ALASKA LEGISLATURE COMMITTEE FILES 1985-1986 8072

4026 SJUD LEGISLATIVE REFORM - LIABILITY INSURANCE

902

#1 CONFERENCE COMMITTEES:

(35) A bill passed in one house and defeated or postponed in the other may be introduced in next session with same language -- 2/3 vote required to consider bill for final passage -- no committee referral

(23) S.R.56 - Sponsors, those in favor of bill and standing committee members given priority (whenever practical).

(27) There are none since Nebraska has a unicameral system.

(45) If first conference committee doesn't agree, second confenrence committee is formed. Bill is dead if they cannot compromise.

(26) Open to the public.

(16) Maximum of two conference committees appointed - can only consider "germane" matters. Members must have copy of conference committee report prior to voting.

(46) Chairman of Committee of Referral selects conferees, sponsor of bill is first choice, two conference committee allowed -- no powers of free conference, very specific.

(14) Report must be approved by minority and majority attorneys before vote, 4 hour rule, unanimous consent of all conference committee members required.

(1) Presiding officer appoints 3 members in each house to committee. If no agreement same committee tries again. Actual practice -- bill is dead after first attempt.

(24) One conference committee is appointed and must agree or bill is dead -- conference committee has wide discretion to rewrite bill. Conference committee report may be amended by concurrent resolution.

(37) Amendment within scope of issues between two houses. Another committee can be appointed if lack of agreement.

(32) Members must include sponsor(s) of bill, committee chairmen or designee, no limit to how many conference committees.

(41) wide powers

#2 FREE CONFERENCE COMMITTEES

(40) 2/3 vote of each house required before free conference committee

(6) J.R. 4(d) - needs majority consent of each house.

(26) 24 hour rule - decision is made in committee of the whole after resting 24 hours on members' desks.

(40) Upon approval of 2/3 vote of entire membership of each house. Any new matter can be stricken by a majority vote of either house.

#3 BILL CONTENT RULE

(35) Only the sponsor can move to amend the title.

(13) S.R. 13 - every bill shall be endorsed with an appropriate title.

(14) One subject per bill per title -- Constitution Sec. 19

(39) One member can request a question to be divided and put separately.

(40) Very specific format and subject matter guidelines.

(32) Must include statement of intent. Summary of provision, fiscal impact on State, fiscal impact on local governments.

(41) One member may request voting separately on any changes to bill, general appropriations bill shall embrace ordinary expenses of Legislative, Judicial andExecutive. All other appropriations must be by individual bills.

#4 "GERMANE" DEFINITION:

(40) No motion or proposition on a subject different from that under consideration shall be admitted under color of amendment unless it refers to the intent of the motion or proposition under consideration. Speaker of House of Representatives will determine germane in a dispute. Precedents are guiding factor for speaker.

(15) Definition of irrelevant amendments being those whose object is different than those under consideration.

(49) No amendments which relate to different subject, different purpose, requires title change, or totally alters nature of original bill. Extensive definition. S.R.50(1-1

(35) No piggybacking of any subject matter pending before the house.

(23) S.R. 37 - will-defined. Final decision is determined by vote.

(27) No germane definition. However, Rule 6-2(g) gives Speaker power to to Reference Committee for question.

(45) One Senator can demand a division of a question if question in debate [illegible]ains more than one point.

(37) No motion or proposition on a subject different from that under consideration shall be admitted under color of amendment.

(41) One subject per bill expressed in title. Title cannot be amended until bill has passed.

~~(15)--No-irrevelant-amendments----those-whose-subject-is-different-than-what-is-under---consideration.~~

(46) No motion or proposition on subject different from that under consideration shall be admitted.

(14) Sponsor must consent to changes in bill not germane.

(39) No motion or subject different from what under consideration.

#5 PUBLIC NOTICE OF COMMITTEE MEETINGS

(40) 24 hour notice when feasable, 5 days for hearings

(42) Specified in official committee schedule - Speaker authorizes changes only after public announcement of chairmen prior to meeting

(49) Minimum of 7 days notice with agenda

(35) No specific number given although prior notice is required.

(44) S.R. 6.04 - meetings at regular time and place except upon "issuance of reasonable notice" of change.

(45) Notice in calendar, oral notice from floor

(23) S.R.58 - 3 day notice whenever practical, standing committees have regualr scheduled meeting dates. All are open to public. H.R.63 - regular schedule with one day notice of change.

(6) Colorado Revised Statutes 24-6-402(2) requires timely notice be given of all committee meetings. This statute is part of Colorado's Sunshine Law.

(27) Rule 3-5 requiresno bill see final committee action without a public hearing and at least 7 days notice of said hearing. (Only 5 days required in first 20 days.) Appears to be no provision for emergencies.

(46) Fixed time and place is published, all meetings public, vote required for executive session.

(14) 3 days includes agenda, all meetings open; exception to Rules Committee.

(39) 2 days with agenda, only waived with 2/3 vote of whole body, does not apply after 40th day of 60 day session.

(24) Notice given by loud speaker or posting on bulletin board.

(1) In Constitution, notice required.

(15) Announced on floor of Senate, posted on bulletin board, 24 hours notice required in House with agenda. 5 days notice required for hearings.

(37) 24 hours Speaker can declare emergency.

(32) Minimum of 2 legislative days, emergency 24 hours public notice -- ranking minority committee members must approve.

(41) Minimum of 1 legislative day public with agenda, 2/3 vote of committee can waive rule.

#6 JOINT COMMITTEE MEETINGS

(49) J.R. Chapter 3 - very specific guidelines

(6) Required by Statute for Budget Committee and Legislative Council (C.R.S. 2-3-201, 2-3-301)

(45) For purpose of public hearings

(26) All appropriations may be considered by joint committee.

(16) One joint committee handles special claims against the state.

(32) By resolution adopted by both houses.

(41) By concurrent resolution J.R.6(2)

(24) 4 specific joint committees. Meetings encouraged where desirable.

(46) Any committee may confer jointly for hearings, studies or meetings.

(39) Established by majority leaders, must have proportional minority representation.

ENCOURAGE

#7 RECOMMENDATIONS USED TO PASS BILL OUT OF COMMITTEES:

(15) Committee recommends as a whole that a bill be passed, amended and passed, indefinitely postponed, without recommendation

(42) Majority of committee must agree: passage as written; passage as amended; passage as written with referral to another committee; for passage for referral with amendments

(49) Committee reports: passage; passage as amended; indefinite postponement; no recommendation.

(35) Majority vote of committee required to pass bills: to pass; not to pass; to refer; to postpone.

(12) S.R. 14D - Passed out of committee by one of the following: Without recommendation; do pass; be amended; do not pass.

(45) Majority vote of committee required.

(26) Majority and minority report can be submitted.

(23) S.R.60 - upon request, roll call vote can accompany report

(6) H.R.29(f) passed out of committee with one of the following: favorably recommend; bill be laid on the tabel; favorably recommend as amended; indefinitely postponed; referred to another committee.

(27) Rule 3-11 - committees acting by a majority recommend bill be placed on general file or indefinitely postponed and Rule 3-13 requires ~~extensive disclosure and~~ vote of each committee member report attached.

(46) Majority report required, do pass, do not pass, recommend to another committee.

(14) Sponsor of bill becomes non-voting members of Committee of Referral. Minority majority report possible. All members must have recorded vote.

(39) 48 hours rule for all bills to rest on members desks.

(24) Do pass, do not pass.

(15) Majority of committee reports do pass, do pass as amended, postponed, no recommendation

(40) Committee report given, majority decides.

(37) Majority/minority report, committee can report no recommendation.

(32) Favorably without amendments to another committee; for house consideration; adversely; for concurrence; held for further action or study; for repassing a house bill which has been recalled and amended.

(41) Do pass; do not pass; without recommendation; do pass as amended.

#8 INTERIM COMMITTEES AUTHORIZATION:

(35) Speaker or President of Senate or majority vote of both houses.

(27) Rule 3-22 authorizes full

(26) Joint resolution required

(16) Handled by joint committee

(44) H.R. & S.R. 6.06 - Special committees may be appointed by resolution

(41) J.R.6(2) By concurrent resolution.

(1) Appointed by chair to study 1 specific question unless money is involved -- then resolution required.

(15) Majority vote required.

(46) Special Committees authorized by bill or resolution. 15 members standing committee makes all appointments to special Study Committees.
Citizens are encouraged to participate on Study Committee for per diem.

(14) Must be approved by Rules Committee.

#9 LIMITATION ON SESSION LENGTH:

(49) Meets biennium

(12) 60 days pay limit

(44) 60 days

(23) 120 days per 2 year period. Must adjourn in May of each year.

(27) Odd years - 90 days
Even years - 60 days

(37) Meets every other year.

#10 CODE OF ETHICS AND DISCIPLINE

(23) S.R.75 - 2 members from majority, 2 from minority--advising capacity only. Can subpoena, hear under oath, three votes for preliminary inquiry, recommend disciplinary action to Senate.

(6) Colorado has extensive statutes on this:
C.R.S. 2-2-204 through 206
C.R.S. 1-45-101
C.R.S 24-6-401
C.R.S 24-6-30

(26) Legislative Administration handles disputes on compalints on staff.

(44) J.R.20.01 - Each house has an ethics committee which is charged with enforcing ethical conduct. Infractions are referred to the full house for action.

(32) Standing Ethics Committee

(15) Addressed under separate cover.

(40) Legislative Ethics Committee, State Ethics Act under separate cover.

(1) Specific on conflict of interest.

#11 CONTRACTING PROCEDURES:

(42) No special committees, studies or investigations allowed in area of responsibility of standing committee

(49) Majority of standing committee must agree to study, legislative service agencies coordinate

(6) Colorado REvised Statutes 2-2-320 - requires that contracts be approved by speaker of house on majority leader of Senate or chairman of legislatively created joint committee.

(27) Rule 5-10; Rule 1-22

#12 LOBBYING LAWS

(40) Chapt. 17 of Title 2 Code of Laws, 1976

(6) Colorado Revised Statutes 24-6-301 - requires extensive disclosure and registration of lobbyists. All records open to public.

(27) Rule 1-17 and in Nebraska statutes.

(37) In statutes.

(15) Addressed under separate cover.

(1) Very detailed specifics on violation, registration. All persons must register including government personnel.

#13 RULES REVIEW & ENFORCEMENT:

(15) Violations referred to House Ethics Committee by Speaker

(6) Colorado Revised Statutes 2-2-404, 405 & 406 - provides for judicial enforcement of legislative rules. However, enforcement may only be iniated by a majority determination of the membership.

(14) Strict penalties for voting irregularities, 2/3 vote may expel any member.

(15)Any alleged violation of rules are referred to House Ethics Committee

#14 LIMIT ON NUMBER OF BILLS INTRODUCED:

(15) Specific time limits for individuals to introduce

(42) No pre-file limit, after 3rd day each member limited to 9 bills

(35) On or after March 15, a majority vote determines if bill introduction shall cease.

(27) Rule 5-5(d)

(12) However, S.R. 11 - No bills introduced after 25th day except by standing committees.

(44) However, no bills may be considered after 57th day of session.

(45) Time limit is specified. After specified date a bill can be introduced through Tules Committee.

(26) Time limits on bill introduction. After deadline, 3/4 of standing committee must consent to introduction of bill.

(16) Specific time limits depending upon introduced by individual or committee.

(37) Time limits with exceptions

(32) Time limits and 10 bills per member unless by unanimous consent.

(24) No new bills during last 3 days.

(15) Time limitations.

(1) Specific time limits.

(14) 1st session -- 2 bills per day per legislator. 2nd session -- 1 bill per day. Strict time limits for committees to introduce.

(39) Strict time limits for individuals and committees to introduce. After deadline 2/3 vote of whole body required.

#15 TIME LIMIT FOR COMMITTEE TO PROCESS BILL:

(42) May be called from committee after 7 days by majority.

(45) 15 days - all bills reach floor for action

(26) Written report required within 7 dyas. Committee can request additional time from house concerned.

(12) J.R. 14E

(44) S.R. 6.14 - Must be considered within 8 days unless extension granted by Senate.

(23) H.R.1.15 - majority can bring bill out of committee.
H.R.1.16 - Author can ask after 20 days, committee then has 10 days to act.

(6) J.R.23 - Bills must be reported out of committee in the house of origin in 45 days.

(27) Rule 3-10 - Legislature can require a committee report after 20 days of inaction by committee.

(39) Committee can have bill a maximum of 16 days before a variety of procedures can be used to bring bill to floor, including a request by sponsor.

(24) House 20 days, Senate 10 days . . . upon motion and majority vote a bill can be removed to committee as a whole. No appropriation bill can be passed in last 5 days.

(37) Maximum of 75 days total for one or more committees before bill must be reported to floor.

(41) Specific time limits J.R.11-3.

#16 RULE WAIVER PROCEDURES:

(40) H.R.4.15 - Only by written resolution which has been referred to Rules Committee and agreed to by 2/3 of members present after committee makes its report
S.R. 45 - Must have unanimous consent or 1 day previous notice and 2/3 vote

(15) Concurrent resolution adopted by constitutional majority of both houses

(27) Suspension of Rules by 3/5 Majority vote.

(45) 3/4 vote

(26) Senate is 2/3 vote
House unanimous consent needed to suspend rules.

(16) Simple majority if 1 day notice is given; 2/3 if no notice.

(37) 2/3 vote

(32) majority vote

(41) 2/3 vote

(24) 3/5 vote upon 3 days notice.

(1) One day's notice in writing, goes to Committee on Rules, any rule may be suspended by unanimous consent, otherwise a majority vote decides.

(15) Concurrent resolution adopted by constitutional majority of both houses.

(40) Written resolution which has been referred to Rules Committee and agreed to by 2/3 vote of house.

(46) 2/3 vote of members elected.

(14) Committee on Rules reports -- majority vote needed.

(39) 2/3 vote

#17 LEGISLATIVE OVERSIGHT:

(6) J.R.25 - encourages legislatove oversight. Colorado Revised Statutes 2-3-201 and 2-3-301 establishes legislative oversight as duty of Legislative Council and Budget Committee.

(40) Standing committee function.

(32) Special Oversight, Analysis and Investigation Committee.

Ethics.

STATE OF ALASKA

ALASKA PUBLIC OFFICES COMMISSION

JAY S. HAMMOND, GOVERNOR

REPLY TO:

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ANCHORAGE, ALASKA 99501-3598
(907) 276-4176

☐ JUNEAU BRANCH OFFICE
POUCH CO
JUNEAU, ALASKA 99811-0222
(907) 465-4864

October 26, 1981

The Honorable Patrick Rodey
601 West 5th Avenue, Suite 820
Anchorage, Alaska 99501

Dear Senator Rodey:

Thank you for the interest you expressed in the annual meeting of the Council on Governmental Ethics Laws to be held December 7 - 9, 1981, in Charleston, South Carolina. I was unable to send you any of the enclosed information sooner because we received it ourselves only last week.

