

THE Review Class Report

THOUGHT LEADERSHIP ON THE KEY RENEWALS ISSUES

TODAY ▶ LIABILITY

Signs of US-style litigation in Europe

AS US LITIGATION CULTURE SPREADS TO EUROPE, INGRID DAHLQUIST HIGHLIGHTS THE IMPORTANCE OF LEGAL SAFEGUARDS AND OPEN COMMUNICATION

With extensive media coverage of US verdicts, many Europeans have become increasingly aware of large awards and expect that they, too, might similarly benefit if injured. In light of this trend, the industry may anticipate increasing claims costs for indemnity and defence that could become a burden to insurers and reinsurers alike.

TENUOUS LIABILITY

While nearly three quarters of residents in the UK are worried about the impact of an increasingly pervasive 'blame, claim and gain' culture, half say they would claim for damages if they were injured.

Legislation and legal precedent are in place for that very reason, but when a culture moves toward seeking damages when the connection to the alleged wrongdoer is tenuous and the alleged negligence and injury are trivial, costs spiral upward and all insureds ultimately foot the bill. Examples of such claims from the US include that of a burglar who won damages after he sued the homeowner because he fell through a skylight.

ACTION POINTS

For the foreseeable future the situation remains under control. The focal consideration for insurers and reinsurers is one of relationship, including open communication regarding reserves and exposures, both known and unknown

In the US, strong emphasis on consumers' rights in the marketplace, the readiness of lawyers to file litigation of often questionable merit and the fact courts frequently allow such cases to proceed to verdict, suggests a reluctance on the part of individuals to accept responsibility for their own actions.

While tenuous cases and excessive awards like the one mentioned before are not to be found in the UK, there is now evidence that UK lawyers are more enterprising and that citizens have a greater tendency now than ever before to seek redress if they suffer a perceived injustice or injury that they are convinced was someone else's fault.

CITIZEN TAX

According to a Towers Perrin Tillinghast study of US tort cost

trends, the total cost of the US tort system relative to GNP increased from 2.04% in 2001 to 2.44% in 2006, and will continue to grow. These costs are in effect a tax on every US citizen. In contrast to the US, UK tort costs are presently 0.6% of GNP. However, with UK tort claims costs now rising at 15% per annum, this percentage will increase.

Supporting these claims has in many minds become a national economic problem.

TO SUM UP

While the statistics and their implications certainly give cause for concern, there are also some encouraging signs of restraint.

European governments and the European Union are discussing and developing appropriate legislation that may help to stem the tide of US-style tort litigation.

In addition, many procedural safeguards already exist, including the absence of juries and punitive damages and the 'loser pays costs' rule. European judges are also generally more conservative when confronted with questions of coverage and liability.

BADEN & BADEN

THE ISSUES:

- US litigation culture in Europe
- Sub-prime and D&O rates
- US pharmaceutical class actions
- Unfolding environmental liability

CONTRIBUTORS



Ingrid Dahlquist is head of global (non US) claims at PartnerRe



Lynn Halper is senior vice president, specialty casualty underwriting at PartnerRe



Ruedi Gaebler is a senior property and casualty underwriter at PartnerRe

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Sub-prime, sub-rates

WHAT IMPACT WILL THE SUB-PRIME CRISIS HAVE ON PRICING IN THE D&O AND E&O SECTORS?
LYNN HALPER INVESTIGATES THE TRENDS

The sub-prime crisis has led to an increase in D&O and E&O law suits against financial institutions. The relevant insurance rates increased for insureds with suits filed against them, but the credit crisis has not prevented the D&O/E&O market – still awash with capital and without significant scope of cover adjustments – from entering its fifth consecutive year of rate decreases (see below).

Although the pace of rate decrease has now begun to level off – the average decrease was 20% in 2007 and closer to 10% in 2008 – the overall trend remains negative.

CLASS ACTIONS

While the market experienced a respite from claim frequency in 2005 and 2006, the filings of securities class actions have returned to historical norms since 2007 (see below).

The sub-prime issue is also not over and frequency is likely therefore to increase further with more write-downs and bankruptcies both within and also outside of the US.

