Revealing Circumstances

New claims litigation software lowers total costs by streamlining the process and making it more transparent to insurers and lawyers.

by Barbara Bowers

The insurance industry's growing use of outside legal help, coupled with increased costs of lawsuits and sky-high plaintiff awards, has translated into soaring legal and indemnity costs. Insurers spent an estimated $13 billion on legal defense alone in 2001.

Early attempts to ease the pain focused on reducing legal bills, but didn't address the bigger issue of improving the claims litigation process itself.

"The whole problem in the insurance industry is that law and claims have never gotten together," said Fred Uehlein, chairman and chief executive officer of Insurance Recovery Group Inc., Natick, Mass., an integrated claims/legal cost containment company in the property/casualty industry. "So the disconnect that costs insurers millions of dollars is the failure of law and claims to work efficiently together."

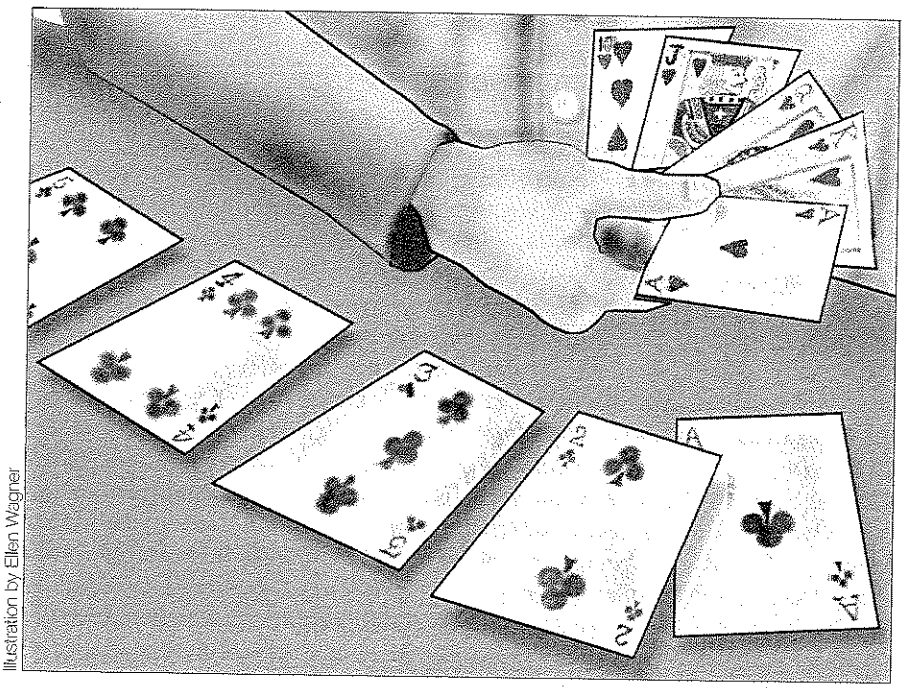

Illustration by Ellen Wagner

That may be changing. In a few short years, vendors have developed versions of claims litigation software that, they say, hold promise in closing this gap and lowering this spending.

"We keep hearing in the marketplace that for the first time, people are looking at specific goals around reducing legal expenditures," said Taylor Smith, national director of TyMetrix Inc., Hartford, Conn. "But more importantly, they're trying to find a way to combine the total outcome of the case, the indemnity piece, with those legal costs."

Along these lines, claims executives have begun to address four primary goals, Smith said. First, they want to find ways to pay invoices more efficiently. "Many of our clients have 100,000 to 150,000 transactions with legal invoice payments a year, and if you can save $15 or $20 on every one of those transactions, it adds up to a lot of money," Smith said.

Second, they want to reduce legal costs. "For the first time this year, we're starting to see actual financial goals set in this arena, which is not something that we have seen historically," Smith said. His company's clients have found that by automating parts of their existing billing guidelines, they have been able to save from 3% to 7% on legal expenditures without alienating their partners, the law firms, in the process.

