

## The Legal Trends Behind 'Social Inflation' In Insurance

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The phrase "social inflation" has been trending in the insurance industry recently. The phrase generally refers to the increasing costs of insurance claims (defense and indemnity) resulting from societal trends such as litigious proclivities, large defense costs, mega jury awards, broad insurance policy interpretation and a plaintiff-friendly and policyholder-friendly environment.

The Wall Street Journal recently described it in insurance industry parlance as referring to "an upward creep in perceptions by an injured party of what they are owed, their willingness to pursue that via the legal system, and what that means for insurance policies covering companies' liabilities." [1]

Social inflation is a concept that, in many respects, is something borrowed. It is endemic within the United States civil justice (tort) system. It has been a fundamental reality throughout the 32 years that I have had the privilege of representing defendant companies, insurers and reinsurers. It has been the dynamic driving tort reform efforts by the defense bar and insurers spanning decades.

In 1977, Warren Buffet referred to social inflation as "a broadening definition by society and juries of what is covered by insurance." [2] Yet, many aspects of social inflation are new and evolving. It is fueled by more recent developments such as litigation funding, social media, and modern attitudes and movements.

To be sure, for insurers, social inflation also is something blue, impacting risks and costing the industry plenty of green in the form of defense and indemnity costs.

### The Traditional Components of Social Inflation

Although other countries such as Australia, Canada and the U.K. may experience impact from social inflation, the effects of social inflation undoubtedly are felt most heavily in the U.S. due to our civil justice system. It's results can be measured in large settlements, jury verdicts and defense costs.

The myriad of underpinnings in the U.S. civil justice system fostering social inflation, include:



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- An organized, well-funded plaintiffs bar;
- The availability of punitive/exemplary damage awards;
- Class action and multidistrict litigation;
- Securities and shareholder derivative litigation;
- The availability of juries in civil actions;
- A system of state and federal law with differing procedural rules, substantive laws, standards and available damages and other relief;
- Extensive pretrial discovery and disclosures (including interrogatories, document requests, requests for admission, physical and medical examinations, depositions of fact witnesses, corporate representative witnesses, and experts witnesses);
- The use of contingent fees in bodily injury cases;
- The American Rule on attorney fees (which generally works against corporate defendants);
- Fee-shifting statutes that, when applicable, usually benefit policyholders and some underlying claimants;
- Junk science and lax evidentiary standards;
- Forum shopping and carpetbagger claims;
- The disparate impact of res judicata and collateral estoppel against corporate defendants; and
- Increased regulatory requirements that either provide for private causes of action or create litigation generating publicity or evidence.

These realities have been the targets of the protracted battle for tort reform. Although some meaningful tort reform measures have improved affairs in some jurisdictions, they have not had a meaningful impact in other jurisdictions. Suffice it to say, tort reform has not been a panacea. At least from the perspectives of defendants and insurers, the civil justice system remains highly flawed.

### **The Current Environment Has the Potential to Constitute Social Inflation on Steroids**

Apart from the ineffectiveness and erosion of tort reform, there are several factors in modern society driving social inflation in the U.S. We examine some of them below.

#### ***Litigation Funding***

Companies and insurers are familiar with the large costs of defending law suits. Traditionally, the availability of contingency fees allowed plaintiffs to pursue bodily injury claims that would not be pursued if plaintiffs were required to pay lawyers an hourly fee concurrently and in the absence of recovery. The costs of prosecuting such cases and risks of no recovery at least acted as a modest check

on the willingness of plaintiff counsel to take on some representations.

The concept of litigation funding and litigation financiers have altered this balance. Under this arrangement, companies agree to cover all or some of the costs of litigation or arbitration in return for a share or percentage of the proceeds, whether from a jury verdict or settlement. The growth and mainstreaming of litigation funding — which by many accounts has more than doubled since 2012 — is one factor of social inflation.

It results in an increase in the volume of cases that are being pursued. It also enhances the ability of plaintiffs to take cases further and pursue larger recoveries, increasing the litigation timeline, the costs of defense and the potential for more and larger verdicts. It also has the potential to alter litigation control and leverage.

### ***Attorney Advertising***

The proliferation of attorney advertising has created awareness of and access to the civil litigation system to most segments of society. Simply stated, media advertising and social media are potent recruiting tools for plaintiff lawyers and they have employed these tools masterfully. They not only generate claimants, they have created great expectations for recovery.

### ***Jurisdiction-Specific Issues Such as Florida's AOB Crisis***

Related to litigation funding are various state initiatives that alter the litigation playing field between policyholders and insurers. Florida, for example, has an assignment-of-benefits, or AOB, law that not only allows a policyholder, without insurer consent, to assign benefits to a third party, but permits plaintiffs attorneys (but not insurers) to collect their fees when they prevail in AOB litigation.

This fee-shifting, like litigation funding, has paved the way for a high increase in the filing of claims and lawsuits. In 2018 alone more than 153,000 AOB lawsuits were filed in Florida, representing a 94% increase over a five year period of time.

Although a measure signed into law by Gov. Ron DeSantis in 2019 somewhat curbs the AOB litigation crisis by putting new requirements on contractors and permitting insurers to offer policies with limited AOB rights, it is only a partial remedy as it only impacts future underwriting and only affects certain third parties and AOB claims (e.g., the bill excludes auto glass repairs).

### ***Lawyering Up***

An increased propensity for claimants to retain counsel and for them to assert claims and file suit factors into social inflation as well.

### ***Anti-Corporate and Anti-Insurer Sentiment***

Hostility toward and distrust of large companies is hardly a new development — it always has been something the plaintiffs bar has exploited adroitly. Still, anti-corporate sentiment seemingly has amped up in recent years due, among other things, to residuals from the financial crises, the so-called Occupy Wall Street movement and various protests. Social media provides a platform for corporate haters to gather and for negative public sentiment about companies to proliferate. Similarly, trust in institutions and individuals has declined in recent years as has trust in elected officials and business leaders.

