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Judgment Preservation Insurance Emerges as a Valuable Risk Management Option

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Every now and then, an insurance product emerges that addresses risks in a manner that facilitates transactions such that the product becomes a regular part of the dealmaker's toolkit. For example, just over a decade ago, representations and warranties insurance (RWI) policies were introduced and today these policies are a standard requirement in most M&A transactions.

While judgment preservation insurance (JPI) may not have the impact that RWI has had, the increasing popularity of JPI suggests that insureds are discovering that it is a very useful tool to mitigate risk.

The Basics of JPI

A plaintiff who has prevailed and obtained a judgment at the trial court level faces at least two significant obstacles to a timely collection of damages awarded: (i) the risk of reversal or reduction of the damage award on appeal; and (ii) the risk of lengthy delay in recovery due to the appellate process.

JPI, a contingent litigation risk product that has become increasingly popular over the last few years, can mitigate the risk of reversal or reduction of the award on appeal. In addition, the plaintiff may be able to use the JPI policy as part of the collateral package for a loan, which can mitigate the risk of a delayed payment.

At its most basic, JPI provides the plaintiff with certainty of recovery of at least some amount on a judgment. For example, if the plaintiff has been awarded a $50 million judgment at the trial court level, a JPI policy might insure $40 million of that judgment. If the award is reversed on appeal, the plaintiff insured would collect $40 million from the insurance policy (less any applicable retention). If the award is cut in half to $25 million on appeal, the plaintiff insured would collect $25 million from the defendant and an additional $15 million from the insurance policy.

In some circumstances, the JPI policy can also be used by the insured as part of the collateral for a financing that permits the insured to monetize the judgment in the short term instead of waiting for the results of the appellate process. By adding the lender as a loss payee on the policy or assigning certain recovery rights to the lender, the plaintiff insured can secure an up-front payment from the lender secured by the lender's interest in the insurance policy and/or the final judgment.

JPI can also be useful in the context of litigation funding agreements. A case may be more attractive to a litigation funder where a judgment preservation policy is in place to minimize the down side risk. Likewise, a litigation funder may itself purchase JPI for that same reason.

In addition, companies that need to recognize judgment-related earnings in their financials in the short term can use JPI to create the necessary assurance of some amount of recovery.

The Underwriting Process

JPI policies are subject to significant underwriting by the insurers before the policies are bound. This is in part due to the multi-million dollar limits often sought by insureds but also because the insurers need to evaluate the insured's likelihood of prevailing on appeal as well as the probability that a judgment may be reduced and by how much. As a result, insurers often retain outside counsel and/or experts with specific subject matter experience to review court documents, including dispositive motion papers, deposition and trial transcripts, expert reports and the appellate briefs (when available).

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The insurer may also require the insured to provide key documents related to the litigation as well as legal memos and analyses prepared by the insured's trial or appellate counsel.

Not all judgments are attractive to insurers writing JPI. Those cases decided on summary judgment, with a clear set of issues in dispute on appeal, are more easily underwritten—but insurers are also willing to take on more complex risks. Likewise, it may be easier to insure the risk after the appellate briefs have been finalized—because the appellate briefs will provide a helpful analysis of the issues of interest to the underwriters. But insurers have proven willing to underwrite risks at earlier stages of litigation.

The insurers use the underwriting process to determine whether to insure the proposed risk, the limits that will be offered, the required premium and the applicable retention. The retention is particularly important, because by requiring the insured to bear some portion of any loss, the insurer can be certain that the insured will continue to make every effort to achieve a favorable appellate result.

The Policy Terms

Each judgment preservation policy is unique and the underwriting process and policy terms will vary to some degree. Most often, the policy will include specific representations made by the insured with respect to the material facts and documents related to the litigation and those representations will be considered material to the risk. In the event the insured makes material misrepresentations, the policy exclusions may bar or reduce coverage to the extent the loss arises out of the misrepresented facts. Otherwise, most judgment preservation policies have limited exclusions.

The JPI policies typically do not cover settlements and certainly not without insurer consent. More often, the policies require the insured to litigate the case to final judgment as if uninsured. Unlike many other types of policies, judgment preservation policies do not cover legal defense fees or related costs. Nor do judgment preservation policies typically insure the collectability of a judgment.

Most judgment preservation policies give the insured the responsibility and discretion to litigate the appeal and make strategy decisions. However, the policy may include specific reporting requirements designed so that the insurer can be kept apprised of the status.

Looking Forward

Over the past few years, different types of contingent litigation risk insurance policies, including JPI and adverse judgment insurance policies, have become more prevalent in the market. However, because JPI provides a mechanism for plaintiffs to monetize their trial court victories and minimize the down side risk of appeals, and because it is attractive to lenders and litigation funders, it appears to have emerged as a product.

We expect the market for judgment preservation insurance to continue to grow as more plaintiffs and lenders become aware and comfortable with the product.

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