The third focus is on reducing indemnity losses, an issue that the market is looking at intensively now, Smith said. "Our prospective customers, many of whom are engaged in the process of gathering information about this technology, are recognizing they need to have this in place quickly, within the next 12 to 16 months," he said.

And fourth, using this technology also can strengthen partnerships between insurers and outside law firms, thus preventing the sometimes bitter disputes that can arise. "There is an ability to see all claim files up front, to see that the planned projected cost is accurate, and to ensure that both the adjuster and the attorney agree to the road map for resolving the case," said Faiz Ahmed, chief executive officer of Visibillity Inc., Chicago. "Obviously, if cases need to change direction, the system is flexible to allow for that as well."

Visibillity, founded in 1999, has a flagship product called the Collaborative Litigation Management Solution. This delivers claims litigation results via an Internet-based tool to insurance industry leaders such as CNA, American

In Search of Savings

by Fred Uehlein

In the property/casualty industry, individual claim awards, and attendant litigation costs for them, continue to escalate. Many studies over the past decade have chronicled these continuously increasing costs. Much is to blame for the increase, including mismanagement and fraud. But by far the greatest reasons are lack of skill, time and motivation on the part of insurance adjusters, claims supervisors and other insurance company management to oversee their provider law firms and the litigation process.

Litigation management is the management of legal processes, lawyers and legal subject matter related to property/casualty insurance claims, supported by the medium of litigation management software. Holistic litigation management is the total process which combines a communication platform, a document exchange, an audit rules engine, a reporting system and a methodology for knowledge transfer in an integrated fashion, all of which enhance communication between adjusters and counsel for the purpose of reducing both litigation and total claims costs.

The single most volatile aspect of the property/casualty business involves claims that are put into litigation. While the volume of these claims, as a percentage of the overall number of claims in the system, represents a relatively small fraction—in the range of 10% to 15% of all claims—the cost percentage of these claims may come closer to 75% to 85% of all losses.

Correspondingly, the legal costs incurred via attempts to control exposure under these claims have increased at a pace that far outstrips inflation and often account for 5% to 15% of the total incurred costs in the property/casualty insurance system. In California alone, the rate of increase of this cost has exceeded 10% annually.

Restructuring internal legal delivery systems and the way they are integrated into claims management systems offers the most direct impact on reducing both short- and long-term legal and total claim costs.

Currently, the property/casualty industry has two legal delivery systems:

• The insurance company's "in-house," state-by-state, legal team, whose members are nominally employees of a law firm but are in fact employees of the insurer. They are used for both third-party administrative work and for insurer-owned work. They are fractionalized—an insurer can use 50 to 100 separate state-licensed law firms—and tend to operate as islands unto themselves, with little or no sharing of knowledge or experience nationally.

They represent an inefficient delivery system because they are often under- or overqualified for a task. They work for a salary, which is not usually tied to claims success and only in some instances tied to litigation success.

There is usually no pay-for-performance system in place to give them the proper incentives to resolve claims quickly, efficiently and as inexpensively as possible. Because of the lack of a direct centralized process-management system, they tend to work inefficiently, and do not adapt well to changes in work volume, which leads to either overstaffing or underperformance.

A bureaucratic mentality is often a symptom of this system. The good lawyers that do exist too often are working in a vacuum that fails to bring out their best performances. Rarely are their activities coordinated closely with the plans of the claims department and, in reality, even if on paper, not guided by an overall process implemented by knowledgeable claims people.

• The use of panel, or outside, counsel. Again, this is a fractionalized group of 50 to 200 law firms. The tendency is for insurers to choose them based on low price, with a one-size-fits-all mentality, rather than for their ability to drive desired outcomes. Often, they have been described as commodities whose license fills a function, rather than professionals whose training drives a certain result.

The function of panel counsel probably is 80% commodity, impacting only 20% of the total cost. But the balance of their function, about 20%, involving legal risk analysis, legal strategy and trial skill, impacts possibly as much as 80% of the ultimate total cost.