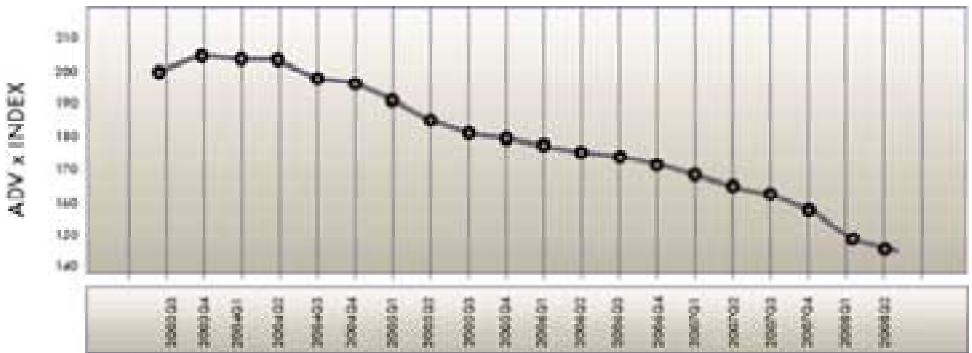
Since it is too early to judge the magnitude of the losses that the legal environment will impose on sub-prime related law suits and indeed the extent and effect of governmental ‘rescues’, current short-term rate levels remain

a risky proposition.

Increasing claim frequency and risk uncertainty are not the only inflationary factors at play; to these we must add the current backdrop of high inflation, stock volatility and ever-increasing legal and discovery expenses.

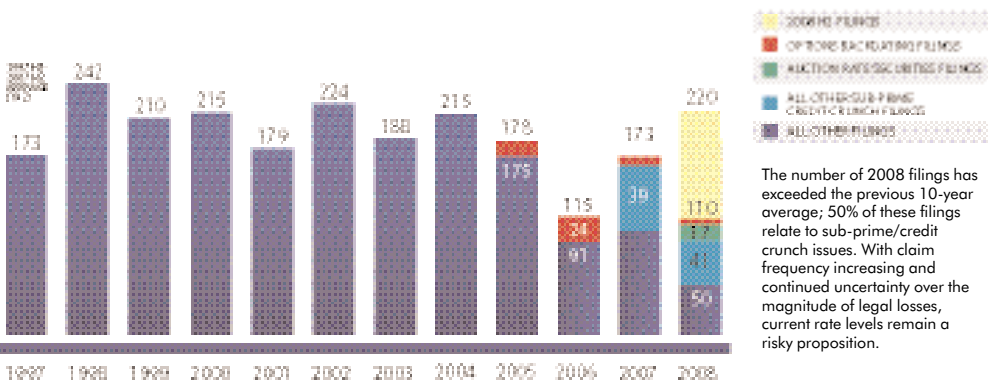
Over the last two years and in affected markets, reinsurers have tended to reduce the capacity committed to this segment, awaiting an improved loss ratio outlook. In terms of timing, however, the sub-prime issue has not caused an immediate turnaround of the D&O/E&O market, which will develop in-line with the emerging loss costs.

GLOBAL D&O RATES HAVE CONTINUED TO FALL OVER THE LAST FIVE YEARS



Source: Advisen

US FEDERAL CLASS ACTION FILINGS - 1997 TO 2008



Source: Cornerstone Research

The number of 2008 filings has exceeded the previous 10-year average; 50% of these filings relate to sub-prime/credit crunch issues. With claim frequency increasing and continued uncertainty over the magnitude of legal losses, current rate levels remain a risky proposition.

Pharmaceutical class actions

INGRID DAHLQUIST EXAMINES HOW KEY US CLASS ACTION VERDICTS WILL DETERMINE THE POTENTIAL SCALE AND EASE OF FUTURE CLAIMS AGAINST PHARMACEUTICALS

In recent years, hundreds of thousands of individuals have consolidated their complaints into class actions and sued pharmaceutical companies in the US.

The plaintiffs include individuals alleging personal injury, uninjured persons claiming that they would not have purchased the drugs had they known all the side effects and health insurers seeking to recover money paid to reimburse policyholders for drug purchases.

PUNITIVE DAMAGES

Because class actions often include demands for punitive damages, which are generally excluded from insurance coverage, they often threaten the existence of the defendant company even if it transpires that it was not negligent and followed all rules in the development, approval and marketing of a drug. The associated defence costs are so prohibitively high that product liability insurers and their policyholders often propose otherwise legally unwarranted settlements in order to control losses.

A UNIQUE CHALLENGE

Approval for the marketing and sale of any drug in the US is granted only upon determination by the US Food

and Drug Administration (FDA) that a drug is safe and effective for its intended use.

