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Rapid Growth of TPLF Impacts Insurance Affordability

Over the last decade, third-party litigation funding (TPLF) has evolved into a $18.2 billion industry worldwide. More than half of that money is being spent in the U.S, making TPLF a major contributor to social inflation and hiking up jury awards and claim settlements that may have a significant impact on insurance prices and coverage availability.[1,4, 12, 13]

In 2023, 89 lawsuits againts corporate defendants resulted in a nuclear verdict of at least $10M, while 27 were thermonuclear verdicts of more than $100M. This is the largest number of such cases identified in a single year since 2009.[13]

WHAT IS THIRD PARTY LITIGATION FUNDING (TPLF)?

TPLF occurs when an outside entity finances the legal representation of a party involved in a court case. Litigation funding companies (LFCs) often invest in consumer and commercial litigation in return for a percentage of the award or settlement. Typically, TPLF focuses on personal injury claims, mass tort product liability claims, or commercial litigation between companies and the government. In contrast to contingency funding, where attorneys work on a no win - no fee basis, third-party funders give financial assistance, often in the form of a loan that accrues interest, in exchange for a stake in the potential award. This kind of financing is often offered to law firms unwilling or unable to cover the costs of a drawn-out legal battle or help claimants unable to pay legal fees.[3]

The growing involvement of TPLF is generating more massive award amounts and increasing total liability costs because plaintiffs can pursue cases further and make better use of effective litigation strategies that contribute to social inflation.[2] And, there's no limit to the kinds of risk litigation funders will consider. Funding has supported various cases, both first-party and third-party liability, including wildfire, product liability, hurricane, and COVID business interruption claims.[3]

HOW IS TPLF IMPACTING THE INSURANCE INDUSTRY AND CONSUMERS?

Driven by general anti-corporate sentiment born of the Great Recession, social inflation continues to grow, aided mainly by a continuous news cycle and the pervasive use of social media. Ten years ago, settlements in the millions were rare, and a judgment in the billions was unthinkable. Still, as jurors become desensitized to huge verdicts and seek to empathize with plaintiffs by backing “the little guy,” nuclear verdicts are becoming all too common. Companies now face threats from a steadily rising baseline, which is returning to pre-pandemic levels.[13]

In August 2021, a $1 billion judgment was handed down by a Florida jury in a case against two commercial trucking companies deemed responsible for the death of a college freshman in an accident. After only five days of testimony, the deceased student’s parents were granted a $100 million verdict for their pain and suffering, as well as a $900 million judgment for punitive damages.[5] While that amount was highly unlikely to be paid due to the appeals process, it was shocking, nonetheless. In December 2021, a Texas jury granted a largely symbolic award of more than $301 billion in a lawsuit brought against a Corpus Christi bar by the family of a grandmother and her 16-year-old granddaughter killed in a drunk driving accident. The suit alleged that the bar was responsible because the establishment had over-served the drunk driver.[6]

It is estimated that only 10% - 15% of cases fail when backed by third-party financaing.[2]

Breathtaking as these judgments are, plaintiffs don’t always see the massive amount emblazoned in the headlines as jaw-dropping verdicts are often significantly reduced on appeal. In the trucking case mentioned above, both trucking companies were insured. The plaintiff may have collected up to the policies’ limits, but receipt of anything beyond that depends at least in part on the trucking companies’ financial status.[7] While the Corpus Christi bar verdict represented the largest verdict in U.S. history for such a crime at the time, it’s unclear what the family may receive because Texas doesn’t require bars to maintain liquor liability insurance and in many instances, appeals can last 3-5 years.[8] However, even reduced or symbolic nuclear verdicts do immeasurable damage by fanning the flame of public outrage and setting a new high floor for future verdicts.

The top states for corporate nuclear verdicts in 2023 were:[13]

- **Missouri ($4.1B)**
- **Texas ($3.7B)**
- **Pennsylvania ($1.2B)**
- **Washington ($1.1B)**

Not all awards hit 9 or 10 digits, but from 2010 to 2019, the percentage of verdicts worth more than $5 million increased from about 29% in liability cases to 36%.2 In 2023, the median nuclear verdict rose to $44 million.[13] TPLF-driven super-sized legal awards have worked to increase loss ratios for excess liability, commercial auto, medical malpractice, and general liability lines.[2] The combined ratio for commercial auto in 2023 was projected to hit 110.2%, the highest level since 2017, thanks to a substantial rise in the frequency of multi-million-dollar claims over the last decade.[10]

It may seem like significant verdicts paid out by companies with deep pockets and high insurance limits balance the scales of justice. In actuality, they increase hardship for many consumers and insureds. Insurance companies charge prices today that are intended to cover the claims they'll pay tomorrow. So, as insurance companies pay for outsized awards, they balance the loss by narrowing coverage terms, expanding deductibles, and raising premiums until they achieve a profit or leave the line of business altogether, which further reduces the availability of liability coverage. All of these costs are ultimately born by consumers and insureds who must find a way to pay for rate increases, bigger deductibles and retentions, and assume uninsured liability risks. As prices rise and terms narrow, challenging classes will only get tougher.