With panel counsel, there can be a wide variance in ability from state to state, law firm to law firm and lawyer to lawyer. The only management of these lawyers in terms of quality, consistency and performance has been left to management of the law firms themselves.

This is totally ineffective and counterproductive, because the law-firm manager drives the lawyer to billable hours and hence litigation, whether needed or not.

This is not necessarily schemed, but is inevitable because the margins of property/casualty defense firms are very low and most law firm managers do not have the tools at hand to improve margins, other than to charge more time or higher rates.

Fred Uehlein is chairman and chief executive officer of Insurance Recovery Group Inc.

International Group, Employers Mutual Casualty Co. and Argonaut Insurance Co.

Traditionally, insurance companies have used paper-based methods to manage litigation. "But that doesn't allow for people to work in a way that they can plan and manage a case properly, set up expectations on both sides, and judge how well a case is progressing," said Ahmed, who formerly worked as a claims officer for GE Employers Reinsurance Corp. and an attorney representing both carriers and their policyholders.

Visibillity's product offers a solution which allows adjusters and law firms to work together and "proactively set strategic and financial expectations at the very beginning of a case so both sides know what to expect, and there are fewer surprises," he said.

The result should be more efficient spending of litigation expenses for the carriers, as well as the best outcome on indemnity because both sides have input into how a case should be resolved, Ahmed said.

Generally, clients are seeing reductions in legal expenses in the range of 8% to 12%, but one client has saved 20%, an outcome that surprised that particular company, he said. The biggest savings came in the self-correcting behavior of law firms that altered invoices they were about to submit to their carrier-clients when the lawyers recognized that the expenses exceeded the carrier's guidelines or were not in sync with what they'd agreed to at the start of the case.

The technology can be applied to standard litigation, or one-on-one cases, as well as some mass tort cases, Ahmed said. "It's simply because we see in the marketplace today a real focus on managing the costs as well as the indemnity related to some of these very high exposure cases such as asbestos or mold litigation," he said.

Visibillity is just beginning to measure how use of the product is affecting indemnity costs, a far bigger dollar figure for insurers than legal fees. So far, Ahmed noted, the results appear positive. "What our clients have been able to do is identify early on those problematic cases that exist in their pending claim files, then have them assigned to the appropriate people within the claims organization," he said. "So they have the right people handling the right cases."

Claims Litigation Software Goals

- **Pay invoices more efficiently.** Many insurers deal with 100,000 to 150,000 legal invoice payments a year. Claims litigation software can potentially save $15 or $20 on each transaction.
- **Reduce legal costs.** Some insurers are finding that by automating parts of their existing billing guidelines, they can save from 3% to 7% on legal expenditures without alienating their partners, the law firms, in the process.
- **Reduce indemnity losses.** An issue that the market is looking at intensively and hopes to resolve within the next 12 to 16 months.
- **Strengthen partnerships between insurers and outside law firms.** By viewing claim files up front to ensure the planned project cost is accurate, disputes can be avoided.

Filling Unique Needs

Visibillity was the first company to market the idea of collaborative litigation management, Ahmed said. "Our focus is very much the insurance industry, whereas a lot of other companies focus beyond insurance," he said.

Early on, the company recognized that insurers and the thousands of attorneys who might use the product often have different and unique needs. "As an ASP-deployed solution, we are able to incorporate feedback, quickly release new functionality and continually enhance our products as the industry's needs evolve," Ahmed said. The company considers this flexibility and its extensive understanding of the insurance industry to be its greatest assets, he said.

TyMetrix Inc., which is among the handful of other software companies active in this arena, got its start "almost as a favor," said R. E. Heinemann, president of TyMetrix. The idea arose during a 1993 conversation with the general counsel of Hartford Financial Services, who suggested a follow-up discussion with the recently appointed head of claims litigation, Heinemann said.

"Claims organizations are probably the most active consumers of legal services of any business entity," Heinemann said. "The amount of legal expenditures that are transacted by property/casualty and med-mal carriers dwarfs those made by other corporate entities."