In light of your interest in ethics legislation, I also have enclosed a letter from the South Carolina State Ethics Commission which offers a comparative analysis of ethics laws. I ordered a copy for the APOC sometime ago, but since it has not arrived, I can't say whether it lives up to its promise as a reference document or not. At one time the work on SB 175 attempted to incorporate portions of the Ethics Model from the National Municipal League, although my understanding is that some of the individuals who worked on the draft of 175 had questions about the League's model for which they didn't find satisfactory answers.

After the first of the year, I will let you know about any reference materials which become available as a result of the Charleston meeting.

Sincerely,

ALASKA PUBLIC OFFICES COMMISSION

Theda S. Pittman

THEDA S. PITTMAN
Executive Director

TSP/mab

enclosures

COUNCIL ON GOVERNMENTAL ETHICS LAWS

Steering Committee:

Melvin G. Cooper
Alabama Ethics Commission

Jean-Marc Hamel
Chief Electoral Officer of Canada

Shari Holmes
Alaska Public Offices Commission

Betty J. Reynolds
Oregon Government Ethics Commission

Robert W. Shellenberg
Florida Commission on Ethics

Robert Stern (Chairperson)
California Fair Political Practices Commission

Dannie Trautwein
Nebraska Accountability and Disclosure Commission

J. Jackson Walter
U.S. Office of Government Ethics

Please reply to:

OCT 20 1981 RECEIVED

OCT 26 1981

APOC-ANCH
PM HC

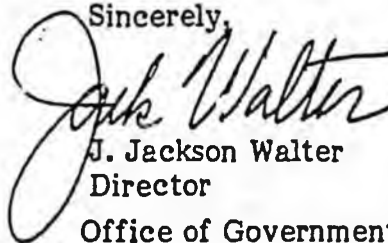
Dear Council Member:

Mel Cooper from Alabama and Bob Schellenberg from Florida, who have arranged the program for the Charleston Conference of the Council on Governmental Ethics Laws, asked me to assist them in securing better attendance at our Conference. We have a program that should be of particular interest to members of your Commission and want to ask you to extend a special invitation to each of them to participate. In addition to that, you might want to give each of them a copy of the Conference information that you received from Bob Stern and to emphasize that other Commission members will be there and that there will be ample opportunity for discussing mutual problems and concerns.

I have enclosed a revised version of the Conference schedule; the one that Bob Stern sent you didn't do complete justice to the outstanding job done by Mel and Bob in arranging our Conference. Please note the additions to the list of speakers: Governor Richard Riley of South Carolina, Major Joseph Riley of Charleston, former Ambassador and Governor Reubin Askew of Florida, Commissioner Frank Reiche of the Federal Election Commission, and David Cohen, former President of Common Cause. This truly is an "all-star" line-up.

From here on, it is up to you. Mel and Bob have arranged a superb program but its real success will be only as good as the "selling job" you do to your Commission members. I personally believe it is important to the Council that this year's Conference be a great success, that our program will be first-rate, and that you and the members of your Commission will find your participation to be most worthwhile.

Sincerely,



J. Jackson Walter
Director
Office of Government Ethics

Enclosure

Council on Governmental Ethics Laws
Preliminary Conference Program (10/20/81)

December 6-9, 1981
Mills House Hotel
Charleston, South Carolina

"IS POLITICAL REFORM DEAD?"

Sunday, December 6, 1981

6:00 - 7:00 p.m.	**Reception**

Monday, December 7, 1981

9:00 - 9:30 a.m.	**Opening Remarks and Greetings** Governor Richard W. Riley, South Carolina Mayor Joseph Riley, Charleston Robert Stern, Chairperson, Council on Governmental Ethics Laws
9:30 a.m. - 12 noon	"Political Reform Laws: Milestones or Millstones? A Debate" David Cohen, former President, Common Cause Frank Reiche, Member, Federal Election Commission - - - - - - - -
12:15 - 1:45 p.m.	**Luncheon** Honorable Howell Heflin, Vice Chairman, Select Committee on Ethics, U.S. Senate
2:00 - 3:00 p.m.	**Seminar Discussions** (discussion leaders to include Melvin G. Cooper, Alabama Ethics Commission; Robert W. Schellenberg, Florida Commission on Ethics; J. Jackson Walter, United States Office of Government Ethics)
3:15 - 4:15 p.m.	**Seminar Reports and General Discussion**

Tuesday, December 8, 1981

	Ethics, Conflict of Interests	Campaign Finance
9:00 - 10:15 a.m.	"CASE STUDIES IN ETHICS" Dr. John Dempsey College of Charleston	"UPDATE ON LITIGATION AND LEGISLATION" Tom Houston Jim Davis California FPPC
10:30 - 11:45 a.m.	"UPDATE ON LITIGATION AND LEGISLATION" Rosa Hamlett Assistant Attorney General Alabama	"CAMPAIGN FINANCE IN SELECTED COUNTRIES" Dr. K. Z. Palteil Carleton University, Ottawa

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State of South Carolina
State Ethics Commission

GARY R. BAKER
EXECUTIVE DIRECTOR

(803) 758-7408
Rembert Dennis Bldg., Ste. 545
1000 Assembly Street
Columbia, S.C. 29201

September 1, 1981

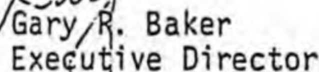
Ms. Shari Holmes
Alaska Public Offices Commission
610 C Street, Ste. 211
Anchorage, AK 99501

Dear Shari:

I have just received your latest newsletter. I was hoping to include another item in it but you were faster at publishing that I was in contacting you.

We have recently completed publications of State of South Carolina State Ethics Act: A Comparative Analysis. The publication was put together by the staff of the South Carolina Ethics Commission as a research aid for the staff and commission. This publication compares other states' statutes with each section of the South Carolina Ethics Act. Each code section of the South Carolina Act is listed separately, followed by similar or same code sections from other states. In addition, tne Model State Statutes of the National Municipal League are also included. Copies can be made available to other agencies at cost, plus postage, approximately $10.00.

Sincerely,



Gary R. Baker
Executive Director

GRB:lhl

12:00 Noon - 1:30 p.m. **Luncheon**
Honorable Reubin O'D. Askew
Former United States Trade Representative
and Governor of Florida

1:45 - 2:45 p.m.	"CODES OF ETHICS IN STATE GOVERNMENT" Dr. Stephen Hays University of South Carolina	"PUBLIC FINANCING IN SELECTED STATES" Ed Farrell, Counsel New Jersey Election Law Enforcement Commission

3:00 - 3:30 p.m. **Question and Answer Session**

3:30 - 4:30 p.m. **Council Business Session**

Wednesday, December 9, 1981

9:00 - 11:00 a.m. "THE IMPACT OF POLITICAL ACTION COMMITTEES ON THE GOVERNMENTAL PROCESS"
Howard Vaughn
Vice President, Liberty National Life Insurance Company and PAC Secretary
Edward Roeder
Washington, journalist and author of PACS AMERICANA
(S.C. Legislator)

11:00 - 12:00 Noon **Question and Answer Session**

STAFF FILE
Ethics Bill

Anch Times 1/27/82

Senate committee puts off ethics bill for new revision

by Bill White
Times Juneau Bureau

Juneau — A Senate committee, torn over whether to write an ethics code for public officials broadly or narrowly, postponed action on a proposed bill until next week.

The code would set out a strict standard of conduct for appointed or elected state and local officials. Sen. Vic Fischer, D-Anchorage, chairman of the Senate State Affairs Committee, said the bill is aimed specifically at "the invisible people" who fill the halls of the bureaucracy.

The committee debated a newly revised, 20-page version of the bill for 75 minutes Tuesday, then sent it back to lawyers for further revision.

Sen.. Terry Stimson, D-Anchorage, questioned whether the bill goes far enough. The bill contains no provisions for reprimanding public officials who commit crimes, he said.

"We can't establish parameters and then say anything outside of those parameters is not within our purview," he said. He also criticized the bill for not giving the Senate — which will get cases when the public official can be impeached — guidelines on how to handle the cases.

"If we have got some loopholes, I'd like to plug them before we move along," Stimson said.

Sen. Mike Colletta, R-Anchorage, agreed on the need for ethics standards and an outline of how cases of unethical conduct should be handled. But, any proposal should give the ethics commission that enforces the code flexibility in deciding what behavior is good and bad, he said.

"If you try to get it all in, you're never going to get it done," he said. A sounder approach to an ethics code lay in his two-page proposal for a legislative code that he pushed in 1980, he said.

Ethics legislation is not a new idea. But this year the proposal has been given a shot in the arm by stinging public demands for the ouster of Sen. George Hohman, the Bethel Democrat convicted last month on two bribery charges.

The aura of the Hohman issue hung behind much of the debate over the ethics bill Tuesday, but Fischer, chief sponsor of the bill — Hohman's name ironically was the second sponsor originally — pointed out that the panel has been working on the bill for a year.

Sen. Arliss Sturgulewski, R-Anchorage, also called for more flexibility in defining what is ethical conduct.

She said the provision barring former public officials from lobbying on matters they influenced when working for the government could cause problems. "I would see (some people) having trouble getting out of bed in the morning. It's far, far too broad," she said.

Further, the bill should address how a legislator can vote when he has a conflict of interest, she said. Would her role as a bank director prevent her from voting on a bill to let Outside banks buy Alaskan banks, she asked.

The bill's provisions include bans against public officials:

- Accepting gifts intended to influence them.
- Using for personal gain or disclosing information closed to the public.
- Using state time, equipment or facilities for private purposes.
- Taking official action affecting a business of which he is part owner.
- Obtaining a state contract unless it is let by competitive bidding.

Ethics legislation not top priority item

by Dave Carpenter
Times Juneau Bureau

Juneau — Interrupting the struggle over Alaska's oil megabucks for the past couple of legislative sessions has been a sporadic call to establish formal ethical standards for public officials.

This year, despite the brouhaha over the recent bribery conviction of Sen. George Hohman, D-Bethel, the cry by lawmakers to create an ethics code or commission is surprisingly muted. In fact, an ethics bill appears nowhere among the priorities of House and Senate leaders.

"When I get up in the morning, I know the difference between right and wrong," Senate Finance Committee Co-chairman Ed Dankworth said in an interview in his Capitol office this week. "I don't need anybody to write it down for me."

Former State Ombudsman Frank Flavin, among others, feels differently.

"If everybody knew what was right and wrong, we wouldn't need a code," said Flavin, an Anchorage attorney here on a business trip. "Unfortunately, it doesn't work that way."

The only ethics statutes currently on the books in Alaska are the conflict of interest law, which Flavin calls "limited," and criminal law.

During five years as the official watchdog of state government, Flavin encountered many instances of public officials abusing their positions, he says — cases of people blocking business competitors in their roles as state board members, setting themselves up for jobs for after their government stints, using public equipment for private purposes, and the like.

Public support began mounting for an ethics code for legislators, if not non-elected officials, about two years ago in the wake of a controversy involving alleged influence-peddling by former Anchorage Sen. Bill Sumner (the issue was never resolved).

(See ETHICS, page A-3)

that flip-flopped the House leader-

specifically addressed during his or her employment.

— Employees could not be disciplined for "blowing the whistle" on state officials.

A current Alaska statute protects "whistleblowers" who communicate public records or information. The new proposal, based on a Michigan statute, would be much broader.

Both bills face the imposing task of hurdling substantial legislative apathy — or at least a lack of enthusiasm at present.

"We're interested in further legislative reform . . . but we haven't identified ethics legislation specifically as a priority," said House Speaker Joe Hayes.

The Anchorage Republican said he adamantly opposes incorporating an ethics commission into the often-criticized public offices commission — a point that could snag the bill even if it clears the Senate.

"It (ethics) should be a constant thing that we're evaluating," added House Rules Chairman Jack Fuller, D-Nome. "But with the desperate need of getting out in 104 days (a House leadership target), I don't think we can spend the time on it."

Even those who backed the legislation last year are quiet about the subject early in the 1982 session. House Democrats put a lot of work and public words into the effort before falling from power, but the now-minority caucus has not broached the subject.

"The problem is we've been working hand to mouth," said Minority Leader Fred Brown, D-Fairbanks.

On the Senate side, Rules Chairman Tim Kelly, R-Anchorage, expresses support for an ethics code but was unaware of the status of the Senate legislation. And the two top Senate powers — Dankworth and President Jay Kerttula, D-Palmer — said they have no burning desire to pass it. Both stressed that the Hohman case involves criminal law.

"Frankly, ethical conduct and proper respect for the law and morality is the responsibility of every member individually," said Kerttula. "Ethics is very difficult to police....

"There are some things that it would take a representative of the good Lord himself to determine."

A burst of legislative support for ethics legislation could push it through before the 12th Legislature is history. But Flavin expressed doubt that anything will pass unless a key lawmaker makes it a priority.

"It takes a lot of work to put something as detailed as that through," he said, "and I don't know if anybody is that committed to it."

Ombudsman

Frank Flavin

State of Alaska

Reply to:

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Pouch WO
Juneau, Alaska 99811
(907) 465-4970

P.O. Box 74358
Fairbanks, Alaska 99707
(907) 452-4001

February 12, 1981

Senator Patrick M. Rodey
Pouch V
Juneau, AK. 99811

Dear Senator Rodey

The Office of the Ombudsman has prepared the first two of several special reports for members of the Legislature. The first report, titled 'Protection of the Public Interest in the Expenditure of Voter Approved Bond funds', explains the problems found during the investigation of two citizen complaints lodged with this office. In both complaints, voter approved bond funds were not spent as described in the bond authorization acts and as stated in the bond propositions on the ballot. This present practice leaves the final decision as to the reasonableness of voter approved bond expenditures with departmental level administrators. The report suggests measures to return this decision to the voter.

The second report is titled 'Standards of Ethical Conduct for Public Officials and employees and the need for an Independent Ethics Commission'. It highlights our experience with complaints dealing with ethical conduct, and details the need for legislation in this area.

Sincerely,

Frank Flavin
Ombudsman

FF:ss

LLIB 8100410

OFFICE OF THE OMBUDSMAN
STATE OF ALASKA

SPECIAL REPORT 81-2

STANDARDS OF ETHICAL CONDUCT FOR PUBLIC OFFICIALS AND EMPLOYEES AND THE NEED FOR AN INDEPENDENT ETHICS COMMISSION

FEBRUARY 11, 1981

FRANK FLAVIN
OMBUDSMAN

Legislative Reference Library
Legislative Affairs Agency
Pouch Y State Capital

Senator Vic Fischer
Alaska State Legislature
Pouch V • Juneau, Alaska 99811 • (907) 465-4954

July 31, 1985

M E M O R A N D U M

To: All Senators

From: Senator Vic Fischer

Re: Executive branch ethics code

The second recomendation of the grand jury report proposed the enactment of a code of ethics for the executive branch of state government.

In response to a question on Wednesday afternoon, the Governor said that a proposed ethics code was stalled in the Senate State Affairs Committee in 1984.

Attached is information on what transpired and why the Attorney General's office did not resubmit a revised executive ethics bill.