The drug's packaging must also include an adequate warning that is itself subject to FDA approval. To overcome the presumption of a drug's efficacy with existing FDA approval in a specific case, plaintiffs' lawyers have claimed that manufacturers withheld critical facts from the FDA, misrepresented clinical trial data, or concealed negative results, and that the manufacturers knowingly misled the government.

ACTION POINTS

If the US Supreme Court finds for the defendants in *Wyeth*, plaintiffs in pharmaceutical litigation will have to bring their suits in federal venues rather than in state courts, dramatically reducing their chances of securing verdicts or even settlements in the multiple millions as in the past

Such allegations are always accompanied by testimony from a paid expert who opines that the FDA would not have approved the drug had all facts been known.

There is a question under US law whether such evidence is permissible or barred by the doctrine of federal pre-emption (that state law theories of liability must yield to conflicting federal law).

ESTABLISHING PRECEDENT

Wyeth Pharmaceuticals, the original defendants in *Wyeth v. Levine*, asked the US Supreme Court in late 2007 to decide on the issue of federal pre-emption.

COURT HEARING

The Court is expected to hear *Wyeth* this autumn and to issue its opinion in early 2009.

In February 2008, the Court established favourable precedent in *Riegel v. Medtronic*, where it determined that medical device companies are shielded from lawsuits under state product liability laws over safety or efficacy after the FDA has signed off on those issues, as long as the device is the same and is used in the approved manner.

In *Wyeth*, suit was brought by a patient who used *Wyeth's* drug Phenergan in a way warned against on the label. The general consensus in the legal community is that a ruling in *Wyeth* will follow the reasoning in *Riegel*, favouring the defendants. However, even if that happens, it appears unlikely that the FDA will be ready to take full responsibility for drug approval without allowing later recourse in the courts if something goes wrong.

EDITOR: GREG DOBIE, ART EDITOR: NICKI SITARAS,
DEPUTY EDITOR: RUTH LYTNE, SENIOR REPORTER: SARAH AHMAD,
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Environmental liability

ENVIRONMENTAL DAMAGE ACTS CREATE NEW LIABILITIES AND THE CHANCE TO EXTEND SUPPORT TO CLIENTS, AS RUEDI GAehler EXPLAINS

Imagine, one evening an accidental fire destroys the premises of a small, EU based manufacturing business. Forge water escapes from the factory into a pond on the operator's premises and onto neighbouring ground.

The operator will invoke his property insurance to compensate his own fire loss, and his liability insurance to attend to his neighbour's claim for compensation in respect of economic loss (to fix a smoke-damaged wall and clean-up ground polluted by the escaping forge water).

Moreover, the operator is confronted with a new type of environmental claim. A rare, protected species of dragonfly living in his property disappeared when the forge water entered the pond and surrounding area.

Based on the European Environmental Directive (2004/35/EC), public legislation now requires that he carries out:

- Primary remediation, for example, that he cleans-up the affected ground and restores the pond to its pre-fire condition. This includes relocation of the dragonflies.
- Compensatory remediation to compensate society for the loss of enjoyment of the dragonflies by investing in other nature benefiting projects.
- Complementary remediation to other nature sites if restoration of the pond and dragonflies cannot be made in full, to compensate for the shortfall.

THE DIRECTIVE

Following the European Environmental Directive (2004/35/EC), European member countries have either already

ACTION POINTS

As a result, risk assessment for all businesses should be extended to include potential liabilities arising from environmental damage legislation, i.e. monitoring of an operation's surroundings, loss scenario analyses and quantification of the associated pure environmental damage risk

implemented new environmental damage legislation or will do so soon. The respective environmental damage acts (EDAs) are new and apply in addition to existing environmental liability acts.

They create a new liability between the public authorities and individuals to prevent and remediate pure environmental damage based on a 'polluter-pays principle'. The legislation applies to any legal entity or private person that operates or controls an occupational (i.e. business) activity.

The legislation covers significant damage to land, water and biodiversity, i.e. protected species and natural habitats, but not pure damage to the atmosphere. Depending on the operator's activity, either strict or tort liability applies.

LOSS COVERED?

Is such pure environmental loss covered under an operator's general liability policy? Most policies exclude losses governed by public law, however, cover might be extended.

And the cost of relocating dragonflies? So far, only a very low number of pure environmental losses have been settled and there are many unknown factors as regards claims handling. The likelihood however is that these claims will be expensive and have long-tail potential.