Ten years ago, Hartford was spending "many hundreds of millions of dollars at thousands of law firms through hundreds of thousands of transactions with no truly efficient means of analysis or control," he said.

Heinemann, who had experience in finance and investment banking, also had worked with computer companies. Through his consulting business in the 1980s, he also got to know the ins-and-outs of task-based billing, which is a standardized coding system that enables lawyers to budget and bill by certain activity and task codes.

He recommended this approach to Hartford. "Some way or another," Heinemann said he suggested, "you've got to get your law firms to start billing you in a manner that lets you assess what it is they are really doing for you."

Heinemann further suggested a way to accomplish that. "I offered to put together a task-based approach for legal billing to the claims organization," he said. "A few months later, we delivered a small piece of software that allowed the law firms to create invoice files where their time and charges were associated with a set of 'standard' task descriptions." While the original codes were derived by Heinemann from discussions with attorneys, the codes later would be supplanted by the standards

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—Taylor Smith, TyMetrix Inc.

developed by the American Bar Association and the American Corporate Counsel Association.

From the start, TyMetrix wasn't so much interested in the invoice processing as it was in acquiring data. "We're not just about building an electronic pipeline between the law firm and the carrier," said Smith, national director. "We're really about helping the carrier data mine this rich source of information so that management-level reports and the tools available to litigation managers are really enhanced."

Improving the system took almost two years. Then the software was installed at more than 200 law firms, but didn't take off, at least at first. At that point, there was no compelling reason for these firms to use the system, Heinemann said. Finally, TyMetrix made sure it obtained the data it wanted by advising law firms that the only way they would be paid was to submit their bills electronically.

The law firms retained by TyMetrix's clients have continued to use their existing time and billing software. However, instead of sending paper invoices to their clients as they'd done for years—an invoice that's hard to manage from a process and data mining standpoint—the lawyers now submit the bills through TyMetrix. This is done via an existing link in their time and billing software.

"They just forward it electronically through us for their client's review," Smith said. "In the process of coming through us, the client's billing guidelines and litigation guidelines are automated to a great degree and applied against the bill. When the client actually sees the bill, certain items are highlighted for deeper review. That allows the insurance company to focus just on those items that are relevant in the bill and have a more efficient process."

Having these bills come through an electronic format means that all the activities can be data mined. This, combined with the loss payments from the insurance side, helps the law-firm executive or litigation manager see a complete picture of how the law firm is working with the company and what the outcomes are, Smith said.

Along with Hartford, TyMetrix's larger insurance clients include OneBeacon Insurance Group, Ace, Employers Reinsurance Corp., GE Medical Protective Co., Selective Insurance Group and Ohio Casualty, among others. TyMetrix's system links with about 4,000 law firms, Heinemann said.

Case Assignment and E-Billing

Another vendor, Examen, based in Sacramento, Calif., offers two claims-litigation processes—one for alternative legal-fee management and the other for e-billing. The alternative fee process allows adjusters to assign legal matters to outside counsel on an alternative pricing basis, mostly flat fees or stage-based fixed fees. Once the matter is assigned, an e-mail alerts the lawyer and he or she then can review the case, and accept or decline it. All the billing is done electronically through the application.

"If the matter's been assigned on a straight hourly basis, counsel would have the opportunity to put in a litigation plan and a budget," said Ted Best, director of product. At this juncture, the lawyer can add information concerning his or her opinion of the case in general, whether it should be tried or settled, and what depositions might be needed.

The information then goes back to the claims adjuster and, if the attorney has agreed to take the case, the law firm begins work. Through Examen, the law firm submits its bills electronically

Adjusters and law firms "proactively set strategic and financial expectations at the very beginning of a case so both sides know what to expect."

—Faiz Ahmed, Visibillity

to the claims adjuster. Once the bills have gone through Examen's automated review process, the insurance carrier is able to look at the results of the review process, make additional adjustments or refinements to the bill and approve the bill for payment.

"One thing we have on the insurance carrier side is a very flexible work flow system—to be able to route the invoices inside the insurance company for approval and payments," Best said.