July 12, 1985

M E M O R A N D U M

To: Senator Vic Fischer

From: Ginger Baim

Re: Legislative History/ SB 501 - Executive branch ethics

February 1983	DOL begins drafting bill to cover legislative, judicial, and executive branch
April 2, 1983	1st draft bill circulated to department heads (DOL had been instructed to separate executive & legislative branches - judicial branch asked to be excluded - draft bill only delt with executive branch)
April 20, 1983	2nd draft bill circulated after incorporating comments
March 3, 1983	3rd draft bill circulated - incorporates APOC comments
March 20, 1983	4th draft bill circulated
Mid-June, 1983	final draft circulated
June 17, 1983	final draft approved by Gov's office for introduction in 1984 session
January, 1984	circulated again throughout departments
February 8, 1984	submitted to Governor's office
February 13, 1984	transmitted to the legislature by Gov. Introduced in the Senate, referred to the State Affairs Committee.

(NOTE: THE ABOVE INFORMATION WAS PROVIDED TO THE COMMITTEE VIA A MARCH 1, 1984 MEMO FROM DIANE COLVIN, DEPARTMENT OF LAW).

March 1, 1984	1st SA hearing

April 17, 1984	2nd hearing (While each department/agency supported the intent of the bill, AHFC, APOC, DOA, and APEA were all opposed to specific parts of it and the Judicial branch was excluded by the DOL.
April 24, 1984	3rd SA hearing - the committee raised numerous questions and suggestions about the bill. They suggested that the DOL re-draft it in response to problems raised during committee hearings. DOL was to work with SA staff over the interim to prepare a new draft bill.
Mid-summer, 1984	S.Tryck called Diane Colvin several times asking about the progress in working on a new version of SB 501. DOL said they would contact ST when they were ready.
November 21, 1984	VF letter to Diane Colvin expressing frustration in the lack of action on the new draft and making it plain that SA staff could not and would not proceed with preparing legislation - it was the responsibility of the DOL. VF also expressed disappointment that the SA Committee was unable to have interim hearings on the bill because of DOL's lack of action.
December 7, 1984	Diane Colvin responds saying the DOL couldn't proceed with the bill without the APOC and that APOC had been too busy to work on it. Colvin said that the DOL and APOC would prepare legislation for introduction in 1985. Colvin also expressed dismay at what she considered undue criticism of the DOL's performance and cooperation.
December 27, 1984	VF writes to Colvin saying he didn't intend to cast doubt on her work but was stating a fact: the SA committee would not prepare legislation for 1985 - it was up to the DOL to do it.

ALASKA STATE LEGISLATURE

SENATE STATE AFFAIRS COMMITTEE
POUCH V, JUNEAU 99811
SENATOR VIC FISCHER, CHAIRMAN
(907) 465-4954

November 21, 1984

Diane Colvin
Assistant Attorney General
Pouch K
Juneau, Alaska 99811

Dear Ms. Colvin:

I am writing to inform you that the State Affairs Committee will not be preparing Executive Branch standards of conduct legislation for introduction in January. It is our position that the Administration develop and introduce that and any related ethics legislation.

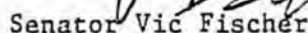
Last session, the administration and the committee agreed that SB 501 was not adequate and that we would work together over the interim to come up with a bill able to pass the legislature. My office contacted you over the summer, and was told that you would call once you were ready to begin this joint effort. We have not heard from you, and I think it is much too late in the interim for us to begin work on this complex subject.

I think it is unfortunate that we did not have the opportunity to hold hearings this interim on revised legislation. However, I feel confident that you will come up with appropriate legislation addressing the problems identified during committee meetings last year.

In particular, I look foreward to reviewing what agency, other than APOC, is put in charge of administering the law, and how "public official" is defined for purposes of reporting.

I very much appreciated your efforts last session, and I'm sure your work next year will be just as good.

Best regards,



Senator Vic Fischer

cc: Norm Gorsuch, Attorney General

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

REPLY TO:

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☒ POUCH K - STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3600

December 7, 1984

Honorable Vic Fischer
Alaska State Legislature
Pouch V
Juneau, AK 99811

Dear Senator Fischer:

Thank you for your letter of November 21 informing us that the State Affairs Committee will not be preparing executive branch conflict of interests legislation for introduction in the Fourteenth Legislature. We appreciate your interest in this subject and the efforts made by your committee in its consideration of the legislation introduced last session.

Your letter appears to indicate that we failed to cooperate with your office in a joint effort to develop new ethics proposals during the interim. I hope that this is not your belief. As I recall, I agreed with your staff to keep you informed of any activity on our part in the development of revised legislation. Due to the involvement of the Alaska Public Offices Commission in a variety of election controversies, of which you are well aware, we were unable to work with APOC staff on ethics legislation this summer and fall. It is our belief that APOC's participation in preparation of ethics legislation is important, and we thus delayed work on the legislation because APOC staff was unable to commit time to the project. We are just now beginning to make a concerted effort to work on ethics legislation.

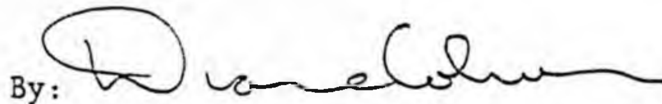
We expect to develop some new proposals on ethics for introduction in the upcoming session. I hope your interest in

03-C5LH

this area will continue. We look forward to working with you during the session.

Sincerely,

NORMAN C. GORSUCH
ATTORNEY GENERAL

By: 
Diane T. Colvin
Assistant Attorney General

DTC:cct
cc: Theda S. Pittman
Director
Public Offices Commission
Department of Administration

ALASKA STATE LEGISLATURE
SENATE STATE AFFAIRS COMMITTEE
SENATOR VIC FISCHER, CHAIRMAN
POUCH V, JUNEAU 99811
(907) 465-4954

December 27, 1984

Diane Colvin
Assistant Attorney General
State of Alaska
Pouch K
Juneau, Alaska

Dear Ms. Colvin,

Thanks for your response to my November twenty-first letter. I would like to lay your concern to rest. It is certainly not my opinion that you or your office failed to cooperate in working on the conflict of interest legislation. On the contrary, I have always found you very helpful and you work quite satisfactory.

The purpose of my November correspondence was merely to inform you of a fact: the Senate State Affairs Committee will have no conflict of interest legislation prepared for introduction this January. I do not think it necessary to go into details on the subject at this time. However, in no way should you perceive this as a reflection of your work.

I hope this clears up any confusion.

Best regards,

Vic Fischer (VB)

Senator Vic Fischer

ADN July 13, 1985

Legislators expected to pass ethics code

By JOHN LINDBACK
Daily News reporter

JUNEAU — The recent grand jury report about Gov. Bill Sheffield is bound to force the legislature to pass an ethics code for governors and other officials of the executive branch, some senators said this week.

"I guess we'll have to, in light of recent events," said veteran Sen. Bob Ziegler, D-Ketchikan, a lawyer and a cynic about the effectiveness of ethics legislation in regulating the behavior of public officials.

"The trouble is that you can drive trucks — Mack trucks — through the holes in most ethics legislation if you're inclined that way," Ziegler said Friday.

The Sheffield administration in 1984 introduced a proposed ethics code for the executive branch. But the proposal died in the Senate State Affairs Committee and it was not reintroduced during this year's session.

Assistant Attorney General Diane Colvin said the bill

See Back Page, LEGISLATORS

Legislators may look at ethics

Continued from Page A-1

wasn't reintroduced because the administration was not able to do a badly needed rewrite between the 1984 and 1985 sessions. The Alaska Public Offices Commission, the state agency that would have been enforcing the new law, needed to be consulted on the changes, but the agency was embroiled in a time-consuming controversy about campaign fundraising, Colvin said.

"We never got the time to put the work into it that would have made it comfortable enough to have it reintroduced," Colvin said.

Sen. Tim Kelly, R-Anchorage and a member of the State Affairs Committee in 1984, agreed that an ethics bill will undoubtedly reappear as a result of the grand jury's report.

Kelly said the governor's bill didn't pass in 1984 because the legislature was concentrating on approving an ethics code for itself. Also, he said, writing the bill was difficult.

"We found it hard to resolve some of the issues involving a person's right to own property, start a business and also be a public servant," Kelly said.

The Juneau grand jury, in the same report that asked the legislature to consider impeachment proceedings against Sheffield, issued a recommendation for an executive branch ethics code.

"In order to deter the conduct described in this report from occurring in the future, and to insure that all state officials are adequately informed of their ethical obligation to protect the public interest, the grand jury recommends that legislation be drafted and introduced, or that a regulatory code of ethics be promulgated, setting forth standards to govern the conduct of executive branch officials. This code of ethics must provide for appropriate disciplinary sanctions," the grand jury said.

In its report, the grand jury said that Sheffield and his former chief of staff, John Shively, deliberately steered a $9.1 million state lease for office space in Fairbanks to one of Sheffield's political supporters. The motive cited in the report was political favoritism rather than personal financial gain for either Shively or Sheffield.

Ironically, political favoritism was not addressed in the ethics code considered for the executive branch in 1984, so if it had passed it would not have applied to the Fairbanks lease case. Political favoritism in carrying out public duties is also not part of an ethics code the legislature approved for itself that same year.

Neither legislators interviewed this week nor Colvin said they knew of any efforts in the past to regulate political favoritism.

Sen. Arliss Sturgulewski, R-Anchorage, said political favoritism can perhaps be outlawed best by revisions to the state contracting and procurement laws.

But, she said, the legislature will most certainly pass an ethics code in response to the grand jury's recommendation.

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James O. Smith
Signature of Camera Operator

11/7/89
Date

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LIABILITY INSURANCE

THE "CRISIS" OF COST

AND

LACK OF AVAILABILITY

OF

LIABILITY INSURANCE

William A. K. Titelman, Esq.
Pennsylvania Trial Lawyers Associati
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December 9, 1985

Preface

Problems regarding the cost and lack of availability of liability insurance are affecting a variety of insurance consumers. The following article is based on testimony which the Pennsylvania Trial Lawyers Association presented on this important issue before several committees of the General Assembly.

The first part of the article reveals that the problem is not the result of a crisis in our legal system--there has been no sudden increase in claims or litigation. Further, the total cost of paying liability claims has done nothing more than keep pace with the underlying rate of inflation for the goods and services for which the compensation is paid. It goes on to demonstrate that tort "reforms"--restrictions on the rights of injured citizens--have no effect on the cost and availability of liability insurance. One of the best examples of this is what has happened in the area of municipal liability insurance despite the extremely restrictive Pensylvania Political Subdivision Tort Claims Act of 1978.

The second part reveals that the root cause of the current problem is the cyclical economics of the insurance business and its relationship to underlying economic conditions. Competing insurance companies were engaged in a price war when interest rates were high and rising. When interest rates fell sharply, as a result of the economic recovery, the insurance companies began to raise prices dramatically and even cut off coverage in less profitable lines in order to increase their profitability. The following example demonstrates how this "crisis" of cost and lack of availability develops:

Hypothetical Insurance Company

Year	Surplus [1]	Total Permitted Written Premiums [2]	(Cost) Average Premium Per Policy	(Availability) Number of Policies Which Can Be Written
1980	$1,000,000	$3,000,000	$1,000	3,000
1981	$1,000,000	$3,000,000	$900	3,333
1982	$1,000,000	$3,000,000	$800	3,750
1983	$1,000,000	$3,000,000	$700	4,286
1984	$1,000,000	$3,000,000	$600	5,000
1985	$1,000,000	$3,000,000	$1,500	2,000

1 Insurance industry jargon for net worth.

2 Based on the typical 3 to 1 written premiums to surplus ratio permitted in most states.

Presuming that the 1980 average $1,000 premium per policy represents adequate rates, this insurance company proceeded over the next several years to engage in a price war with competitors by cutting premiums to expand its market share. This caused the average premium to become progressively more inadequate. This company became increasingly over reliant on investment income to make up the difference. Such a strategy may be successful when investment yields are high or increasing, but when yields fall and claims must be paid on the increased number of policies which were sold at inadequate rates, profitability suffers. The result is that the average premium rises dramatically. This, in turn, causes an equally dramatic decrease in the number of policies which can be written.

Examining the cost side of the "crisis"--even if it were necessary for the average premium to go from $1,000 to $1,500 five years later, that should only have required a relatively tolerable 8.45% annual rate increase, instead of the average 150% one year increase from $600 to $1,500 to improve profitability because of previously unwarranted premium reductions.

Looking at the availability side of the "crisis"--when an insurance company is forced to reduce the number of policies it is writing due to changes in surplus or rates, it naturally looks at the profitability of each line of insurance it is writing in order to select where the cutbacks will occur. For example, if it writes six lines, each having a return on investment of 25%, 20%, 17%, 15%, 12% and 10% respectively, to improve profitability it will, wherever possible, stop writing those lines where the profit is lowest. It makes no difference what the claim history is of the individual policyholders in any of these less profitable lines. The company may also stop writing a few of its more profitable lines where it has relatively little data and some reason for uncertainty. For example, the company may be writing fifty insurance policies for day care centers yielding a 20% return with little or no claim history. Being aware of a case involving mistreatment of children in a day care center in California, it may choose to drop this line to help achieve the necessary overall reduction in policies, rather than drop 500 policies in lines, such as auto or homeowners insurance, which may be yielding a highly predictable and steady 17%.

There is simply no way to justify the abrupt increase in cost and lack of availability of liability insurance occurring in the current phase of the insurance cycle, except to suggest that there is a "crisis." Clearly, this problem could be avoided by better discipline in the insurance market exercised by both the companies involved in this conduct and those charged with the regulatory responsibility.

The third part of the article suggests some of the types of solutions which would provide prompt and effective relief. The accompanying exhibits will also be of particular interest.

Only by understanding the true nature of a problem can appropriate remedies be developed. This article was written in the hope of furthering that understanding.

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I. The Tort System and its Impact On Liability Insurance Costs

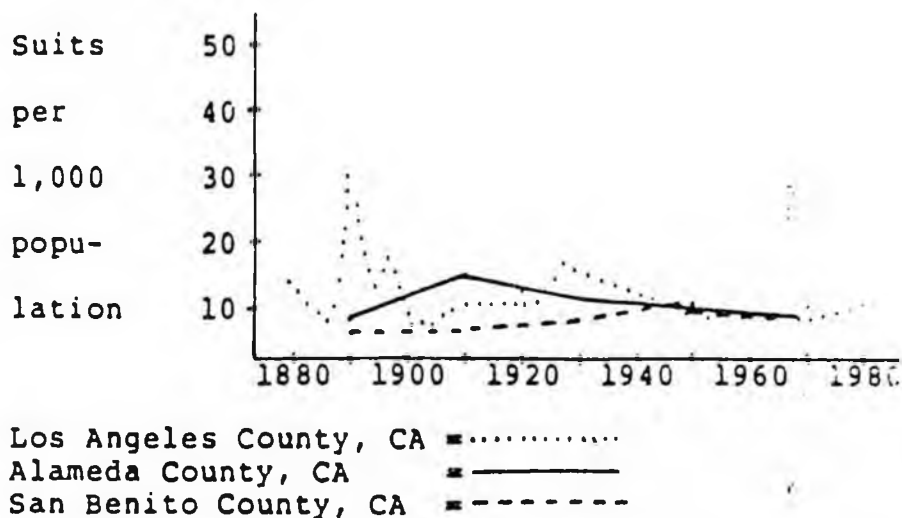
Whether it is an article or editorial on rising liability insurance costs for municipalities, day care centers, doctors, nurse midwives, tavern owners, manufacturers of various products from asbestos to autos, from chemicals to drugs, or the owners of commercial vehicles or private passenger automobiles, or any number of other areas, the focus always seems to be that we live in a "litigious society." The basic tenents of this perception are that we, as a people, are not only more likely to sue than other people, but that we are also more likely to sue than we used to be. Neither turns out to be true.

