LOSS RECOVERY: A PROACTIVE APPROACH FOR SELF-INSURED RISK MANAGEMENT

By James B. Glennon, George M. Ferreti and George D. Pilja

SELF-INSURED RETENTION ("SIR"), a concept relatively foreign to many companies until quite recently, is now becoming a useful and effective risk management tool for companies across the country. Over the past several years rising insurance premiums have forced companies to internally assume a greater risk of formerly insured losses by increasing their SIRs in property, casualty, and other areas.

Put simply, SIR is a method through which a company essentially eliminates its primary layer of insurance (and thus the associated costly insurance premium) and directly assumes the risk of loss up to the amount at which excess insurance coverage applies. The excess insurance remains intact to cover the risk of large scale and catastrophic losses that most companies cannot afford to bear themselves. SIR can be a risky proposition, which is one reason why recovery of uninsured/self-insured losses has risen to prominence in the new millennium.

When a loss occurs, insurers typically investigate the claim for the purpose of pursuing potential recovery through subrogation from third parties responsible for a loss. However, where the value of a claim falls below the excess insurance coverage threshold, the responsibility of thoroughly investigating recovery potential will reside with the self-insured's risk management department or its General Counsel.

Following is an overview of how self-insured companies can adequately protect the company by identifying and preserving the company's rights to recover these losses from a responsible third party.

First, the Risk Manager or General Counsel must act promptly after a loss has occurred in order to identify recovery options. This proactive approach to loss recovery will help minimize insurance premium increases as well as reduce uninsured losses. Loss recovery in this fashion also provides an additional source of revenue to offset operational costs and maximize profits. Indeed, such loss recovery actually serves to reduce the risk of SIR.

The amount of SIR a self-insured entity chooses is particularly important. According to Dun & Bradstreet, many companies now have a $1 million SIR. The larger the selected SIR, the more critical it becomes to the self-insured to ensure that loss recovery is actively and competently investigated. The self-insured should initially choose experienced recovery counsel to work with the company from the outset of a loss. This will allow the company to maximize recovery potential by insuring that the necessary steps are taken to preserve the company's rights to recovery. For example, it will be critical for the company to preserve all evidence that will be necessary to pursue an action. In addition, the company may be required to notify potentially culpable parties immediately upon becoming aware of the parties potential responsibility for the loss.

Other critical steps the company should take include retaining appropriate forensic experts, obtaining interviews of important witnesses, compiling reports from investigative agencies such as local fire or police departments, and obtaining and evaluating relevant contract documents.

Following this investigation, the paramount question becomes: "Under what circumstances is it feasible and advantageous for the company to pursue recovery of its SIR?" When a loss is covered by insurance, the insurer will advance the costs of investigation and litigation, which are usually reimbursed by the insured upon a recovery, and then in a pro rata fashion.

However, when it becomes apparent that insurance will not be implicated, those costs will be borne solely by the self-insured entity. Because of these cost considerations, as well as the added burden of internal human resources that will be needed to litigate a self-insured claim, it is imperative that a detailed cost-benefit analysis be conducted early in the process.

Such analysis necessarily involves a legal evaluation of the prospects for recovery along with projected costs, expenses and range of recovery amount. The self-insured's risk management and/or General Counsel should work closely with recovery counsel to complete this analysis in order to determine whether recovery through litigation would be a cost effective and viable option.

The company should strive to conduct a cost effective analysis of the loss, including a review of the projected costs and expenses in comparison to with likelihood of success in any recovery action. In addition, the company should consider alternative dispute resolution forums, such as court-sponsored settlement conferences, media-

tion and/or arbitration, which might be desirable and appropriate under the circumstances. The company should also be aware that many law firms offer flexible cost reimbursement and fee options, which can reduce the company's risk of expense in the litigation and maximize loss recovery.

For example, the company can often custom tailor the fee agreement from a variety of fee arrangements, such as hourly, contingent, flat rate, or some type of blend of two or more of these structures, to fit the company's needs and preferences.

Self-insureds should also be mindful of the reality that loss recovery is not limited to property loss settings. Recovery may also be available to the self-insured by way of contribution or indemnity, where the company has settled a third party claim. The distinction between contribution and indemnification is important for the self-insured to understand: contribution allows recovery against joint-tortfeasors, while indemnity allows one party to completely shift the risk of an entire loss to another.

Many circumstances may require a self-insured to essentially front payment of a third party claim for both the self-insured's and another responsible party's responsibility for a loss. However, the self-insured may be able to recover all of the money it paid on behalf of a joint-tortfeasor through contribution.

Indemnity may be available to recover from a culpable person a settlement sum previously paid to a third party claimant. While indemnity may be obtainable as a matter of law or by contract, contractual indemnification is more common. Significantly, indemnity may only be available where the indemnitor is compelled to pay the indemnitee because the indemnitor is actually liable to the claimant; the payment must not be "voluntary." In most states, the settlement amount in an indemnity action must be reasonable, and will be subject to a good faith finding of reasonableness by a court or other judicial body having authority over the claim.

Self-insureds should remember that loss recovery is not limited to property loss settings, but may also be available by way of contribution or indemnity, where the company has settled a third party claim.

The company should always attempt to negotiate and include enforceable indemnity and liability limitation provisions in all its contracts with third parties. Where possible, the contracts should require the contracting party to name the company as an additional insured on their commercial general liability insurance policies.

Additionally, the company should specify a minimum dollar amount for primary and excess coverage to be maintained by those third parties in order to further reduce the company's risk and enable the company to more readily and accurately assess its range of risk with respect to a particular contractual undertaking.

Given the recent and steady upsurge of national and global losses, the insurance industry trend toward increasing insurance premiums appears to have no end in sight. Faced with the burden of these significant rising costs, more and more companies are developing SIR programs.

Of course, SIR programs do not come without their own risks of significant cost, since the self-insured company has no primary layer of insurance to cover most of its non-catastrophic losses. Fortunately, pursuing recovery of any losses can help self-insured entities manage and minimize the risks associated with SIR, through the recovery of those entities' self-insured losses.

James B. Glennon, George M. Ferreti and George D. Pilja are attorneys who specialize in subrogation, casualty, commercial, construction and product liability litigation with the Chicago-based law firm of Foran Glennon Palandech & Ponzi PC. They can be contacted at 312-863-5000 and at jglennon@fgpp.com,gferreti@fgpp.com,or gpilja@fgpp.com.