Examen was launched in 1990 as a consulting company to help manage outside legal counsel for corporate legal and risk departments, as well as property/casualty insurers and third-party administrators. The initial bill-review technology was introduced in 1995, the Web-based pricing alternative solution in 2000 and the latest e-billing technology in 2001, said Rebecca Wood, vice president of marketing.

More than 50,000 legal matters have been processed through Examen's alternative fee application, Wood said. Currently, the company has signed on 1,000 law firms with more than 4,800 attorneys who have offered flat fee pricing through its system, she said.

"We can accept any type of media—paper, floppy disk, e-mail—that the law firm wants to send the bill to us on and we can then translate that into an electronic bill and send it on to the customer," Best said. This helps customers to start immediately with a program, even if all of their law firms can't submit a bill electronically.

Wood described the field of claims-litigation technology as fairly competitive. "There are probably four primary players in the industry and we all have a different approach to the business," she said. "What differentiates us is our SmartReview technology."

Examen enables companies to use industry standard codes that identify certain tasks for budgeting and reporting purposes. The law firms also can employ these codes to identify the actions they are taking. "But when it comes to the bill review, we take it one step further: Our SmartReview technology literally reads the bills to make sure that they match and comply with the corporate billing guidelines," Wood said.

The corporate client can adjust the billing guidelines, which can differ markedly depending upon the scope and complexity of a case, she said. "We have an infrastructure that is very, very flexible because we recognize that every company is run differently—they have different ways of approving bills and of managing their outside counsel," Wood said.

Through Examen, insurance companies can receive better information about fees, expenses and the time it will take to close a case, Best said. "That means more accurate predictions of how much they will need to reserve for legal expenses and outcome," he said.

Examen estimates that its e-billing technology has saved companies as much as 20% on their legal expenses. The most dramatic change has come for companies, including insurers, that have adopted pricing alternatives. "They have experienced much lower and more predictable legal fees, and much faster matter resolution," Wood said. "So the time it takes to close a matter is as much as 40% faster. More importantly, they have seen their indemnity lowered as much as 38%."

Quick Compliance Check

DataCert Inc., founded in 1998 as Occam's Razors Technologies, originally moved and standardized data such as electronic invoices over the Internet. Lately, the Houston-based company has evolved into a solutions provider for cost management of legal services.

In 1999, DataCert launched ShareDoc, an application service provider that allows law firms to submit electronic invoices to insurance claims departments. "Typically, a billing clerk will log into the site and upload a file, which generally will contain multiple invoices," said John Gilman, DataCert's director of product management. "We take that invoice, in a format that is standard for legal invoices in the insurance sphere, convert it to another format and do an outside counsel guidelines compliance check."

Errors will cause the invoice to bounce back to the law firm within 30 seconds, he said, noting that some other systems might take 20 minutes or more for the same result. "This turns out to be an important thing to the billing clerk at the law firm—to know immediately if there is a problem with the invoice or not," Gilman said.

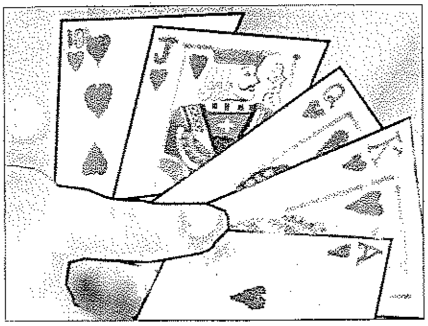
Items in the invoice that might warrant a claims handler's personal attention are flagged with warnings, he said. Then, the invoice is securely pulled inside the client's firewall by the client, Gilman said. "Those invoices continue to sit at ShareDoc, in a highly encrypted, nonfielded form, for a short period—typically 30 days—until they are purged," he said. "So that data is not sitting anywhere for long periods of time where somebody potentially could have access to it. We want to get it inside the client's firewall as quickly as possible and out of our hands."