A. The Myth of Litigiousness

A recent survey by Professor Marc Galanter, published in the UCLA Law Review, of the litigiousness of citizens of major industrial nations clearly showed that Americans are really quite normal in terms of their tendency to sue:

> "[T]he United States rate of per capita use of the regular civil courts in 1975 was just below 44 per thousand. This is in the same range as England, Ontario, Australia, Denmark, New Zealand, somewhat higher than Germany or Sweden, and far higher than Japan, Spain or Italy. ... According to a recent report, some five million cases are filed in Yugoslavia each year, an astonishing figure for a country of 22 million persons."[1]

If we are not more likely to sue than the citizens of other major industrial nations, are we more likely to sue than we used to be? Again, the answer is no. There is no clear trend toward an increase in the tendency of Americans to bring a civil lawsuit. Recent articles by Stephen Daniels, Ph.D., "We're Not a Litigious Society: The Facts Do Not Support the Rhetoric Surrounding the Litigation Explosion," published in The Judges Journal, Spring 1985, and "Ladders and Bushes: The Problem of Caseloads and Studying Court Activities over Time," published in the American Bar Foundation Research Journal, Volume 1984, Fall, Number 4, support this. Also note the following graph, showing litigation trends in three major California counties, a state with a reputation for litigiousness.



Sources: Galanter, supra at fn (1), p.40; Selvin, M. and Ebener, P., Managing the Unmanageable: A History of Civil Delay in the Los Angeles Superior Court, The Institute for Civil Justice, Rand Corporation (1984), p.34.

As Professor Galanter explains, "the pattern of use [of the law to resolve disputes] is conservative, departing relatively little from earlier patterns."[2]

What, then, of such facts that nearly twice as many civil actions were filed in federal district courts in 1983 as in 1977?[3] Doesn't that prove we are more likely to sue than we used to be? No, as Professor Galanter explains:

> "[O]ne third of the whole increase consisted of a jump from 600 to 41,000 cases filed by the federal government to reclaim overpayment of veterans' or Social Security benefits or to collect on student loans. The next largest gain was an increase from 3,000 to 20,000 in claims to restore disability payments cut off by the Reagan Administration. ... These numbers reflect specific social and political events and don't point to any across-the-board increase or decrease in litigiousness."[4]

In Pennsylvania, noted Philadelphia author, John Guinther, found that filings of civil actions in Pennsylvania courts have risen at an average rate of 1% per year over the last five years, a rate of increase which is one-third of the national average. Further, most, if not all of this negligible increase can be accounted for by increases in those civil actions involving family law matters such as support, alimony, custody

and divorce which account for the overwhelming bulk of all civil preceedings in our courts. Whereas liability insurance comes into play in personal injury cases, which actually account for only a small percentage of the cases in the courts. There has been virtually no difference in the rate of filing personal injury cases from year to year since about the mid-1970's.[5] (See Exhibit A)

While the overall rate of filing personal injury cases is stable, there will always be subtle changes in the types of cases brought. This would reflect the continuing evolution of the increasingly complex society in which we live. For example, there may be more pollution or drug liability cases now than there were fifty or one hundred years ago. Now there are thousands of complex chemical compounds being released into our environment and we are better able to determine the harm they can cause. In the past there were not nearly as many chemicals and it was far more difficult, if not impossible, to prove that they were the cause of the harm people suffered. Surely, there are less travelers involved in railroad accident cases per capita today, but more involved in airplane accident cases, and so on.

Finally, some critics have the idea that the increased number of lawyers is somehow meaningful in terms of litigation. What they overlook or forget is that a legal education has come to be viewed as having value beyond the practice of law. Thus, many lawyers today never practice law. Further, even for those who do, most of the modern practice of law does not involve litigation.

B. The Cost of Paying Liability Claims

Generally, the cost of paying all liability claims annually rises at a predictable rate, roughly parallel to the underlying rate of inflation in the economy for the goods and services the compensation is based upon, including medical expenses, lost income, etc. This is pointed out by a number of recent studies. For example, a Rand Corporation study of jury verdicts in Cook County, Illinois (Chicago), revealed that when inflation is considered, verdicts today are, generally speaking, no higher than they were in 1960. Mark Peterson and Audrey Chin, both of the Rand Corporation's Institute for Civil Justice were quoted in the National Law Journal of November 11, 1985, as follows:

> "Our research shows that juries are usually sensible and that their decisions have been remarkably stable over 20 years."

It should be pointed out that verdicts account for only a small percentage of claims paid, but are generally thought to have the greatest potential for volatility in terms of cost.

Another example, a recent study of medical malpractice in Pennsylvania revealed that the Medical Professional Liability Catastrophe Loss Fund loss costs are precisely where they should have been predicted to be 10 years ago when the fund was started. This study, by Professors Alfred E. Hofflander and Blaine F. Nye, also revealed that there is no discernable trend in Pennsylvania in the number of malpractice claims (frequency) and the cost of paying those claims (severity) when the underlying rate of inflation in health care costs is considered.[7] (Note: There is a phenomenon, called "pseudo-growth" by the authors of this study, which accounts for the current appearance of substantial growth in the number of claims, and, therefore, cost, because of the way claims are reported into the system and the fact that the bulk of malpractice insurance is handled by insurers which did not exist before the 1975 "crisis.")

Unfortunately, the media tends to report only extraordinarily large personal injury verdicts. This gives the public the distinct impression that the

exception is the general rule. It is never reported that the average of all awards, settlements and verdicts in personal injury cases of all types is probably less than $15,000--with substantially less in many cases. Further, the overwhelming harm which justifies the rare big verdict is often overlooked. For example, a person who has been turned into a brain-damaged quadriplegic can require $15,000 or more _per month_ in care for the rest of his or her life. This can amount to many millions of dollars when the victim is young and has a long life expectancy. Likewise, when these large awards are appealed and reduced, or when the total reported represents the value of an annuity which actually costs a fraction of the reported amount, this is never mentioned. No evidence has ever been produced that Pennsylvania, when compared to other states with similar demographics, is a "big verdict" state, in fact, it is probably true that Pennsylvania produces, on a per capita basis, less "million dollar verdicts" than most other similar states.

Further, it is the total cost of paying all liability claims, not the cost of a single, or even a few, large claims, that is really important. As already pointed out, the total cost of paying all liability claims annually rises at a predictable rate, roughly parallel

to the underlying rate of inflation in the economy, for the goods and services the compensation is based upon.

C. "Easy" Answers: Ineffective and Inapproporiate Solutions

When liability insurance premiums are soaring, it is just so easy to believe the simplistic notion that the problem is "all those lawyers, lawsuits and big verdicts." It just fits so neatly into the general perception of the way things are. Why should experts in the field give a detailed and lengthy answer to a complex problem when it is so easy and perhaps a little self-serving to give an answer which is likely to be accepted without question?

Worse, however, are the easy solutions to the problem of soaring insurance premiums which are all too readily proferred. The most frequently mentioned "solution" to liability insurance problems is placing limits on awards. Certainly, in the rare case which would exceed the limit, the attorney's contingent fee will be reduced, but the real cost of such solutions will be borne by the victims and the tax-paying public. This is because the only effect of a limit on awards is to shift the cost of harm in the most catastrophic cases away from the person or persons whose carelessness caused the harm and onto the backs of the victim and the victim's family. Ultimately a large share of the cost is shifted to the tax-paying public through

various public and medical assistance programs which end up picking up the burden, but only after the victim is forced into poverty to qualify for benefits. A poor solution indeed.

Importantly, such solutions do not prevent soaring insurance premiums. A study, "State Responses to the Malpractice Insurance 'Crisis' of the 1970s: An Empirical Assessment," published in The Journal of Health Politics, Policy and Law, Volume 9, Number 4, Winter 1985, found the following:

> "Almost all states enacted legislation in response to the rapid rise in malpractice insurance premiums which occurred during the mid-19[illegible]s. After describing the types of statutory changes enacted, this study evaluates the influence of these changes on levels and growth of premiums paid by general practitioners, opthalmologists, and orthopedic surgeons during 1974-78. The empirical results of the study presented here give no indication that individual state legislative actions, or actions taken collectively, had their intended effects on premiums."

Likewise, Pennsylvanians need only examine what has happened to municipal liability insurance premiums in the face of the Political Subdivision Tort Claims Act of 1978, with its severe restrictions, including a limit on awards, for proof of the failure of such solutions to control soaring rates.

In the search to control periodic surges in the cost of liability insurance premiums, it must never be

forgotten that the purpose of liability is not only to compensate the victims of careless conduct, but also to deter such conduct in the future. In the absence of liability, carelessness and its true cost to society would likely be far greater.

II. The Insurance "Crisis"

What now follows is not intended to throw stones at the insurance industry, but to describe the phenomenon at the root of the current "crisis." A crisis that no one, consumers or insurers, should want.

A. Factors Causing Periodic Fluctuations in Premiums

As we have seen, the recent, sometimes severe, increases in liability insurance premiums have virtually nothing to do with either the frequency with which claims are being filed, or with the size of jury verdicts. This perhaps has never been made more clear than this year, as the following statement from Best's, the insurance industry bible, reveals:

> "In 1984, insurance industry's own estimate of incurred loss and loss expense payments increased by the smallest amount since 1977. Yet, at the same time as the rate of growth of losses was declining, premiums increased by the largest margin since 1976, over 13%."[8]

Premiums should, over the years, have been rising steadily, in line with and controlled by the appropriate underlying rates of inflation, if they were to reflect accurately the underlying cost of the liability system alone. This has not happened. There are periods where rates stay level or even decline despite inflation and others where rates surge upwards far more rapidly than inflation. The reasons are to be found both in the nature of the property and casualty insurance marketplace and its relationship to general economic trends and, like the economy, the problem is cyclical.

Insurance claims are paid out of the total of premium income and the income earned in the investment of these premiums. Price wars among competing insurance companies to gain market share, hopefully increasing premium income, or at least investment income, when interest rates are high, create havoc when interest rates fall. Profitability declines and each insurance company is faced with a no-win choice: raise rates and lose market share to the competition, or continue to compete with increasingly inadequate rates in order to maintain or increase market share--hoping that the competition will be forced to raise their rates first so that it can then follow suit. It is tough to win back policyholders; it is a lot easier to

hope that investment income will rise to improve the corporate bottom line.

*NOTE: The prime rate is currently 9.5%.

As the chart above might indicate, property and casualty insurers have seen the income that can be earned on the investment of premium dollars cut in

half or more by falling interest rates during the current economic recovery, necessitating premium increases on top of those rate increases currently required to overcome previously inadequate rates which were the result of the competitive price wars within the insurance industry as interest rates rose to record heights earlier in the economic cycle.

The phase of the insurance cycle where property and casualty insurers become over reliant on investment income and premiums become increasingly inadequate has been euphemistically described as "cash flow" underwriting. As Professor Alfred Jaffe pointed out in a recent letter to the editor published in The New York Times on August 25, 1985:

> "That phase of the cycle commenced about the fourth quarter of 1978 and turned around about the third quarter of 1984. We had close to six years...during which American businesses, institutions and municipalities got their insurance well below "manufacturers' costs" and saved billions of dollars on premiums....Premium growth is a function of population increase, G.N.P. growth, inflation and other economic and social factors. Premium rate level is what impacts on one's pocketbook, not overall premium growth. A more meaningful statement would be: 'Rate levels for commercial insurance dropped approximately 50 percent on average between 1978 and 1984.'" (See Exhibit B)

The current situation has also been exacerbated by the fact that health care costs continue to rise more

rapidly than other costs and the value of personal injury claims is, to a very large extent, quite understandably controlled by the underlying economics of health care costs. It should be noted that health care costs are continuing to rise in the greater Philadelphia area at the highest rate in the nation, 11.5¼ percent, double the national average, according to the U. S. Bureau of Labor Statistics as reported in The Philadelphia Inquirer on Sunday, March 10, 1985. (See Exhibit C)

In addition to all of the foregoing, other factors are also impacting on the property/casualty reinsurance market which include: 1) recent and enormous losses in the United States as a result of storms, airplane crashes and fires; and 2) the decline of the British pound and other foreign currencies relative to the strong U. S. dollar.

What is now happening with rates was summed up by Grover Czech, regional vice president of the American Insurance Association, as follows:

> "Companies are doing what they feel they have to to get back to price adequacy...Competitive pressure drove rates down for many years. Generally prices today are coming back to what they were in 1977 or 1978 when adjusted for inflation." (See Exhibit D)

B. <u>The Current Phase of the Insurance Cycle and the Outlook for the Future</u>

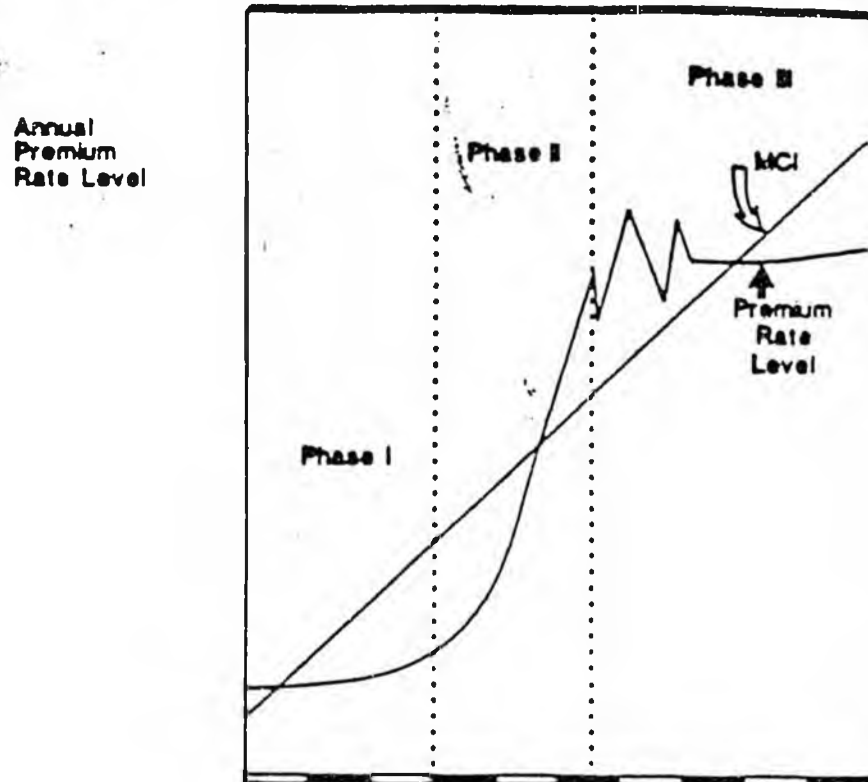
Because of declining profitability, insurance companies have become unwilling to utilize their capital (capacity) to insure risks, causing a "crisis of availability." In the competitive free market, investment capitol tends to flow to those investments where profits are highest and most reliable. After all, "the business of business is profits." Unfortunately, this is not necessarily good for insurance purchasers or, in the long term, for many sectors of the industry itself. When profits are reduced, insurance companies become very selective. They naturally want to maximize profits. Therefore, they try to avoid insuring risks, preferring, instead, to invest in those lines which are a "sure bet" and, in any event, they will charge what the market will bear. In choosing which lines to write when profits are reduced in the insurance business cycle, certain property/casualty lines suffer from a lack of adequate data which prevents proper underwriting, including such things as the consideration of individual claim experience, in the rate making process. Potential purchasers of insurance in these lines are at a disadvantage relative to others under current market conditions.