### ***Political Discourse Factors Into Jurors' Mindset***

Notions of socialism, social justice, wealth and income disparities, and wealth distribution that abound on the airwaves and political discourse in general may not be admitted into evidence, but nonetheless influence the thought process of jurors. This fosters an environment in which juries are more inclined to render awards with less emphases on fault, greater emphasis on company reputation, and perhaps more important based upon the perceived ability of companies to absorb losses. On the whole, millennials appear to be more wired in this direction. Political polarization and disagreeable discourse may not be exempt from the jury deliberation room.

### ***Reptilian Strategy***

The plaintiffs bar is seizing the moment by turning to reptilian psychological techniques calculated to activate jurors' survival instincts and make them more likely to rule in favor of plaintiffs based on emotional stimuli, rather than facts presented in evidence.

### ***Beliefs Over Facts***

A national survey conducted by Sound Jury Consulting in 2019 found three-quarters of respondents eligible for jury service stated they would decide a case based on their own personal beliefs of right or wrong if those beliefs conflicted with the law as instructed by the judge. The number is higher for millennials.

### ***Impact of the Information Age***

Limiting jurors' access to information other than evidence admitted into evidence at trial always has been challenging. However, absent complete sequestration it is an virtually an impossible undertaking in the information age with instant access to the internet and social media.

The civil justice system places great importance on jury instructions and the rule of law depends, in large part, upon jurors following the judge's instructions. According to the 2019 Sound Jury Consulting study, 57% of respondents say they would ignore a judge's instructions to avoid internet research on the case if they believe they could obtain important information, 52% say they would not take the time to look at the jury instructions during deliberations if they believed they understood the issues in the case and 75% say they would disregard the judge's instruction to ignore inadmissible testimony if they believed the testimony was important. We do not vouch for this particular study, but its results are concerning.

### ***The Normalization of Mega Verdicts***

Frequent media reports of multimillion and multibillion dollar verdicts has desensitized jurors and, to some extent, has normalized such awards. This has resulted in awards in excess of policy limits and the impacting of umbrella and excess policies that, absent social inflation, would not have been impacted.

### ***Expanded Liability and Disappearing Defenses***

Unwarranted expansion of liability theories such as public nuisance (e.g., the California lead paint litigation), state legislation suspending or abolishing statutes of limitation (e.g., for sexual abuse/assault cases), and the abolition of or limitation on nondisclosure agreements adds fuel to social inflation.

Similarly, an expanding universe of potential plaintiffs with government entities and others seeking recovery on tort theories has had an impact as well.

### ***Aggressive Governmental Agencies***

State attorneys general and other state and federal governmental entities have become increasingly aggressive in investigating and taking action and seeking relief in various forms against companies and insurers and in seeking resources to offset government deficits. Even where not directly implicating insurance coverage or creating private causes of action, these investigations often trigger private lawsuits and losses and result in public disclosure of evidence that will be used in private litigation.

### ***Pro-Policyholder Rulings***

Unduly broad interpretation of insurance coverage by some courts and liberal application by jurors adds mightily to the social inflation factor. Efforts such as the policyholder advocacy piece which is masquerading as the American Law Institutes' Restatement of the Law of Liability Insurance threatens to distort insurance law.

### ***Technology and Globalization***

The increased geographical scope and rapidity of liability due to technology and globalization produces claims under first-party and third-party coverages and contribute to social inflation.

### ***Large Defense Costs Exposures***

Defense costs exposures have surged over the decades due to an increase in the number and severity of claims, inflated claims and claimant expectations, and to counter well-funded plaintiffs. Sophisticated policyholders' counsel have been more aggressive and successful in having insurers pay for independent counsel. This contribute substantially to the high costs of defending lawsuits.

### ***Large Settlements***

Upward pressure on settlement values, in part, has resulted from the desire to avoid random mega jury awards and doctrines in many states allowing claimants to set up insurers with time-sensitive settlement demands. The consequences associated with breach of the duties to defend and settle can be substantial and potential bad faith exposures may be large.

### ***A Random Universe***

Today, the potential for isolated statements and activities — as well as systemic practices — to result in liability seems ever present. In the age of #MeToo, political correctness and social media, it is hard to predict what will become viral and trigger litigation and liability.

### ***Adjustor Liability***

Recently, there have been some efforts to hold adjustors personally liable for violation of claims handling statutes and alleged bad faith.

## Addressing Social Inflation

The impact of social inflation has been felt across multiple lines of coverage including commercial auto, medical malpractice and professional liability coverages, umbrella and excess coverage, and directors and officers liability coverage.

Insurance plays a vital role in the economy — fostering entrepreneurial risk-taking, research, product development, the availability of goods and services, and risk sharing. The unavailability of insurance would bring the economy to a halt. Yet, this critical sector of the economy constantly is under siege from claimants, policyholders, courts, governmental regulators and media.

Fortunately, insurers employ bright and talented people who find ways to meet the challenges presented. Insurers have several tools to address social inflation.

Among other things, they may assess and better quantify the risks, raise premiums to account for the risks, lower limits and include sublimits where appropriate, draft policies with appropriate terms, conditions and exclusions to contain the risks, exercise underwriting discipline, employ artificial intelligence and technology on both the claims and underwriting sides, train personnel, and retain skilled counsel and experts.

Insurers will work with policyholders to employ cogent loss control, safety and best practices to avoid and limit liability even in an environment supercharged with social inflation.

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[1] “The Specter of Social Inflation Haunts Insurers,” The Wall Street Journal (Dec. 27, 2019).

[2] Id.