# Is the end in sight?

**Robin Cantor**, **Michael Cook** and **Mary Lyman** consider whether recent US state tort reforms and legal decisions could herald better news for asbestos defendants.

**THE FIRST SUCCESSFUL PERSONAL** injury tort claim relating to asbestos in the US was settled in the early 1970s. For the next decade, seriously ill individuals – those with cancer or severe asbestosis – filed almost all of the claims. Many targeted the Johns-Manville Corporation, which was a principal producer of asbestos-containing products (Manville's share of asbestos-containing products has been estimated at roughly 30% of the US market).

Under the weight of the litigation, Manville declared bankruptcy in 1982, resulting in the formation of the Manville Personal Injury Settlement Trust (Manville Trust), funded with more than $2bn in assets, including 80% of the company's stock, to pay the company's asbestos-related liabilities.

In the following years, the focus shifted towards diseases with weaker relationships to asbestos exposure and towards claimants alleging non-malignant conditions, such as pleural plaques, that had not caused impairment.

Specifically, in the mid-1980s there was a surge in filings of asbestos-related claims, of which a growing proportion were claims alleging non-malignant conditions. Many of these were filed by claimants with little or no respiratory impairment. According to a report by RAND Institute for Civil Justice, more than 700,000 claims have been filed and more than $70bn has been spent on asbestos litigation since the first claim was filed. As a result, more than 70 companies have petitioned for bankruptcy protection in the US.

## THE FEDERAL SOLUTION

Not surprisingly, there have been several attempts to control the problem through federal legislation, the most recent being the *Fairness in Asbestos Injury Resolution Act* (FAIR Act), which has been before Congress in various forms since 2003. However, the FAIR Act failed a crucial procedural vote in the US Senate in February and its sponsors have not yet been successful in their efforts to revive it. It thus appears unlikely that asbestos claims will be resolved through a federally-managed claims fund.

A key issue regarding the Act that could not be resolved is whether the funding mechanism was sufficient to meet the cost of all future claims against the fund. No one could predict with reasonable certainty how much the new system would cost. This amplified concerns that funding would fall short and that government would ultimately end up with the liability.

In contrast, there is mounting evidence in the US that other reforms to control the number and cost of asbestos claims are succeeding. Several states, including Texas and Mississippi, which have large numbers of claims, have enacted general or asbestos-specific tort reform legislation. Among the most important are the "medical criteria" bills, which have been enacted in Ohio, Georgia, Florida, Texas, Kansas, and South Carolina and are pending in several other states. These bills require plaintiffs with non-malignant conditions to provide evidence of impairment, meeting strict criteria.

At the end of 2003, stricter medical criteria were implemented in the trust distribution procedures used by the Manville Trust and figure 1 shows the dramatic decline in claims since then. The pattern observed in the trust claims is reflected in claims filed against many US defendants and other bankruptcy settlement trusts.

In addition to medical criteria, other provisions enacted in several states include venue reform to restrict "forum shopping"; limits on consolidation of cases; restrictions on premises claims and claims against innocent sellers; limits on successor liability; and elimination or restriction of joint and several liability, non-economic damages and punitive damages. An important trend in recent years for settlement values has been an increasing number of restrictions or elimination of joint and several liability, with the most recent being Florida, which eliminated joint and several liability in legislation signed into law on 26 April 2006. In the past, with joint and several liability, a particular solvent defendant may have seen

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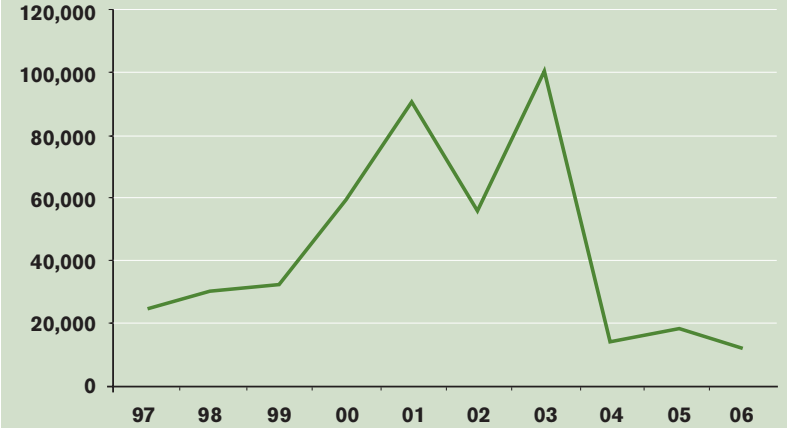
**Manville Trust annual claims filings**




Source: Manville Trust quarterly reports

an increase in its share of indemnity costs as other defendants filed for bankruptcy protection. Currently there are about 36 states – roughly 70% of US jurisdictions – which have either eliminated or modified joint and several liability. Navigant Consulting estimates those states account for about 85% of the claims filed against major defendants in the year 2000.