When profits are down, insurers, like other businesses, will stick with the lines they know the most about and are the most profitable. It does not mean that insuring other lines is not profitable, but rather, that some lines are considered more likely to yield higher profits than others. The slightest indication of risk, any uncertainty or unanticipated event, can lead virtually the entire industry to radically increase prices, reduce or cancel coverage or withdraw from the market, whether or not such actions are justifiable by any objective standard.

Best's says it most succinctly; the net effect was to reduce the incentive of insurers to take risks and to increase the incentive to raise premiums - the dual crises of availability and cost.[9] Observers of the industry, understanding this relationship between this "cycle of profitability" and premiums, predicted in the early 1980's that, once interest rates started to fall significantly, premiums would once again rise, probably sharply.[10] An example of the correctness of this prediction can be seen when comparing the earlier chart depicting the fall of the prime rate to the following charts concerning medical malpractice insurance.

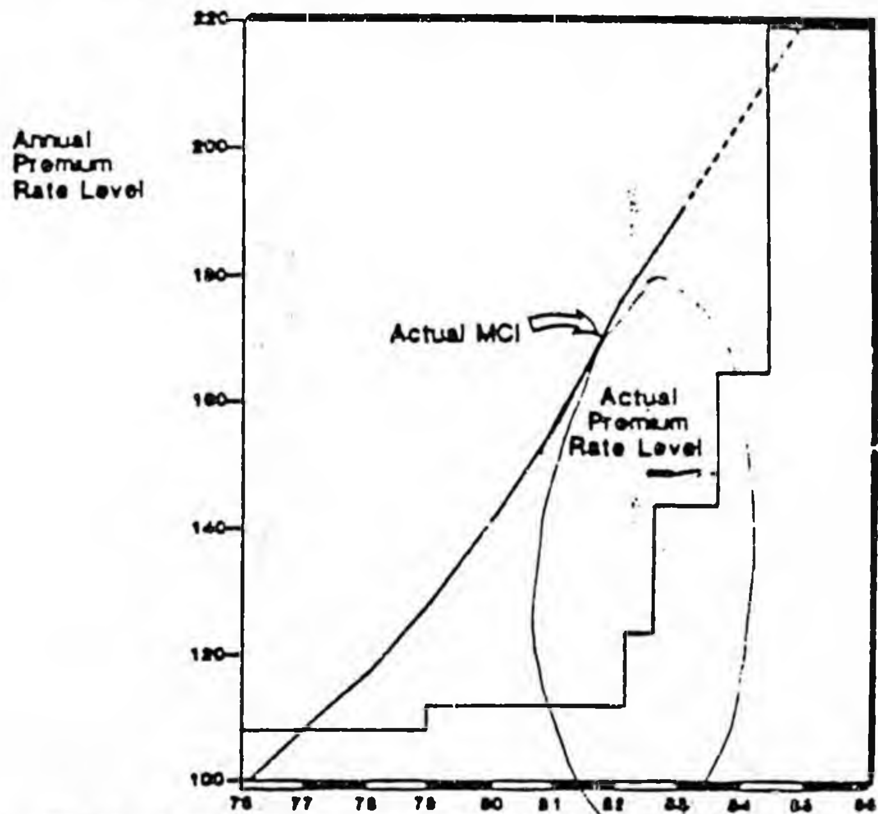
Theoretical Malpractice Premium Rate Cycle

FIGURE III-1



Stylized Actual Malpractice Premium Rate Cycle

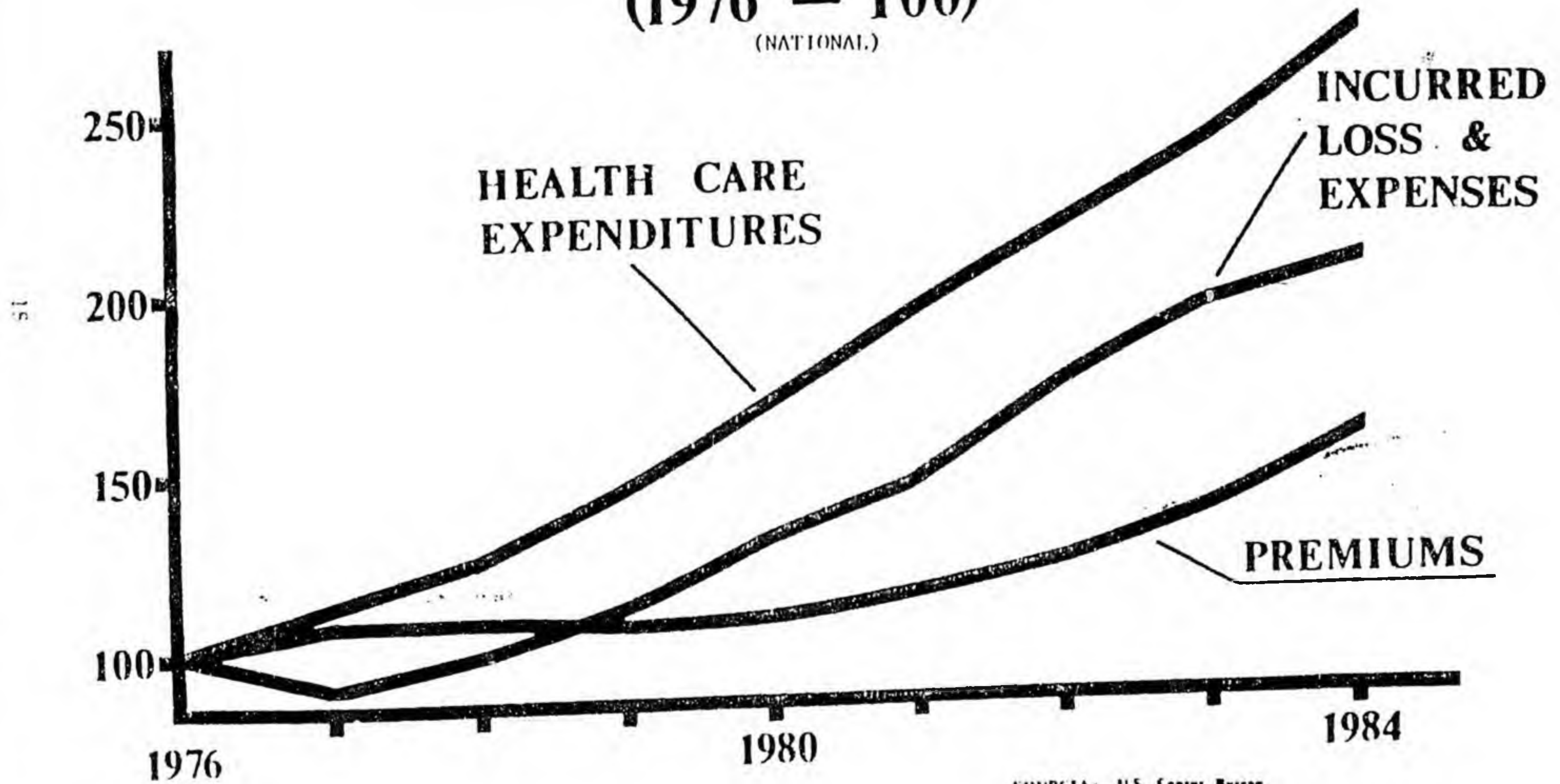
FIGURE III-2



Source: Hofflander and Nye, "Medical Malpractice in Pennsylvania", 1985.

PREMIUM GROWTH

MEDICAL MALPRACTICE
(1976 = 100)
(NATIONAL)

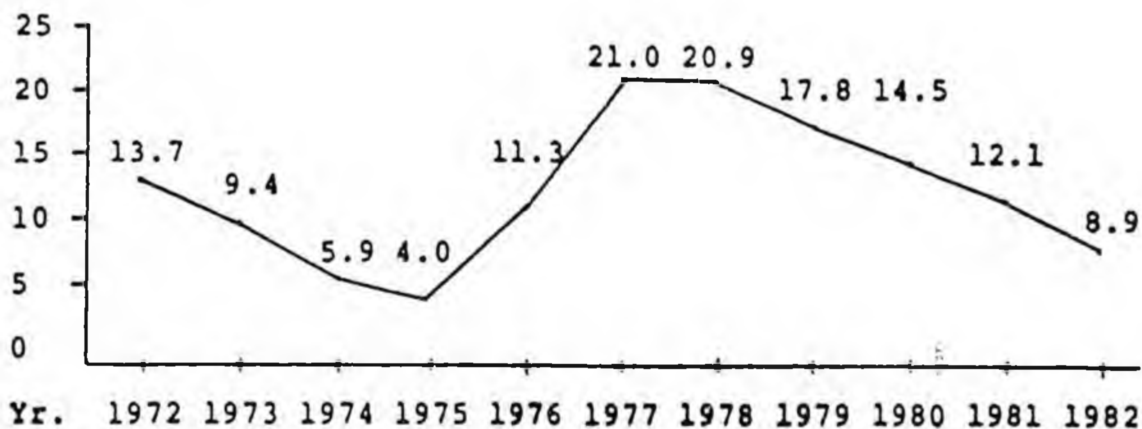


The "boom-bust" cycle in the insurance industry is reflected in the behavior of insurers:

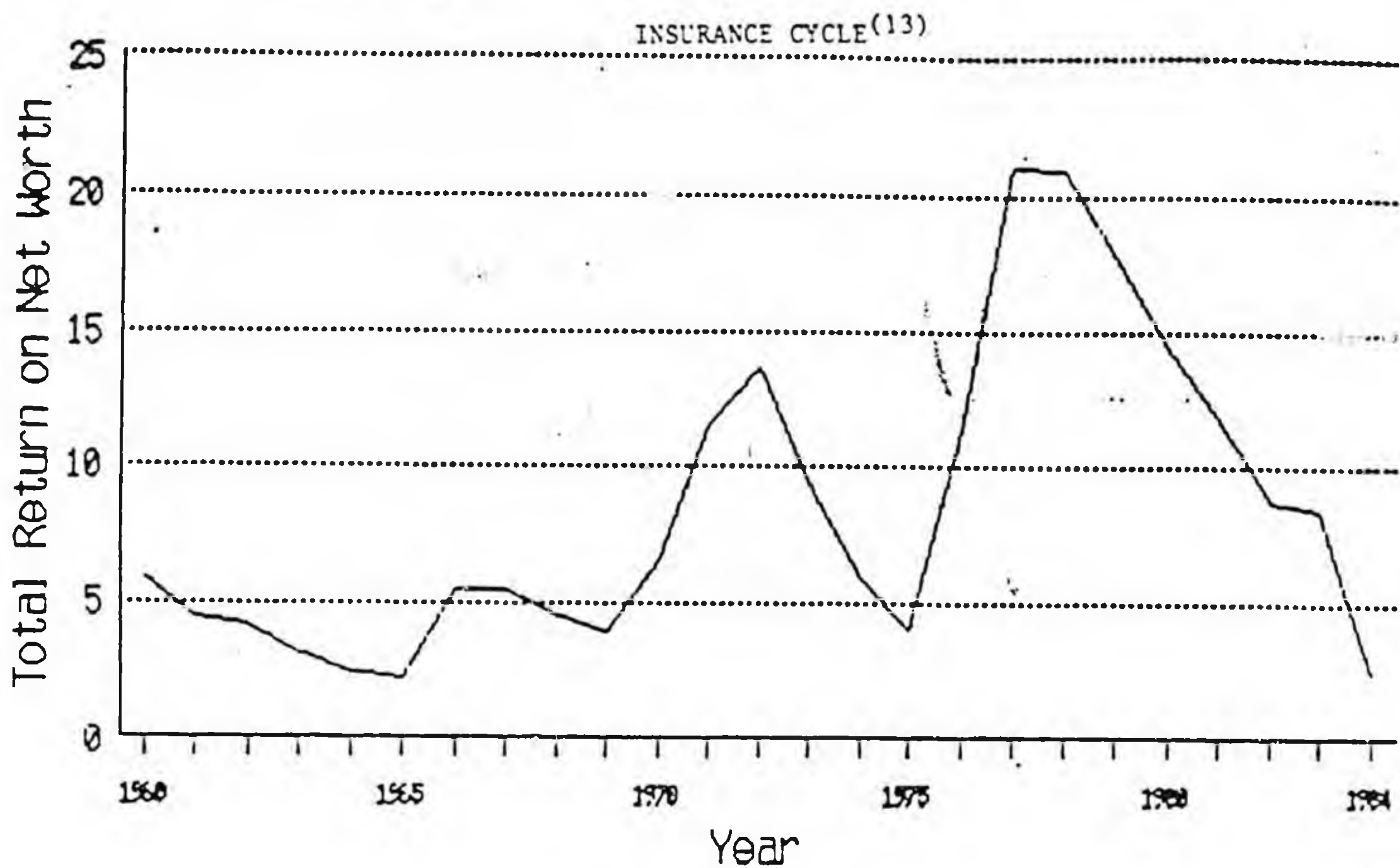
> "It is amazing to see what happens in an insurance cycle to the mental state of underwriters. At the top of the cycle, in 1981, insurers were willing to not only take all of the risks thay are shunning today, but were willing to go so far as to insure the liability of MGM after their Grand Hotel burned down. Compare that with today's doomsday attitude toward risks that the underwriters have subjectively declared to be taboo."[illegible]
>
> (See Also Exhibit E)

This cycle of profitability for insurers can perhaps best be seen in the following chart showing

Average Annual Rates of Return on Net Income After Taxes as a Percent of Net Worth 1972-82 (12)



A longer term look at this cycle can be seen in the following chart.



As the above charts demonstrate, insurance crises are both cyclical and predictable. What we are experiencing now in 1985 is just such a "crisis," a crisis in the insurance marketplace, created by the economics of the insurance business and its interrelationship with underlying economic trends and conditions, born from the struggle between competing insurance companies for market share and profits.

During the current phase of the insurance cycle, insurers are demanding and receiving substantial increases in rates in order to substantially increase their profitability. Once higher profits are restored, the current crisis of availability and cost will disappear and the next round of competitive pricing is likely to reemerge.

It is interesting to note that auto insurance policyholders in Pennsylvania were cushioned against the full impact of the present crisis by the state's new auto insurance law which took effect just as the current phase of the market cycle was beginning. For example, in 1985, State Farm, the largest auto insurer in both Pennsylvania and the United States, took a rate increase averaging 6% for the entire nation, but State Farm's increase was only 3.9% in Pennsylvania. The cost of insuring an automobile in the United States in 1985 has risen at an annualized rate of 18.2%.[1-] Pennsylvania appears to be below the national average for the first time in years.

