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Elephant in the room

Why are we afraid to talk about managing claim costs?

BY KIM HOGREFE

THE U.S. STOCK MARKET has just suffered through one of its worst years in history — one that will put more companies at risk for securities class action litigation. In fact, a trend toward more litigation was already taking shape in the first half of 2008, in large part as a result of the credit crisis and market volatility, according to a study by NERA Economic Consulting.

As of mid-December 2008, shareholder class action filings were on pace to reach almost 267 by the end of 2008, which would represent a 37% increase over 2007 and the largest annual total since 2002, according to NERA's report ("2008 Trends in Securities Class Actions"). At that rate, filings will have more than doubled in just two years from their recent low of 131 in 2006.

At the same time, attorney fees have also been on the rise. Attorneys at some of the top New York law firms, for instance, are now billing as much as $1,000 an hour.

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As the demand for legal services rises and legal defense costs escalate, companies will be at a disadvantage if they do not have a contingency plan in place to manage the threat of a securities class action lawsuit. By planning ahead and developing a strategy to cope with a securities litigation, companies can help to keep their legal defense costs under control, reduce the potential for billing disputes with their law firms and insurers, and better manage their insurance premiums as well.

To get started, companies should meet with their insurance broker, directors and officers (D&O) underwriter, and claim representative when their policy comes up for renewal. At the meeting, three items should be on the agenda:

— Selection of counsel;

— Review of bill payment guidelines; and

— Establishment of bill review process.

The policy renewal period offers a good opportunity to establish the level of importance attached to each item and ensure that all parties are in alignment on this. Once the policy has been renewed, the team should meet again to begin moving forward on each of these three items.

Selection of Counsel: Under their D&O liability insurance policy, defendants generally have the right to choose their own legal counsel, subject to the insurance company's consent, which shall not be unreasonably withheld. Most companies, however, wait until after a lawsuit is filed to begin their search for a law firm. This puts the company in a weak bargaining position because it is under pressure to quickly line up its legal counsel.

Instead of waiting until after a lawsuit is filed, senior executives should consult with their broker and D&O insurer and together begin the process of selecting a securities law firm in advance of any litigation.

The company's representative and its D&O insurer could then meet with several of the top securities law firms in order to negotiate more favorable billing rates. The D&O insurer should have a wealth of experience with securities law firms and may have other clients that have used those law firms. The insurer also may be able to exercise more influence with the law firms in regards to their billing rates because the insurer could be the source of additional work in the future as well.

At the conclusion of the evaluation process, the law firms could be advised that although they are not being retained at that time, the company will keep them on a short list of firms that might be contacted in the event of a future lawsuit. Knowing that they are in competition for the company's business may also make the law firms inclined to negotiate more favorable billing rates and alternative billing structures such as capped fees.

Review of Bill Payment Guidelines: Under their D&O policy, companies are responsible for paying legal bills associated with covered litigation up to a specific deductible. After meeting the deductible, companies may submit bills for additional legal costs to their insurer for payment.

Problems can arise, however, if the insurer finds that a company paid bills that were not reasonable or necessary as defined under the terms of its policy. Even though the company may have paid enough to meet its deductible, the insurer may determine that the deductible has not, in fact, been met. This can lead to disputes between the insured company, its legal defense team, and its D&O insurer at a time when they should be working together to fight a common threat.

To avoid this conflict, companies might discuss the bill payment guidelines with their insurance broker as well as their D&O underwriter and claims management team at the inception of the policy or at policy renewal time. During this discussion, the firm can compare its litigation management guidelines for non-securities lawsuits not covered by insurance with the guidelines established by its D&O insurance carrier. This may help clarify any questions about the bill payment guidelines. A company that wants a customized approach can negotiate those terms with its insurer in advance and those extras can be taken into account in calculat-

Reprinted from Directors & Boards® First Quarter 2009
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ing the premium the insurer will charge.

Establishment of a Bill Review Process: Companies also should discuss setting up a bill review process with their D&O insurer. This would ensure that even the bills that are to be paid by the company under their deductible are first reviewed by the insurer to see if they meet the agreed upon payment guidelines. Most insurers have a great deal of experience reviewing bills and can save their clients the time and expense of reviewing and challenging any questionable bills.

In addition to these steps, companies should give careful consideration to their selection of a D&O insurer. Companies should consider whether the insurance company has the expertise and experience in dealing with securities litigation and the ability to negotiate agreed guidelines and review bills through a well-established and reasonable bill review system. At a time when financial stability is a serious concern, companies also should be sure to select an insurer that is financially strong, well capitalized, and capable of withstanding any additional economic upheaval.

Most companies have done a good job in establishing contingency plans for a variety of business disasters. By planning ahead for the risk of a shareholder lawsuit, companies will be in a better position to respond if they ever are named in such a suit. These crucial steps can help to rein in legal defense costs, keep the insured company and its attorneys and insurers working together rather than against one another, and help to keep litigation costs as low as possible. ■

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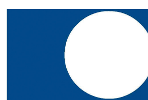

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