Client companies also can opt for installation of a DataCert product called Data Adapter that will feed the client's claims, matter-management or any other system capable of accepting an invoice. "Some clients choose that because it is a good way of dealing with electronic invoices work flow, approval and adjustment," Gilman said. In the legal industry every legal project is a matter. Matter-management systems are computer applications that help organizations to manage legal projects.

Another product, AIMS, which stands for Advanced Invoice Management System, is an invoice presentation tool that takes about 10 minutes to learn to operate, he said. It sends an e-mail alerting the appropriate person that an invoice must be reviewed and that person then can link directly into the system. "If there are adjustments that need to be made, they can take them and ultimately accept or reject the invoice," Gilman said. "It can be used for light claims management, but that's not really its primary function. This product is often deployed in an integrated environment, with a matter management system, a claims system or accounts payable system."

The company plans three launches this year to address the needs it sees in the marketplace. First, it is releasing an easier-to-use version of AIMS, which has enhanced management tools. Then, a sophisticated compliance engine, capable of processing more complex rules, is due out in the fourth quarter to fill in some of the gaps involving outside counsel guidelines, Gilman said. For example, this engine can send an e-mail to outside counsel warning that the law firm is approaching the budget limits, a signal that the lawyer must confer with the claims handler. It also can block or auto adjust invoices if they exceed the budget, he said.

The biggest release, a litigated claims management application, is in



development and will be available at the end of 2003. "This is much more task-based, more holistic, and doesn't just solve the invoice piece but addresses all of the communication that goes on through the life cycle of a litigated claim," Gilman said. "So when the insurance company sends the letter to the firm indicating they want to use them on this claim, there are timers that are built in for the law firm to respond." The system can then fire back to the attorney and warn him at appropriate times that he needs to complete a budget within 60 days, and must complete the litigation-management plan, which can be customized to the clients' needs.

"So we really think we're going to enable better data collection, letting the insurance company gently help the attorney focus on the things that it wants to make sure the attorney focuses on," Gilman said. Currently, DataCert has 42 corporate clients—35 of them Fortune 500 companies—for its legal e-billing system. Customers include Microsoft, GE, Honeywell and UPS, as well as several major insurers.

Lawyer Costs vs. Total Costs

Uehlein, of Insurance Recovery Group, has researched litigation management software services because, if an insurer were to use one of these systems, Uehlein's claims recovery services would be managed through it. His background in insurance includes 30 years as an attorney on both the defense and plaintiff sides. He also has worked with Visibillity on some projects and previously worked with other vendors in the field.

Uehlein noted that many technology companies in this emerging field achieved market entry by focusing on lawyer costs, when the efficient use of litigation management software should focus on reduction in total costs. The reason for the narrow focus is it's far easier for the industry to target only legal fees because they are clearly measurable, he said. And the lack of benchmarks to prove that using the software will bring down total costs has prevented its optimum and widespread use, especially in a tight economy, Uehlein said.

"The real issue isn't the legal management software, but rather that everyone needs to control cost," he said. "The biggest cost is indemnity and medical, and the biggest driver in indemnity and medical cost is litigated cases."

This new software gives the industry an opportunity to shift from worrying about controlling litigation costs, to controlling total costs by using lawyers "smarter, faster and better," Uehlein said. Now, claims and law can work effectively together because everyone can be on the same communication platform working toward a common objective, he said.

Property/casualty insurers have been slow to accept the new technology, however. "The light is going off, but it's still in its developmental stage," Uehlein said. "Some companies get it—but they haven't fully committed the money to it—and most companies don't get it."

He thinks the technology will find a wider audience eventually, but for now, it's not yet on the radar screens at the highest levels of many companies. "The people who are in operations know that they want to get it to be a corporate initiative, but corporate management has not yet embraced it," he said.

Still, Heinemann of TyMetrix is optimistic because market acceptance seems to be growing and companies in the post-Y2K era have been able to direct more resources into seeing that their corporate data is in order. "Those two things have now come together, so I think the appetite and the urgency has definitely grown in the last year, rather dramatically," he said. BR