Significantly, a recent article in the Journal of Commerce reported on a new study entitled "1985, A Critical Year," done by the insurance industry itself, through the Insurance Services Office and the National Association of Independent Insurers. The study concluded, "The property/casualty industry must accept the major responsibility for its current financial condition." (See Exhibit F)

However, it is not yet time to mourn for the property/casualty industry or fear for its demise. Dr. Michael E. Hogue, President and

Managing Director of the Philadelphia Insurance Research Group, in recent remarks to the annual convention of the National Association of Professional Insurance Agents, said:

> "The property-casualty insurance industry today is in a stronger capital and surplus position than it has ever been in and it clearly has enough capital and surplus to meet the needs of the insurance industry today and in the near future." (See Exhibit G)

The National Underwriter reported that Dr. Hogue "also predicted a quicker than expected return to 'a period of a lack of price discipline';" in other words, a return to competitive price cutting.

The National Underwriter report continued:

> "Dr. Hogue said A.M. Best reported consolidated policyholder surplus of $64 billion as of Dec. 31, 1984, and then in a July 15, 1985, report indicated an adjusted surplus of $92 billion. Thus, he said, Best saw an equity in the balance sheet of $28 billion which he said arises out of undervalued assets and overstated liabilities. He said it comes primarily from the unearned premium reserve for that portion already paid out in acquisition costs and from the estimate of the loss reserves on a discounted basis.
>
> "'In general, what that means,' he said, 'is that the property-casualty industry, if it were put into a runoff situation and assuming the reserves are accurate, when the period of runoff is completed, not only would there be $64 [b]illion in capital and surplus, but there would be another $29 billion left over.'

"Even assuming a reserve deficiency of as much as 20 percent, he said, after the period of runoff, the industry would have not only the $64 billion of reported surplus, but another $8 billion or $9 billion of undisclosed profits.

"'It is for this reason,' Dr. Hogue said, 'that we believe the property and casualty insurance industry is overcapitalized; and that, frankly, is going to be a detriment, not an advantage.'...

"'It's for that reason,' he continued, 'that we maintain that the industry does not have a capacity problem.'...

"...What it does indicate, he said, is that the insurance industry is not pleased with the profitability of the market and is unwilling to release the capacity in search of taking risk. 'There lies our major concern,' he said.

"When the profitability appears in the financial statements of the carriers, particularly in the regional and other small companies that have not had the extent of problems that many of the larger carriers have had, they will begin to release the surplus in anticipation of growth of market share.

"Dr. Hogue said Chubb and Ohio Casualty recently released nine-month results showing that earnings per share have already doubled in 1985.

"'It is our concern,' he said, 'that we're going to find a more rapid release of that surplus in search of market share than is otherwise being predicted relative to when the markets will turn. It is our belief that that is going to result again in a period of lack of price discipline.

"We believe that the requirement to allocate the surplus because of the necessity to leverage that surplus against returns to meet the target return on investments of many of these corporations, we will begin to start the process of market competitiveness.'

"He called it 'gross mismanagement' of a property-casualty insurance company to attempt to increase market share unless there are indicators available showing where the price and relative exposure are at any point in time. He said it has been his experience that there are few insurance companies in the U.S. market which are fully aware of the current price and exposure relationship in their portfolio on a recurring basis..."
(See Exhibit G)

In other words, Dr. Hogue apparently believes that the insurance cycle, with its peaks and valleys, is most likely to be repeated again in the future just as it has in the past. (For further discussion and other views on the capacity aspect of Dr. Hogue's remarks, see Exhibit H)

While it appears certain that the insurance industry will continue and profitability will improve, there will be some inevitable changes. The nature and extent of these changes remains to be seen. There may be increased government intervention to attempt to control the swings of the insurance cycle and to assure availability of coverage and provide adequate data for rate making purposes for certain lines, as well as to prevent such abuses as midterm cancellations. There will certainly be some structural changes in the

marketplace, including increased reliance on self-insurance. Insurance purchasers have much at stake. Will they continue to be at the mercy of the insurance cycle or will they take an active role in improving their situation? Changes are constant in our society and, just as the law adapts to these changes, so must insurance. So far, the competing insurance companies have apparently found it easier to agree among themselves to try to shift the blame for their problems onto the legal system than to agree on how to solve them.

III. The Search for Effective Solutions

As must be clear by now, the reality of the "crisis" is far different and more complex than is commonly perceived. The answers to these problems do not lie in cost shifting devices such as various arbitrary limitations on the rights of the citizens of Pennsylvania. The answers are numerous and what follows is not intended to be an all inclusive list. Part of the answer lies in assuring that the insurance industry does real underwriting, considers individual experience in rate making and has adequate data in order to do this job. Further, while competition may be desirable as a general rule, insurance companies cannot be permitted to charge rates which are inade-

quate or excessive. In some lines, the market in a state may be so concentrated as to not be conducive to open competition. This must be carefully examined. Also necessary is action to reduce dependence on the foreign reinsurance market and particularly the dominance of Lloyd's of London over the American insurance market. Another part of the answer lies in reexamining the investment laws governing property and casualty insurance companies so that they can engage in appropriate modern investment practices which might enable them to smooth out the effects of changing economic conditions on their corporate bottom lines. Pennsylvania's law governing insurance company investments dates from 1921. An additional answer lies in increased insistence on risk management on part of both insurance providers and consumers in order to prevent injuries from occurring in the first place. A further part of the answer lies in increased knowledge on the part of insurance consumers as to how to buy insurance and who to buy it from. This would include increasing use of self-insurance and pooling mechanisms.

Through the pooling of risks many groups needing insurance coverage, including Pennsylvania's political subdivisions, could accomplish several objectives.

First, they could collectively self-insure their low-

end exposure.

Second, they could use the strength of their numbers and the stability of risk inherent in such an arrangement to negotiate the most favorable rates from the private sector for their collective high-end exposure. Thus, the pooling mechanism would work very much like a group insurance plan with a high deductible.

Third, the pooling mechanism could provide a data base on all claims against its participants which would enable effective risk management--claim prevention--the only real way to cut costs.

Fourth, such a data base would provide its participants with the ability to determine if their insurance rates are fair and reasonable.

The pooling mechanism I am describing could be run by a private insurer with the appropriate expertise. Most importantly, such a program would effectively free groups such as Pennsylvania's political subdivisions from the vicissitudes of the insurance cycle. This is because they would have created their own capacity to the extent they self-insure, thus hoarding the sometimes extremely limited capacity available in the private sector for their high-end exposure. Further, it would give them the data necessary both to prevent claims and negotiate insurance rates far more effectively.

In remarks to the Florida Senate Commerce Committee regarding property and liability insurance on October 8, 1985, Florida Insurance Commissioner, Bill Gunter, supported the views expressed herein as to the solutions which would appear to be appropriate under the circumstances. (See Exhibit I)

In this regard, it should be remembered that insurance first began in England when the owners of merchant vessels decided that the best way they could handle the risks inherent in their business was to share that risk. Maybe it is time to return to the basics in insurance. Importantly, the solutions I am suggesting are applicable to others, besides political subdivisions, who are affected by this problem of cost and availability of liability insurance.

This cyclical problem with liability insurance rates will remain with us until decision makers in government, business and the professions, as well as the observers in the media, shift their focus. We must stop dealing with perceptions and begin to address reality. Prompt and effective relief can only be acheived by addressing the reality of the problem through the type of solutions suggested herein.

IV. More on Pennsylvania's Experience

The need for this shift of focus could not be any clearer in Pennsylvania than with the problem of municipal liability insurance. The Political Subdivision Tort Claims Act of 1978 is among the most restrictive laws with regard to tort law as has ever been passed in any state. For example, it contains an absolute bar on tort claims against local governments with only eight areas where exceptions are granted. In those areas where claims can be brought, there is an absolute limit, a cap, on the amount of liability and any compensation is further reduced because the victim cannot recover any damages which are paid or payable from any other source, with the exception of life insurance. This law even contains a "threshold" including the requirement that the injury be permanent, which must be met before a claim can be instituted. (For a synopsis of the Political Subdivision Tort Claims Act, see Exhibit J). Lawyers who represent political subdivisions throughout Pennsylvania have testified that there is not a crisis of claims here in Pennsylvania. There has not been some sudden or recent increase in litigation against political subdivisions. (See Exhibit K) Despite these facts, municipal liability insurance rates in Pennsylvania are currently soaring, just as

they are in other states without tort restrictions, demonstrating that so-called tort "reform," the restriction of the rights of our citizens, does virtually nothing to affect insurance rates.

It is interesting to note that the Political Subdivision Tort Claims Act grants the political subdivisions the authority to establish a pooling mechanism and help themselves as described above, (See 42 Pa. C.S.A. Section 8564), but they have failed thus far to act. Of course, they could wait until the current crisis is over and allow the cycle to recur, and there is evidence that this phase of the cycle is ending. <u>Best's</u> reports as follows:

> "In the first half of 1985, property/casualty stocks on Best's Index have advanced 30%, investor excitement being generated by a reasonable consensus that the longest industry down-cycle in history has finally turned, albeit by a small margin. They were rewarded on average, by advances twice the size as those reaped by the general stock market."(See Appendix I)

V. <u>Conclusion</u>

If solutions to the problems confronting those who need insurance coverage, including political subdivisions and others are to be effective, these solutions must address the real problems, not the common misconceptions, however popular they may be. These problems are the result of a "cycle of profitability" in the

insurance industry born from the struggle between competing insurance companies for market share and profits. They are not the result of some sudden increase in litigiousness or in the total volume or cost (considering inflation) of claims.

The current phase of the insurance cycle, with its "crisis" of cost and availability, is apparently ending. Will this cycle be allowed to recur unabated?

This article was written in hope that it will not. The Pennsylvania Trial Lawyers Association is sympathetic to the problems confronting all groups of insurance consumers and is always willing to be involved in the search for constructive solutions.

Footnotes

1 Galanter, Marc, "Reading the Landscape of Disputes: What We Know and Don't Know (And Think We Know) About Our Allegedly Contentious and Litigious Society," 31 U.C.L.A. L. Rev. 4, 55-56 (October, 1983).

2 Galanter, supra at fn (1), at 70.

3 "Federal Judicial Workload Statistics During the Twelve Month Period Ended December 31, 1983," Administrative Office of the United States Courts, (1984).

4 "Americans' 'Litigation Binge' Is A Myth," U.S. News & World Report (November, 1984).

5 Guinter, John, "Stalking Burger's Wild and Elusive Litigation Flood," The Barrister, Vol. #XVI, No. 2, Summer, 1985.

6 M. A. Peterson and G. L. Priest, 1982. Rand Corporation, The Institute for Civil Justice, Santa Monica, CA Civil Jury, Trends in Trials and Verdicts, Cook County, Illinois, 1960 - 1979

7 Hofflander, Alfred E., and Nye, Blaine F., "Medical Malpractice Insurance in Pennsylvania," 1985, Management Analysis Center, Inc., Menlo Park, CA.

8 A. M. Best's Casualty Loss Reserve Development, 1985.

9 Id.

10 Id.

11 "The Insurance Crisis of 1985: What Can Be Done?" National Insurance Consumers Organization, Alexandria, VA (June, 1985), p.2.

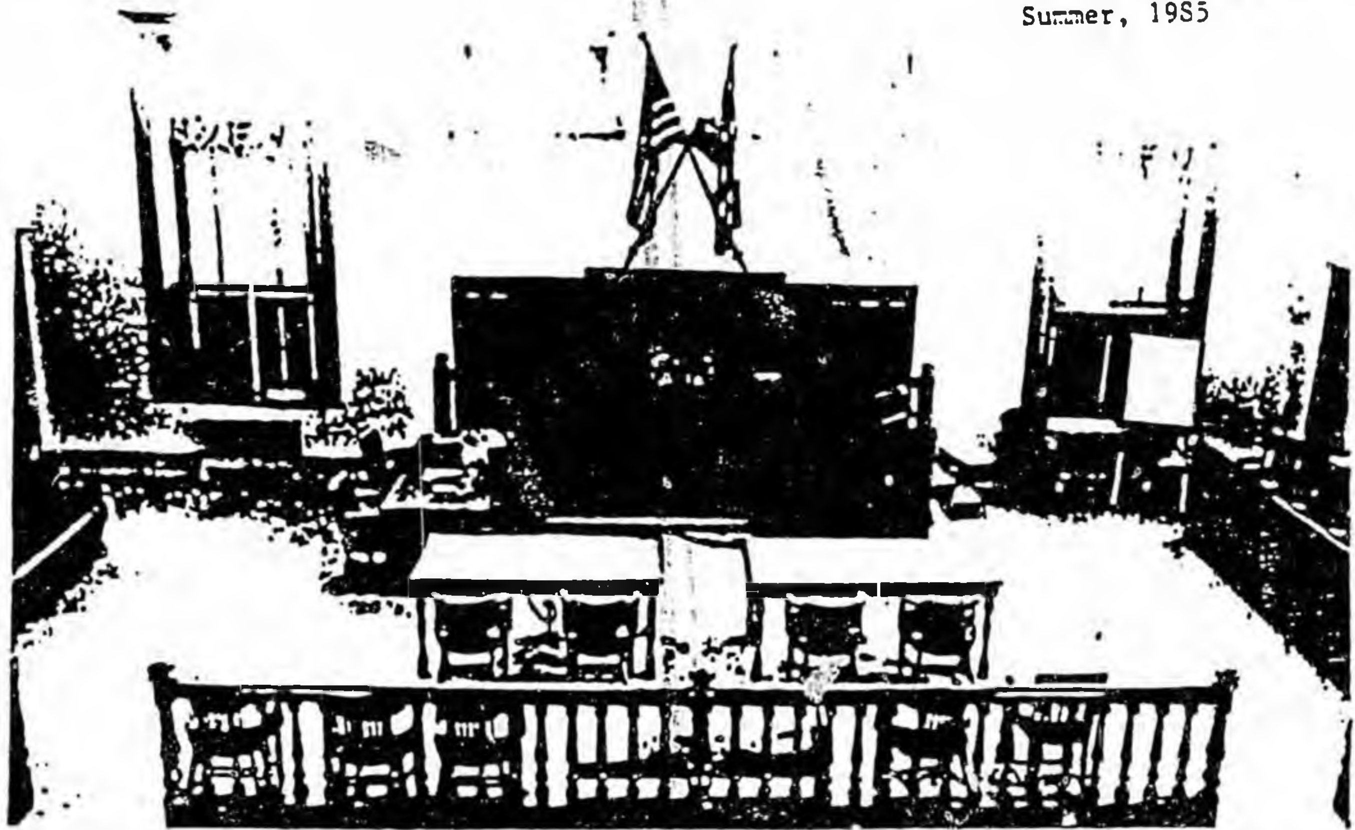
12 Refers to capital stock property/casualty insurers only. Figures are from "Congress Should Consider Changing Federal Income Taxation of the Property/Casualty Insurance Industry," U.S. General Accounting Office, GAO/GGD/85/10, March 25, 1985, p.7.

13 Chart is from National Insurance Consumer Organization press release of August 15, 1985, which identifies the source of the data for the chart as Citibank Economics and Insurance Services Offices.