Juries across the U.S. found corporate defendants liable for over $14.5B in nuclear verdicts in 2023.[13]

As carriers scramble to recoup underwriting losses, litigation funding companies continue to see attractive returns on their investments. Research indicates that from 2019 to 2021, personal injury case profits ranged from 25% to 35%, and mass-tort lawsuits raked in profits of 20% to 25%, which is a significantly higher rate of return than the S&P 500's average of 10%.[2] According to a report from the U.S. Government Accountability Office, one funder reported a 93% return on investment in 2021.[11]

However, as litigation funders take in huge profits, plaintiffs are receiving less. Plaintiffs typically receive 55% of awards when not backed by third parties, but those that utilize third-party funds collect only 43% of the judgment on average.[2] In addition, plaintiffs run the risk that a settlement could be rejected because of TPLF pressure to profit from the investment, meaning they may walk away with nothing if a trial verdict goes against them.[3]

HOW IS THIRD-PARTY LITIGATION FUNDING REGULATED?

While it has huge consequences for both consumers and the insurance industry, TPLF is a multi-billion-dollar industry that remains highly opaque.[3] Despite its rapid-fire growth, regulations around third-party litigation funding haven't kept pace. To date, there are no federal laws that require the disclosure of TPLF funding, despite growing public appeals by industry groups. However, Republicans in the U.S. House of Representatives have recently moved to address concerns about TPLF by introducing a draft transparency bill. The legislation would require parties to disclose any third-party funders who would share in any eventual judgments or settlements but would not require disclosure of funders who simply provide loans but do not hold a stake in the outcome.[14]

For most of the country, there are very few requirements around disclosure of whether a third-party litigation firm is involved in a case or how much it would receive from an award.[4] This also makes it difficult to determine if there are potential conflicts of interest between funders and defendants. Much like insurance regulations, the rules around TPLF vary from state to state, and litigation funders are adept at exploiting those differences, often choosing which cases to back based on the jurisdiction.

Today, only 25 of 94 U.S. district courts require disclosure of litigation funding agreements for civil cases. Many are calling for tighter regulation of third-party litigation funding, including disclosure around funding agreements and interest caps on those agreements structured as loans, as well as the inclusion of anti-usury regulations to safeguard plaintiffs against excessive interest rates.[2]

Some state governments have also proposed and implemented their own TPLF disclosure laws. Legislators in several states have taken steps ranging from comprehensive tort reform packages to more specific measures, like Iowa's law capping liability damages against trucking companies, to limit large jury verdicts. Other states, like Montana and Indiana, have enacted measures to increase transparency in third-party litigation financing.[12]. [13] In 2023, Florida proposed a sweeping "consumer protection" act on litigation financing, which would require a series of disclosures.

In addition to a current general lack of regulation around TPLF, the plaintiffs' bar is benefiting by more quickly leveraging evolving legal technology that can help in the pursuit of large settlements. The use of predicative analytics helps the plaintiff firms better understand their opponents, know what size of award to ask for, and stay abreast of successful legal precedents to use in securing bigger awards. On the other hand, the defense bar, typically working for insurance companies, is generally less tech savvy, is hindered by tight cost controls, and suffers from a a lack of experienced staff, which creates heavier caseloads. Combine all of that with the fact that the plaintiffs' bar has a better history of sharing data than the defense bar, and it becomes even more challenging to defend insurers in the courtroom.[9]

Among claims awarded more than $1M, the average general liability award has climbed from $8M to more than $10M, and average vehicle negligence judgments have risen from $6M to $8M.[2]

HOW AGENTS CAN HELP

It can be difficult for clients to understand why social inflation causes their premium to increase or coverage conditions to tighten, even when they haven't filed a claim. Many have no idea TPLF exists or how its consequences trickle down to the individual insured. Agents can help clients understand market conditions by proactively educating clients about the changes driven by TPLF. While the news isn't always positive, agents that are upfront and able to articulate the drivers behind market changes can avoid catching clients off-guard at renewal and stand a much better chance of retaining long-term business.

Agents should also encourage clients to Invest in solid risk management plans and processes to help reduce the likelihood of a claim. If a company's risk management plan is gathering dust on a shelf, it's time to dust it off, modernize the action steps, and put it into practice. This is important for businesses across all industries, especially those without dedicated risk management departments.

BOTTOM LINE

Juries are poised to award even more nuclear verdicts in the years ahead. Third-party litigation funding is here to stay, and it continues to have far-reaching consequences for consumers/insureds. The ripple effect of TPLF practices will continue to be felt by insurers by increasing their loss costs. Policyholders will feel the pinch as they struggle to pay for uncovered losses and higher premiums stemming from the increase in frivolous litigation and higher settlements partially driven by a TPLF.[3]

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CONTRIBUTORS

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