amicable pretrial settlement. Identifying counsel with the specific knowledge and expertise of the relevant area of law, the jurisdiction and of current plaintiff strategies is foundational to favorable outcomes. Companies and their counsel should attempt to settle all appropriate cases expediently. Alternative dispute resolution mechanisms generally present fewer volatile forums to reach settlements, and bench trials more often are preferable to jury trials.

In some cases, plaintiffs and their counsel will not be dissuaded from a trial and specific trial tactics must be undertaken. In those instances, it is beneficial to identify an empathetic physical presence to represent the organization and make sure they are present and attentive throughout the trial. Defense witnesses should be well prepared by counsel to be able to provide unfettered positive testimony and not fall victim to opposing counsel tactics. A trial theme should be developed that seeks to "humanize" the company and demonstrates the competence and relatability of individuals as well as the commitment of the organization to responsible conduct and moral citizenship.

Since the publication of Don Keenan and David Ball's book, "Reptile: The 2009 Manual of the Plaintiff's Revolution," plaintiffs' attorneys have successfully adopted the tactics described therein and others that similarly appeal to fears, psychologically creating equivalence between punishment and protection by appealing to instincts for survival and protection. Defense counsel must adopt strategies to counter these tactics through an understanding of the psychology behind them in the context of today's social climate. Astute defense counsel is referencing the devices of "reptile theory" and reverse engineering defenses in preparing opening arguments, closing arguments and witness testimony.

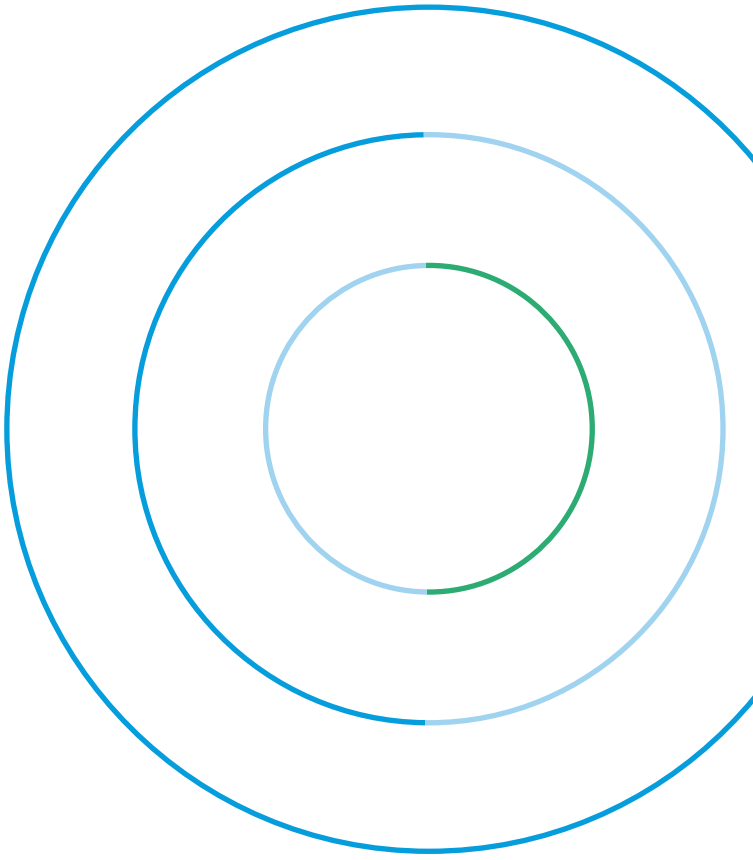
Another mechanism that has been used successfully by plaintiffs' counsel that can be countered by defense counsel is a tactic called "anchoring." Anchoring is a cognitive bias to rely on a reference point for making later decisions or evaluations. Defense counsel can and should begin shaping the narrative and setting anchored expectations early in interactions. But it is more than just a matter of being first, most repeated or loudest. Further studies have shown that anchors tied to understandable and believable derivations are more persuasive. Competent, affable experts and explanations that can be understood and resonate with jurors are imperative.

Conclusion

The frequency of litigation in liability insurance claims, while still comparatively limited, is continuing to increase. Despite the deceptively small percentage of claims that are litigated, the relative costs of litigated claims are disproportionately large and may account for more than half of all claims costs. Claimants are engaging counsel earlier and more often, and the frequency of litigation is increasing. Contemporaneous with the increase in the frequency of liability claim litigation, the costs of resolving litigated claims continue to increase at a rate exceeding normal inflation and market conditions, bolstered by social inflation, growing third-party litigation financing, nuclear verdicts and class action lawsuits. The brief disruption to the rising trajectories of frequency and severity of litigated claims during pandemic-related court closures appears to be behind us, overshadowed by the litigation COVID-19 itself generated — exceeding that of any previous single event.

But the forecast is not all continued escalation and gloom. At the time of this writing, Florida — historically a state with some of the highest litigation rates, highest legal costs, and known for excessive awards — has passed a comprehensive tort reform package (Florida HB 837). Additionally, U.S. Congress and the courts are showing signs of bringing more transparency and scrutiny to third-party litigation financing.

The most powerful defenses to litigation exposures are mitigation and avoidance strategies and execution. In partnership with risk and claims specialists, insurers and the businesses they insure can leverage emerging technologies, data, expert knowledge and proficiencies to reduce the frequency and severity of litigation and its associated costs from the risks they face.



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