14 Testimony of J. Robert Hunter, President, National Insurance Consumer Organization, before the Sub-committee on Commerce, Transportation and Tourism, U. S. House of Representatives, on "Liability Insurance" which identifies the source as CPI data on "auto insurance," U. S. Bureau of Labor Statistics.

EXHIBIT A

The Barrister
Vol. #XVI, No. 2
Summer, 1985



STALKING BURGER'S WILD AND ELUSIVE LITIGATION FLOOD

by John Guinther

Whenever someone in power announces that we Americans are facing a crisis—swine flu, for example—my experience has been that the crisis rarely exists, but the cure is likely to kill us.

Some crises have as their purpose to allow gentlemen-warriors to go shooting second-hand—(the blood spilled is ours, not theirs), in foreign climes, be they Vietnam or Nicaragua. Other crises, less sanguinary but no less lethal, seem designed to convince us to give up some Constitutional right that it is no longer convenient for us to have.

An adept practitioner of the latter variety of crisis-mongering has been the Chief Justice of the United States Supreme Court, Warren Burger. For about the past 10 years, he has been trouping through every Middlesex village and town (i.e., every American Bar Association meeting) telling us we are in the midst of a great "litigation crisis" that has so flooded our courtrooms that our right to free access to the courts and to a jury to hear our case should be sharply curtailed. He has found allies in the popular press, who write sensational articles about Americans indulging in an "epidemic of hair-trigger suing," causing our multi-billion-dollar multi-national corporations to weep with sheer vexation at the money they have to pay out when they put products on the market that maim people. All this has been caused, Burger says, by the "inherently litigious nature of Americans," who, in the rather elegant phrasing of another commentator, display "an abandoned eagerness to hail into court all and sundry."

Out of curiosity, I decided to take a look at the statistics, to see exactly how greedy we Americans are. Certainly, if we are as avid for money as Burger says we are, then something ought to be done to stop us for our own good, after all, our suits force insurance companies to pay verdicts, their costs are passed on to their customers, who in turn pass them on to us—both the contentious and the passive among us.

The federal court figures seem to back Burger. They show that between 1980 and 1984, the number of civil cases filed jumped from about 170,000 to 260,000, more than a 50% increase which, if it doesn't mean a crisis, means something close kin to one.

That is, it did until I let my eyes wander down the long rows of figures that show where the increase in cases is coming from. I then learned that nearly two-thirds of the increase was brought about by cases in which the United States government was either the plaintiff or defendant. Of these, almost all the plaintiff cases were ones in which the government

was trying to collect defaulted student loans or alleged overpayments to veterans. Of the ones in which the government was the defendent, almost all of them involved people who were suing to stop the Reagan adminstration from cutting off their Social Security supplemental benefits.

Without arguing the merits of these governmental policies, such suits hardly come under the heading of "hair-trigger suing" by "an inherently litigious" citizenry.

But, thought I, since federal cases make up only about four percent of all those that are filed in the United States each year, what I should be looking at are state court statistics. I found them, too, in several huge volumes filled with hundreds of pages of tables, which, when the browsing among those numerical thistles was complete, reveals that—since about the mid-1970's—civil case filings in state court have been increasing at about three precent a year, or one-quarter of the federal rate.

It's all a matter of perspective, no doubt, but to me that increase doesn't even amount to a kissing cousin of a crisis.

While I was at it, I thought I'd try to find out the origins of the increase, such as it was. Although, it seems, no two states keep their statistics the same way, as nearly as I could tell—and I had a sample of states making up about 50% of the population—personal injury cases, the ones where we're supposed to be doing all that hair-trigger greedy suing—were strolling along with virtually no difference in the rate of filing from year to year.

I did, however, find one category in which there was a sharp increase, and a predictable one considering the doubling of the divorce rate in the United States between 1970 and 1980, and that was in domestic relations cases, including child custody matters. There, the rate had grown by a hefty 30%. Apparently, if Americans are contentious, it's manifested mostly in their marriages.

I also learned that, if we Americans are litigious, we certainly vary a lot from state to state in that quality. The peaceful Pennsylvanians, for example, filed civil suits at a one percent increase in 1983 over 1978; the laidback Californians were right at the national average, while the big bad New Yorkers were way above it. In 1980, New Yorkers filed—according to their official statistics—about 730,000 civil suits; in 1983, a walloping 1.2 million. Now, there's a crisis of headline-making proportions, and headlines have been made of it. The only problem is that it is a false figure. A call to a New York court official revealed that the 1983 statistics included counts from two courts that previously had been omitted, and they weren't any small omissions, either—about 400,000 of them a year.

In other words, as the official noted, the real rate of increase in New York is about two percent a year since the late 1970's, not more than 70% in three years, as the published statistics seemed to indicate.

Perhaps, just perhaps, we should hang on to our right to trial and jury a wee bit longer and not let those who would save some money for insurance companies and big businesses scare us out of it. Perhaps our real crisis comes from the quality of those who advise us.

ABOUT THE AUTHOR

John Guinther is one of the most able and distinguished journalists in the Philadelphia area. Long-recognized for his readable style and his careful research, Guinther has often written on legal matters for such Delaware Valley publications as Philadelphia Magazine and the Welcomat (where this article originally appeared).

EXHIBIT B

The Hard Search for Property Insurance

To hold down costs, consumers may have to chase discounts. 'Bad risks' may be turned away altogether.

RECENT news reports have described the drastic rate increases inflicted upon businesses seeking property and casualty insurance, but little has been said about the prospects for individual drivers, homeowners and renters. Unfortunately, the huge losses that insurers have suffered recently are putting rate pressure on the so-called personal lines as well as on commercial insurance. Although the increases have been far less dramatic, personal premiums are continuing their steady climb, with auto rates leading the upward trend. Industry spokesmen also warn that insurance will be harder to get for "bad risks," including those people with poor driving records, for example, or whose homes are far from fire stations.

Individuals who want to hold down their insurance costs may find it necessary to do some sophisticated shopping, to assume more risks themselves, and to be aggressive about getting every possible discount.

The reason rates are under such pressure derives from a practice known as "cash-flow underwriting." For a three-year period that ended last fall, insurers focused much more on investing premium income than on the quality of the risks they were insuring. Lured by very high interest rates, companies competed intensely for dollars to invest.

The insurers were gambling that the cash flow from their investments would be great enough to cover their underwriting losses. But unexpectedly high commercial losses and dropping interest rates combined to bring about an industry underwriting loss last year of $21.3 billion, according to the A. N. Best Company, the widely respected insurance industry rater and analyst. In a year-end report, Best said, "The penalty for trying to substitute finance for underwriting is now being paid."

For businesses, at least, the period of cash-flow underwriting brought substantial premium savings. Individuals, however, enjoyed no such bargains, points out J. Robert Hunter, president of the National Insurance Consumer Organization. From 1981 through 1984, premiums on commercial lines of property and casualty insurance went up only 10 percent, on average. Premiums for personal lines rose 20 percent over that period, notes the Insurance Services Office, an industry organization that tracks trends and issues rate guidelines.

This 20 percent increase was what the I.S.O. had said was needed, according to a spokesman, David Ostwald. Similarly, the I.S.O. had recommended commercial increases of 30 percent, but the industry ignored that recommendation. Now, with the property/casualty companies facing severe losses and needing to rebuild their reserves against future claims, some commercial customers face premium increases of 200 percent to 500 percent.

Fortunately, individuals face no such budget-breaking changes, partly because their rates have risen all along. The average premium for individual drivers nationally was up 8.1 percent for the first quarter of 1985 from a year earlier, according to the I.S.O. Homeowners premiums over the same period went up 5 percent. Experts expect near-term increases to stay within a similar range.

However, Mr. Ostwald advises that auto rates may move up somewhat faster. The number of auto collisions is up, and with it came a 6 percent rise in the number of claims for physical damage in the fourth quarter of 1984 compared with the period a year earlier. More important, he says, there will be pressure on the industry to "limit the availability of insurance to people in less desirable risk categories" for all types of coverage.

Individual insurance buyers who want to control their insurance costs can take the following steps:

- When policy renewal time approaches, shop for comparison prices. Be sure to get a quote from at least one company that does only limited commercial business — because it will probably not be facing such serious losses. This group includes such companies as State Farm, Nationwide, Geico, Allstate and Safeco.
- On auto policies, consider accepting a deductible as high as $1,000. Mr. Hunter, of the National Insurance Consumer Organization, points out that this form of self-insurance is nearly always worth the risk. Among other reasons, he says, someone with a $250 deductible who suffers a $500 loss often decides not to file the claim because the action might force up future premiums. Over the years, the premium savings from the larger deductible should more than outweigh the cost of paying for a minor accident yourself. "Let time be your insurance company," Mr. Hunter advised.
- If you have a poor driving record, ask an independent insurance agent to check the Assigned Risk Plan rates. They are sometimes cheaper than those available from individual companies.
- Check to make sure you are getting the benefit of all possible homeowner or renter discounts. Although only a few companies advertise discounts for homeowners who have smoke alarms, for example, almost all companies offer them. Discounts are also commonly offered to senior citizens and to people with dead-bolt locks protecting their homes.
- Co-op owners should take advantage of new policies available to them. Until recently they were restricted to tenant policies, but now they can purchase the same kind of policy that homeowners have — often at a 30 percent to 40 percent saving over the old coverage, according to Anthony Giaccone, an agent in Huntington, L.I.
- In the past, some companies have been charged with "redlining," or refusing to write insurance coverage within a given neighborhood, usually one in the inner city. Companies deny these charges, but Mr. Hunter advises that individuals who live in such areas and find themselves unable to get coverage for reasons that seem illogical should consider complaining to their state insurance department.

INSURANCE is a cyclical industry, but the current downturn is more severe and prolonged than most, and some companies may go under. Consumers are protected by state law if their insurance company fails. New York, for example, created a guarantee fund to honor consumer claims against bankrupt companies. However, payment can be much slower than normal. As a precaution, consumers should check company ratings in Best's Insurance Reports, available in libraries, or with an agent. Best's top rating is A-plus; industry experts advise that consumers deal only with companies rated B-plus or better. ■

THE NEW YORK TIMES, SUNDAY, AUGUST 25, 1985

LETTERS

Insurance

To the Editor:

Frances Cerra made some misleading statements concerning commercial insurance ("The Hard Search for Property Insurance," Personal Finance, July 28). She referred to the period of "cash-flow" underwriting as "a three-year period that ended last fall." That phase of the cycle commenced about the fourth quarter of 1978 and turned around about the third quarter of 1984. We had close to six years — not three — during which American businesses, institutions and municipalities got their insurance well below "manufacturers' costs" and saved billions of dollars on premiums.

She stated that premiums on commercial lines went up only 10 percent on average, from 1981 to 1984. Premium growth is a function of population increase, G.N.P. growth, inflation and other economic and social factors. Premium rate level is what impacts on one's pocketbook, not overall premium growth. A more meaningful statement would be: "Rate levels for commercial insurance dropped approximately 50 percent on average between 1978 and 1984."

Finally, Ms. Cerra stated that co-op owners "can purchase the same kind of policy that homeowners have." Not so; but change "homeowners" to "condo owners," and you have it.

ALFRED I. JAFFE
Associate Professor (retired)
The College of Insurance
New York, July 28

EXHIBIT C

The Philadelphia Inquirer

business

Sunday, March 10, 1985

Area has the nation's fastest-rising medical prices

By Gilbert M. Gaul
Inquirer Staff Writer

The prices consumers pay for medical care in the eight-county Philadelphia area are rising faster than anywhere else in the nation.

Not only that, but they are rising from levels already considered among the highest in the nation and at a time when the pace of price increases for medical care in other cities appears to be slowing.

From January 1984 to January of this year, the price of medical care in the Philadelphia area increased by 11.51 percent, double the national average of 5.8 percent.

The data, gathered by the regional office of the Bureau of Labor Statistics, have left health-care experts groping for explanations.

"Why we're going up while the other cities are slowing, I can't say," said Charles Scott, the bureau's regional economist.

"That's hard to rationalize," agreed Wharton School professor Robert A. Zelten.

The only city whose health-care price trend mirrors Philadelphia's is Houston, which, like Philadelphia, has a high concentration of medical schools, teaching hospitals and medical research centers. Prices for medical care in the Houston area rose 11.5 percent, a whisker behind Philadelphia's rate.

In many cities commonly thought to have higher costs of living than Philadelphia, medical-service prices rose at much slower rates.

For example, in New York, often considered the nation's most expensive city, medical prices rose 7 percent. In Boston, prices climbed 7.7 percent; in Los Angeles, 6.7 percent; San Francisco, 5.3 percent, and in Washington, prices rose 2.9 percent.

The rapid price increase here comes at a time when the rise in medical-care prices elsewhere is slowing. In January 1984, the medical-price index for Philadelphia stood 5.1 percent higher than the national figure. A year later, the index in Philadelphia was 10.7 percent higher than the national average.

When compared with other components of the Consumer Price Index (CPI), which measures price changes on a broad range of goods and services, the rate of increases in medical care stands out starkly.

Housing prices in the region, for example, increased 5.03 percent in 1984. Food and beverage prices rose 1.59 percent. Transportation prices were up 3.49 percent, and clothing prices inched up just 0.39 percent.

The overall CPI for the Philadelphia region — Philadelphia, Bucks, Chester, Delaware and Montgomery Counties in Pennsylvania and Camden, Burlington and Gloucester Counties in New Jersey — rose 4.04 percent in the year ended January 1985. In the same period, the national Consumer Price Index climbed 3.57 percent.

Why are prices for medical care here rising so quickly? And, more particularly, why is the Philadelphia region out of line with price trends in the rest of the country?

"We think we know why it has increased in Philadelphia. But I don't know why with other cities," said Labor Statistics economist Scott.

Scott said prices for services from hospitals, nursing homes and dentists here all had increased at a rate greater than the national average. Also rising quickly were premiums for health insurance. But price increases for prescription and nonprescription drugs and medical equipment did not exceed the national average, Scott said.

"We record what the increase is, but the reason why, we really don't know. There could be an element of 'this is just our year,'" Scott said.

Scott and others at the Bureau of Labor Statistics caution that the regional CPI survey is subject to some distortion because it uses a small sample. But those distortions tend to be smoothed out when viewed over longer periods, the BLS officials say.

CONTINUED

CONTINUED

Medical prices here are nation's fastest-rising

"We always tell people not to place much emphasis on a monthly shift because it could be wrong. But over long periods of time those things tend to wash out. Looking over a calendar year you expect to see a consistent pattern," said Daniel Ginsburg, supervisory economist for the BLS in Washington.

Officials here and in the 27 other BLS regions use the same methodology to gather the price data. Starting with the main components of health care — hospitals, nursing homes, physician fees, drugs — they survey prices of individual items at varying locations. The same items are selected each month so economists can measure the rise in prices from the index base of 100, the price level in 1967.

The weight given to each component of the CPI varies from city to city, reflecting the diversity of their medical-care economies. The CPI here, for example, reflects the high concentration of hospitals.

What the CPI does not purport to measure is the cost of goods and services. "We're measuring the changes in the prices of those goods, not the costs," Scott said.

