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Feature Story

Settling Large Insurance Claims

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In order to resolve large insurance claims, litigation has become the order of the day. Insurance companies have long known that the time value of money far outweighs the cost of litigation and, therefore, their marching orders to their claim representatives would appear to be "delay, delay, delay." Insurance coverage litigation can be expensive and disruptive because few judges understand how to move such cases forward and avoid playing into the hands of insurance company lawyers. Policyholders who stick it out in litigation may recover their attorneys fees under certain circumstances and in certain states. The business pressures to settle before trial often become overwhelming, however, forcing the policyholder to take discounts in addition to having borne the cost of litigation.

In order to avoid playing into the hands of their insurance companies, policyholders should plan for settlement from the earliest moment. A well-thought-out strategy can be the best way to resolve these disputes quickly, inexpensively, and on terms favorable to policyholders.

Put together a winning team: Your team should consist of persons familiar with your liabilities (past and future), your insurance coverage (past and present), and the issues common to insurance coverage disputes. Each area of knowledge is critical to achieving a good settlement. These persons can be in-house personnel alone or accompanied by outside consultants. With respect to outside consultants, in addition to law firms, accounting firms, loss adjusters, insurance brokers, environmental consultants, insurance archaeologists, and myriad other consultants profess expertise in helping policyholders collect on claims. Be careful, many are better at marketing than achieving results. By all means demand and check references.

Be prepared: Before beginning to negotiate, your team needs to collect and organize some basic information, such as:

1. The total amount you have already spent on liabilities

2. The total amount you have already spent on defense

3. How much you are likely to be liable for in the future, and to spend on defense

4. The cause or basis of your liability, such as (product liability claims, ownership, premises liability, negligence, professional liability)

5. Expenses that arguably are not covered should be separated from those that clearly are

6. The wording of policy provisions that impact coverage for the disputed claim (insuring agreements, exclusions, limits deductibles, premium agreements)

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Calculate each insurance company's exposure: When a large claim involves multiple insurance companies, as most do, each insurance company's exposure should be calculated separately. For "long-tail claims," those involving multiple years of coverage, the calculation methods are practically infinite. Alternative calculations should be done to evaluate key variables for each insurance company's liability.

Negotiate with one company at a time: Negotiations that bring all the insurance companies together at the same time are unlikely to result in prompt settlements. Because the issues in these negotiations are numerous and complex, settlements usually take place separately with each insurance company. As with all rules, there can be exceptions; particularly where the claim involves a single year of coverage.

Keep control with the principals: The fastest way to bring settlement negotiations to a grinding halt is to allow outside lawyers to control the process. Virtually all insurance company lawyers have a financial interest in delaying settlement. They often get tangled in unproductive arguments with opposing counsel. There must be a principal-to-principal line of communication to keep control over the process.

Develop an early focus on the scope of the release: When a policyholder comes to its insurance company to resolve one claim or group of claims, insurance companies often use it as an opportunity to foreclose future claims. For the insurance company, this is the time it has the greatest leverage, when its policyholder expects to be paid for a claim. Insisting on such tying may be bad faith, however. An insurance company should pay valid claims, without using them as an opportunity to extract unrelated concessions from its policyholder.

Nevertheless, policyholders need to think early about what is negotiable and what is not. Plan a strategy and stick to your guns. In order to preserve future coverage, it is critical to consider what are commonly referred to as "carve-outs." These are potential future claims that are not covered by the release under the settlement agreement. Examples of classes of future claims that a policyholder should consider carving out include bodily injury, product liability, employment liability, asbestos, lead paint, and environmental. In making these determinations, policyholders should consider the future viability of each insurance company.

Make sure that all settlements are "net of retro": If you have a retrospective premium agreement, make sure that the insurance company understands that any settlement agreed to is net of the retrospective premium adjustment. Sometimes an insurance company will offer a substantial settlement amount during negotiations without any reference to outstanding retro issues. Then, once the agreement is final and it is time to make payment, the insurance company will subtract the retrospective premium adjustment from the agreed-upon amount. The insurance company will then issue the check for the lower amount and argue that it is consistent with the agreement. Be sure to check everything before signing anything.

Beware of indemnification provisions: Insurance companies frequently will try to insert an indemnification provision in the settlement agreement. This will take the form of language pledging the policyholder to "defend, indemnify, and hold harmless" the settling insurance companies against claims by third parties and by nonsettling insurance companies. Although these provisions rarely come into play, if they do, they effectively turn the policyholder into an insurance company for the insurance company. This is not a position you want to be in. They — not policyholders — are the professionals at managing, spreading, and accepting risk.

Examine allocation issues: Insurance companies often add a provision to draft settlement agreements, providing that they are allowed to allocate their payments among multiple insurance policies as they see fit. They might claim that this is nothing more than a matter of internal bookkeeping and is no concern of the policyholder because it will not affect the amount due under the settlement.

This is true, as far as it goes. Policyholders nonetheless need to review and to have the opportunity and right to approve of the insurance company's allocation. While it might not affect this settlement, a clever allocation scheme could close out good policies that would otherwise be available to pay future claims. The policyholder should try to allocate as much as possible to the bad policies. Issues to consider, among others, include exclusions, deductibles, self-insured retentions, retrospective premium issues, and per occurrence and aggregate limits.

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Do not bind future acquisitions: With all settlements, watch out for language that would prevent you from asserting claims arising from corporations that you (or the insurance company) acquire in the future. By the same token, carefully review all "release" language to avoid any unintended releases of claims for which you will become the indemnitor.

Try to accommodate reinsurance companies: Insurance companies worry whether their reinsurance companies will cover them for the settlement. Whenever possible, honor requests that assist your insurance companies in getting reimbursed. Being cooperative puts more money on the table for you.

Beware of open-ended "standstill agreements": Parties sometimes agree to delay or suspend litigation to allow time for a settlement. A "standstill agreement" might have the benefit of reducing the costs of unnecessary litigation. On the other hand, they also have a tendency to reduce the policyholder's settlement leverage. If the parties agree to a standstill, its duration must be clearly defined. It needs to be commensurate with a realistic period for the policyholder to provide necessary information, for review and response by the insurance company, and then negotiations. Anything longer simply means more time that the insurance company inevitably will continue to hold on to money it owes the policyholder.

Assume that nothing is confidential: Individual insurance companies insist on confidentiality provisions. You should assume that such provisions bind you, but not them.

Try a little tenderness: Insurance company employees are people who do get weary — a fact often forgotten in the heat of battle. The skills you have learned while negotiating in other contexts should be applied even if you believe that your insurance company wrongly denied you coverage. Keeping the discussions businesslike will help to advance the successful outcome of the negotiations.

Although many observers thought extremely large disputes could not be settled out of court, past experience with asbestos and environmental claims has demonstrated that as the law governing hotly disputed issues becomes more certain, policyholders can expect more settlement and less litigation. However, as Woody Allen once warned in another context: "Someday, the lamb will lie down with the lion, but the lamb will not get much sleep."

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