## THE STATE ANSWER

States are also enacting legislation that limits claim values in other important ways. A number of states have placed limits on the amount of non-economic and/or punitive damages that can be collected. Some states require that a portion of punitive damages is paid into a state fund rather than to the plaintiff and others have eliminated punitive damages entirely in asbestos cases. Overall, such restrictions have been enacted or proposed in 25 states, including those with the largest proportion of filings, eg Ohio, Texas, and Mississippi. In theory, all these medical and tort restrictions should substantially reduce the financial incentives for parties to bring fraudulent or weak claims.

And this does seem to be the case. Claims filed against large defendants, publicly reporting such data, have gone down by more than 70% since 2002, and reported dismissal rates often exceed 75%. Public filings also show that some companies are experiencing lower average settlement values. If the trend towards limiting joint and several liability continues, settlement values for individual companies could experience a real decrease.

Nonetheless, without a federal solution, some companies may still find bankruptcy an appropriate strategy to manage their asbestos liability. This typically results in the creation of a trust for asbestos claims. While the value and conditions of these trusts vary, those recently proposed by Owens Corning, Federal-Mogul, Armstrong, Congoleum and USG all involve billions of dollars.

## UNCERTAINTY REMAINS

The recent decision in the Fuller Austin case in the US has changed the landscape regarding bankruptcies and how the associated settlement trust funds are established. The decision stipulated that Fuller Austin's insurers only have to respond to claims actually filed against a bankruptcy trust and do not have to pay the full value of their policy limits in order to fund a trust for future claims. Importantly, the Court found that, "Estimations of the individual and aggregate value of present and future asbestos claims served neither to affix nor to accelerate the excess insurers' indemnification obligations and did not provide a basis for coverage of those claims to be presumed. Rather, the bankruptcy confirmation constituted a settlement of the insured's liability, the effect of which was subject to challenge by the excess insurers." This decision has considerable ramifications.

The FAIR Act was designed to create more certainty for the insurance industry. But with concerns regarding the amount of the trust fund, it remained unclear whether insurers and reinsurers would have finally resolved all future liabilities with passage of the Act. There was substantial uncertainty regarding which companies would have paid and how much each insurer and reinsurer would have had to contribute. In addition, there was concern regarding the ability of the fund to collect payment from non-US companies, especially those that were in run-off and thus had no ongoing business in the US. Thus, other solutions as reflected in state tort reform and decisions like Fuller Austin may produce a far more favourable outcome.

All of these issues need to be considered by insurers and reinsurers in their reserving philosophy, settlements, commutations approach and IBNR (incurred but not reported) analysis. A central challenge for reserving is how do you factor in all of these changes? It is a task requiring detailed analysis of the asbestos claims of individual policyholders. For certain jurisdictions, the overall volume of claims will now be substantially reduced – reserving needs to reflect these changes too.

## TIME TO CHANGE

When insurers are discussing settlement or commutation, the traditional values assigned to asbestos claims may no longer be accurate and, in some cases, could be overstated. Deals also need to be "FAIR Act proofed"– essentially involving adding a clause such that all the monies or a proportion of the monies (usually related to the future claims liability) are refunded if the FAIR Act becomes law. If this is not done, the insurer or reinsurer runs the risk of paying the claims twice, once through the deal and once through the FAIR Act funding, should it ever become law.

The state tort reform implications for IBNR could be even more fundamental and so the traditional way of valuing asbestos claims needs to be refined. For example, it may no longer be accurate to assign a single IBNR percentage to a group of asbestos claims spanning multiple policyholders. The more appropriate approach might be to review each policyholder to ensure the valuation of claims for each policyholder is adjusted for any particular state tort conditions that apply.

Fundamentally, insurers and their respective reinsurers want to be able to quantify, reserve for and pay valid asbestos-related claims. The reduction and eventual elimination of the "worried well" or unimpaired claims can only be a good thing for industry, insurers and truly impaired asbestos claimants. The legacy of asbestos liability in the US may eventually be disciplined by a federal solution or by local and regional changes to the tort and trust systems.

Which solution triumphs, however, is a less important factor for bringing asbestos claims under control than is how effectively and quickly these solutions are implemented.

*Robin Cantor, Michael Cook and Mary Lyman are with Navigant Consulting's insurance & claims practice.*

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