Since the Bureau of Labor Statistics began keeping the medical-care index, prices here have climbed 333 percent as of January. The only metropolitan area in the nation where prices have risen more quickly is Houston, where medical-care prices have increased 352 percent since 1967.

"I think there's several explanations for that," said Sharon Cohany, a BLS economist in Dallas. "One is that since 1967, Houston has been one of the fastest-growing areas in the country. That phenomenal growth has put upward pressure on all prices, including those for medical care."

A second explanation offered by Cohany is one that also might apply to the Philadelphia medical marketplace.

"Houston is at the forefront of medical technology," the economist said, "and that also is very likely to put upward pressure on prices. As technology expands, the cost of developing those services also grows. A tremendous financial cost is associated with that."

Albert Zemlinski, managing partner in charge of health care for the Philadelphia accounting firm of Laventhol & Horwath, offered a view similar to Cohany's.

"My feeling in a speculative way is that ... it could be a function of our highly developed medical area here," he said. "It is a highly intensive medical community in terms of physicians per capita and specialists per capita. They are all selling higher-cost services. Prices don't go up unless costs go up."

Other health-care experts, economists and officials offer other reasons why prices for medical care in Philadelphia and its surrounding counties are rising much faster than those in other areas, including many cities with sophisticated medical complexes, such as New York, Boston and Cleveland.

"Many cities have different ways of containing health costs. That may have something to do with it," said Kay Ford, a BLS economist in Washington.

Carol M. McCarthy, president of the Delaware Valley Hospital Council, which represents more than 90 hospitals, said medical institutions here increased their charges by 23 percent last year to make up for $207 million worth of uncompensated care — a 25 percent increase — that they provided to poor and uninsured people.

McCarthy said that blaming the hospitals for the region's increase in prices would be a mistake. In fact, she said, annual increases in hospital spending here have dropped sharply, from 20.7 percent in fiscal year 1982 to 6.6 percent in fiscal year 1984.

Moreover, McCarthy said, hospital profits rose only 6.06 percent in fiscal 1984. "At least from the hospital side, what we're saying is that we think we have a pretty good story to tell. We think we have expenditures pretty well under control."

Another partial explanation for the price increases might be the aggressive building programs recently undertaken by many hospitals and nursing facilities in the area, said Zelten, an assistant professor of insurance and health-care systems at the Wharton School.

Between March 1982 and February 1984, more than $467 million worth of new construction was approved for the five Southeastern Pennsylvania counties by the Health Systems Agency of Southeastern Pennsylvania, a federally mandated planning agency. Hospitals increase room rates to cover the costs of new construction.

EXHIBIT D

POST-GAZETTE: Fri., Nov. 8, 1985 —9

Nader, insurance firms differ on need for liability rate hikes

By Gary Rotstein
Post-Gazette Harrisburg Correspondent

HARRISBURG — Ralph Nader, the spokesman for consumer causes who built his reputation attacking the auto and oil industries, branded insurance companies worst of all yesterday for driving up liability coverage costs.

Although insurers contend huge increases in liability premiums this year were necessitated by $3.8 billion in industry-wide operating losses in 1984, Nader told the House Insurance Committee the losses had been exaggerated.

"Never in economic history has there been such a precipitous increase," the maverick activist said. "We're seeing increases and cancellations at a level totally unsupportable on an actuarial basis."

Nader claimed the dramatic price jumps are designed to aid insurers' political goals of pressuring lawmakers to restrict consumers' rights to sue for damages.

"Horsefeathers — they're being paranoid," an industry representative said when informed of the remarks by Nader and J. Robert Hunter, federal insurance administrator in the Carter administration.

Grover Czech, regional vice president of the American Insurance Association, said, "Companies are doing what they feel they have to to get back to price adequacy ... Competitive pressure drove rates down for many years. Generally prices today are coming back to what they were in 1977 or 1978 when adjusted for inflation."

Nader and Hunter, who now heads the National Insurance Consumer Organization, acknowledged the industry had inadequate revenue last year.

They contend, however, that it would have taken just a 5 percent boost in premiums across the board to meet standard profitability levels. They based the estimate on a U.S. General A[illegible] Office report that com[illegible]d a 3 percent return on [illegible] last year when investments, depreciation and other factors were added to operating costs.

Instead, liability insurance costs are going up 100 percent or more for many local governments, transportation firms, day care providers, taverns and others.

Representatives from those areas in previous Insurance Committee hearings, appealed for state help in controlling those increases. They also complained of being denied coverage at any price because of insurers trying to keep only the most profitable lines of business.

"The key point is ... this crisis is a crisis generated by the industry as a reaction to low profits," Hunter said.

"If the profit potential is there that you say, I can't believe there aren't [insurers] going out there to write it," commented Rep. Robert Godshall, R-Montgomery County.

Nader and Hunter pointed to solid stock market performance of insurance companies this year as another indicator that the industry is not in the dire straits it says it is.

Czech countered that a 30 percent increase in stock prices of insurance companies is related to their low value last year and assumptions that they will be able to return to proper profitability with price increases.

Taming the Insurance Industry's Booms and Busts

EXHIBIT E

While Congress toys with relief plans, business sweats out a steep rise in premiums.

By FRANCES CERRA

WITH premiums for business liability insurance soaring and coverage almost impossible to obtain for such high-risk areas as day-care centers, obstetrics and long-haul trucking, the commercial insurance industry is, by common agreement, in crisis. Insolvencies among state-regulated insurance companies are running at the highest rate since 1969, when the Insurance Services Office, a trade group, started keeping such records.

All this has prompted Congress to investigate new ways to provide coverage for the high-risk areas and to avert future sharp swings in premium costs. Senator John C. Danforth, Republican of Missouri, has proposed a bill that would establish uniform liability standards for products covered by insurance, speed up the claims process and limit payouts.

And Congress could act as a reinsurer for high-risk businesses, granting private insurers guarantees against losses, analysts say. It did this in the 1960's, when businesses in riot-torn, inner-city communities could not obtain coverage.

The current problems — familiar to an industry periodically plagued by boom-and-bust cycles — began in the late 1970's, when rising interest rates dramatically increased insurance companies' profitability from the investment of premiums. From a trough in 1975, when the industry's average return on net worth was a dismal 2.4 percent, returns climbed to 19 percent in 1977 and 18.1 percent in 1978, according to the Insurance Services Office, a trade group.

Critics of the insurance industry claim that, in the race for new business, many insurers abandoned their proper role as risk assessors and focused instead on investing premiums. In the process, they sharply discounted premiums to raise as much investment money as possible.

With the heavy discounting, it was inevitable that returns would fall as the claims streamed in. This began to happen in 1979 and the process accelerated in 1983 when interest rates fell. The average return on net worth dropped from 8.3 percent that year to 1.7 percent in 1984, according to the Insurance Services Office. A rebound finally came in the first half of this year as insurance companies reversed course and let many premiums skyrocket.

"A tremendous amount of new capital came into the industry, both in new companies and old ones that wanted to expand," said Dennis A. Herman, president of American Federal Group Ltd., a major wholesale insurance brokerage based in New York. "Interest rates were near 20 percent, and the companies were begging for business, at any price, to get premium dollars to invest."

The competition for premiums produced some extraordinarily generous deals for businesses. In 1981, Mr. Herman noted, a large, retail electronics chain paid $300,000 for liability insurance. Three years and more than $1 million in paid claims later, its premium was down to $125,000. Another of Mr. Herman's clients, an automobile leasing company with a fleet of over 10,000 cars, saw its premium fall to $450,000 in 1983 from $2.4 million in 1981.

The scramble for premiums reached a peak, at least symbolically, with the purchase by MGM Grand Hotels Inc. of "retroactive" insurance after a fire at its Las Vegas hotel in November 1980 that resulted in the deaths of 85 people and injuries to 591 more. Before the fire, MGM had only $30 million of liability insurance. But for a fee of $38.3 million, an insurance services company, Frank B. Hall Inc., underwrote up to $170 million in claims from the fire. Hall then placed the first $35 million of coverage with its own subsidiary, the Union International Insurance Company.

But Union, lacking assets to cover the policy, obtained a guarantee of payment from the General Reinsurance Corporation under a contract that freed the reinsurer from paying any claims for four years. Critics of the insurance industry cite the MGM case as a classic example of an insurer shifting its focus from risk assessment to investing premiums, hoping to earn enough on the investment to offset future losses. "At the time the policy was written, I predicted that the insurers' profit considerations dictated deferring the settlement of losses for as long as possible," said J. Robert Hunter, executive director of the National Insurance Consumer Organization and former Federal insurance administrator.

When the courts approved MGM's $75 million settlement with the fire victims in January 1983, Union refused to pay, claiming that the agreement included punitive damages that it should not have to cover. The legal dust finally settled last April, when MGM accepted a $75.9 million settlement from Union.

Lawrence Jones, president of the American Insurance Association, denies that the established insurers shifted their sights from assessing risks to investing premiums. Accordingly, he draws a markedly different picture of the industry's behavior during the period of price cuts. "The established companies did not deliberately underprice to get more money to invest," he said. "They underpriced out of necessity — they were meeting market conditions, and it was a buyers' market."

It was new entrants to the insurance industry, Mr. Jones maintained, who "cut what we regarded as sound prices to go after the investment income." He added, "It took six years of steadily declining returns to get the excess capital to withdraw from the market or perform in a manner that we would regard as sound pricing."

CRITICS, citing the case of Fireman's Fund, the American Express subsidiary, scoff at the idea that new entrants forced the established insurers into a game they were reluctant to play. "Fireman's Fund was a prominent price cutter," said Thomas K. Meakin, a securities analyst with Dominick & Dominick Inc., a New York brokerage house. "When the losses barreled in, they didn't put up enough reserves. Somebody made a serious mistake."

A spokesman for Fireman's Fund denied that the company had cut prices unreasonably, saying, "If you looked over the full cycle, I don't think we'd look much different from our major competitors." After two years of heavy losses, Fireman's Fund reported earnings of $20 million in the third quarter.

If peaks and valleys are not new to the insurance industry, neither are the arguments over how to prevent them. Mr. Hunter would prefer — but does not expect — to see "Federal legislation that would look at the industry in a macro way, to be sure that when prices fell, they didn't fall too low, and vice versa." Mr. Jones, the president of the American Insurance Association, while acknowledging that his industry's boom-bust cycle is disruptive to the economy, nonetheless rejects the idea of measures to control it. "Cushioning against the cycle would require government intrusion that I and our companies would not like to see," he said. Mr. Jones and other insurance advocates blame conflicting state liability standards and outrageous jury awards for much of the problems.

Whatever happens in the political arena, the stock market has already rendered a decisive opinion on the industry's future. Property casualty insurance stocks outperformed the rest of the market by nearly 100 percent in the first six months of the year. David Seifer, an analyst with the First Boston Corporation, predicts above-average profits for the industry starting late next year and continuing into 1987, based on reduced losses and rising premiums. And Myron Picoult, a senior vice president with Oppenheimer & Company, the New York brokerage, says that a return on equity in the "high teens" is likely between 1986 and 1990. By then, the buyers' market may have returned, and the stage will be set for another "crisis" in the 1990's. ■

Frances Cerra writes on business from New York.

EXHIBIT E

EXHIBIT F

6/20/85 Journal of Commerce

Study Analyzes Industry Woes

By JAMES NOLAN
Journal of Commerce Staff

NEW YORK — The property/casualty insurance industry's woeful financial state recalls a story from the old pushcart days along Delancey Street on New York's Lower East Side.

A merchant cut his prices sharply on ladies' boots and put up a huge charcoal lettered sign to tell the world.

Across the street, his competition cut prices lower, and said so with signs.

On the price war raged. Finally, the first entrepreneur posted a sign which declared: "Ladies' Boots. I sell below cost."

How can you do that, asked the competition? Sell below cost?

"I can sell below cost," the reply came, "because I buy below cost."

It was just this sort of a mindless price war which brought the property/casualty business to its present low and sorry state.

And no one knows it better than the industry itself. Witness a new study done by the Insurance Services Office and the National Association of Independent Insurers.

"The property/casualty industry must accept the major responsibility for its current financial condition," the study concluded. "But, the brutal price war of the last six years is over. The industry has finally realized that a business cannot indefinitely price its product below cost and expect to survive."

The study, "1985, a Critical Year," pulls together a story that has been told piecemeal for the past 18 months.

It compares the industry in 1984 with back years, using all of the familiar ratios: rates of return, premiums compared to losses and expenses, combined ratios and the like.

> *'The brutal price war of the last six years is over. The industry has finally realized that a business cannot indefinitely price its product below cost and expect to survive.'*

In some cases, the economic data from the insurance industry has been plotted on graphs, laid over similar data from The Fortune 500 industrials and U.S. bond yields. In all cases since mid-1981 the insurance industry graph lines — reflecting profitability — turn down where others rise.

The sponsors want the 31-page document to "help the public and state insurance regulators understand why premium increases are needed to assure the future financial stability of the insurance industry."

Casting back to the origins of the price war, the study notes that "since 1979, while underwriting results have declined, the industry's net investment income has grown continuously.

"In an attempt to generate cash flow for investment, insurers competed aggressively for premium dollars, knocking prices more and more out of line with loss costs," the study said.

But it was poor management strategy. The $1.7 billion in annual investment income could not be stretched far enough to cover the $3 billion annual growth in underwriting lossesthe industry suffered.

Closer to home, the 10 percent climb in investment income of $1.6 billion in 1984 fell far short of the 20 percent increase in underwriting losses of $8 billion for that year.

Such a financial climate worries the industry on several scores.

First, industry actuaries are predicting that in the next few years, corporate America will find soon that it cannot insure all of its assets.

The conclusion flows from operating results for 1984. The study says that during the year, policyholder surplus fell by 3 percent to $63 billion.

The industry measures its ability to write property/casualty coverage by this surplus figure, "indicating," the study said, "that capacity may not be sufficient to meet the insurance needs of an expanding U.S. economy."

Still a more urgent worry is the continued financial solvency of a substantial number of companies. The study said that the ratio tests applied by the National Association of Insurance Commissioners and the A.M. Best Co. show that "the the number of financially impaired insurers has increased."

While the study did not total the number of such companies, in September of last year, the NAIC said that 319 of the 2,477 Property/casualty insurers it keeps tabs on were in bad enough financial shape to require "immediate attention" by state insurance regulators.

The NAIC warning came after it had finished desk audits on the financial results filed by the companies in the spring.

Such audits are in various stages of completion at the moment.

EXHIBIT H

RATHER HOT DISCUSSION ON CAPACITY

By LOIS J. LYONS

NEW YORK—Superintendent James P. Corcoran rolled up his sleeves, looked the industry in the eye and said, "There is no capacity crisis." Donald Kramer, president of Kramer Capital Consultants, took a similar stance, looked the superintendent in the eye and said, "There is a capacity shortage, and it is severe."

Mr. Corcoran, somewhat outnumbered in his opinion and certainly in his ideas of how to handle the situation, was also opposed by David B. Mathis, chairman, president and chief executive officer of Kemper Re, who said unequivocally that there is a "real capacity crisis that is likely to remain at least through 1987," and by Michell J. