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2.4 Million Reasons To Monitor Claim Costs: Five Lessons From A Barnes & Thornburg Victory

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Employers should regularly and carefully monitor the cost of claims even if those claims are handled by a major insurance company or third-party administrator. That is the key takeaway from the Nov. 10, 2015, decision by the U.S. Court of Appeals for the 11th Circuit and the earlier decision by a federal magistrate who presided over a bench trial and awarded $2.4 million to our client Georgia Operators Self Insurers Fund (Georgia Fund) for claims mishandling by its third-party administrator PMA Management Corp. That and other lessons are explained below. **Lesson #1: Monitor Claim Costs and Claim Handling** The Georgia Fund is a not-for-profit entity formed by most McDonald's franchise owners in Georgia so they can self-insure their workers compensation risks. From 2008 to 2012, PMA was the third-party administrator (TPA) that handled all of the Georgia Fund's workers comp claims. PMA had sweep access to a Georgia Fund checking account to pay all lost wage and medical benefits for injured workers as well as all out-of-pocket expenses for investigators, lawyers and other vendors. In 2010-2011, the Georgia Fund noticed that annual reports prepared by its actuarial firm showed that its total claim costs were escalating beyond historical norms. At the same time, some of the McDonald's store owners began complaining that the PMA adjuster was not returning phone calls or timely handling ordinary tasks. **Lesson #2: In Litigation, Internal Emails Can Be Killers** In 2011, the Georgia Fund engaged an outside auditor, who reviewed about 30 of PMA's pending claim files and found that the overall performance of PMA "fell significantly below industry standards." We learned in discovery that PMA's head of quality assurance emailed the head of the claims department that the outside audit was "accurate" and that the outside auditor seemed to be "looking for ways to be favorable." Both the trial court and the 11th Circuit deemed this internal email to be an admission of PMA's systemic claim mishandling. In response to the outside audit, PMA promised to conduct monthly internal audits of the Georgia Fund account and share the findings with the Georgia Fund. The first report sent to the Georgia Fund had a grade of 85 percent. In discovery, we learned that a PMA quality assurance specialist had originally scored PMA at 52 percent. In response, the head of quality assurance—the same one who had just admitted rampant mishandling—emailed back that "we can't release the attached results." The PMA quality assurance specialist spent two days changing the file selection and the individual grades—and doing some of the adjusters' work—to raise the score to 85 percent. The Georgia Fund never heard about the lower score or the revisions until we found it in PMA's internal emails. **Lesson #3: Choose Your Experts Carefully** For litigation purposes, the Georgia Fund hired

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another outside auditor to serve as an expert witness on workers compensation claim handling. The expert has been a workers comp adjuster for 40 years, and he wrote the study guide for the Georgia adjuster licensing exam. In response, PMA hired someone who had run the property and casualty claims departments of major insurance companies in New York and Pennsylvania but who had never worked in Georgia and never directly handled even one workers comp claim. The trial court granted our motion to exclude PMA's expert as lacking the necessary qualifications. Consequently, at trial the Georgia Fund had a preeminent expert on the claim handling issues and PMA had no expert at all. Not surprisingly, the trial court relied heavily on the opinions of the Georgia Fund's expert witness, who found widespread system mishandling among the 88 claims he reviewed. The trial judge inferred that the patterns of mishandling impacted not only the 88 claims particularly scrutinized by the Georgia Fund's expert but also impacted PMA's overall handling of the claims in the account. The 11th Circuit concluded that his inference was "amply supported" by the report of the Georgia Fund's outside auditor, PMA's internal admissions, the Georgia Fund's expert, and "common sense." **Lesson #4: Damages Can Be Estimated on an Overall Basis** Arguably the most important legal dispute in this case was about the method of calculating damages. By the time of trial in 2014, several years' of annual actuarial reports established a pattern in which the Georgia Fund's claim costs had plateaued at a fairly consistent level from 2000 to 2006, increased dramatically in 2007 to 2010 (generally coinciding with the period when PMA was most egregiously mishandling the claims), and went back down to the earlier rate in 2011 to 2013. The trial judge called this "spike" in costs "quite stunning." The Georgia Fund asserted that its damages could be estimated by calculating the difference between the historical level of claim costs and the higher level for 2007-2010. In sharp contrast, PMA argued that the Georgia Fund was required to prove damages separately for each specific claim that was allegedly mishandled. Given that PMA had handled 3,500 claims, many of which involved hundreds of discrete payments and claim handling decisions, PMA plainly sought to hold the Georgia Fund to an extraordinarily expensive and impractical burden of proof. The trial judge and the 11th Circuit rejected PMA's approach and held that the Georgia Fund's method satisfied the standard under Georgia law that damages need only be estimated with reasonable certainty and do not have to be proven to an exact amount. The 11th Circuit explained:

> Ample evidence supports the findings that PMA's deficient practices were widespread and infected its overall performance. The magistrate judge's use of the extraordinary spike in claims costs as a starting point is supported by the fact that the spike occurred in precisely the same time frame during which [the Georgia Fund's outside auditor and expert witness] identified patterns of PMA's mishandling problems. Moreover, as soon as PMA's performance problems were remedied, the claims costs dropped back to approximately the historical rate which preceded the spike. Ample record evidence, as well as common sense, supports the magistrate judge's finding that PMA's performance deficiencies were a major cause of the sudden and extraordinary spike in claims costs.

Lesson #5: You Don't Always Need a Damages Expert The damages calculation we just described was presented at trial by the Georgia Fund's actuary. We called him as a fact witness, not an expert, and PMA objected that the calculation should be excluded as expert testimony that wasn't disclosed in expert discovery. The trial judge and the 11th Circuit agreed with us that the actuary gave permissible lay opinions under Federal Rule of Evidence 701. The actuary based his testimony on his own work in preparing annual reports for the Georgia Fund in the ordinary course of its business before, during and after the period when PMA was handling the claims. Those reports were admitted into evidence without objection as business records of the Georgia Fund. The actuary used grade school math to calculate what the Georgia Fund's claim costs would have been if they had continued at historical levels and to subtract that amount from the actual costs during the period of PMA's mishandling. The 11th Circuit explained: "As the magistrate judge noted, the court itself could do that basic arithmetic on the basis of the data already extant in the actuarial reports." Therefore, the actuary did not have to prepare an expert report under Federal Rule of Civil Procedure 26(a)(2), and his testimony did not have to satisfy the standards of Federal Rule of Evidence 702 and *Daubert*. These lessons have broad application but are particularly relevant to companies with so-called "loss sensitive" insurance programs, which are somewhat common for policyholders that have a relatively high volume of claims such as workers comp, general liability and auto liability. Self-insurance like the Georgia Fund had is just one example of a loss sensitive insurance program. Another is when a policy has a retrospective premium feature in which the policyholder pays relatively low base premium, and the insurance company later calculates additional premiums (or possibly premium refunds) based on the cost of claims actually incurred under that policy. A third example is a policy with a high deductible or self-insured retention, which makes the policyholder ultimately responsible for much of the cost of its own claims. In all of these loss sensitive programs, the claims are typically handled on a day-to-day basis by an insurance company or third-party administrator (TPA) even though the claims are ultimately paid by the policyholder. Thus, the policyholder's financial fate is in the hands of its insurer or TPA, a risk that is especially acute in the arena of workers compensation, in which almost every employer's premiums are calculated in part on an experience modification factor based on the previous three years of claim costs. To protect against these risks, policyholders should regularly monitor their claim costs for adverse trends, conduct claim review meetings with the insurer or TPA, and consistently communicate their expectations of appropriate claim handling. Please contact Ken Gorenberg in Barnes & Thornburg's Chicago office (312-214-5609; kgorenberg@btlaw.com) with any questions on these issues or if you would like a copy of the 11th Circuit or trial court opinion discussed above.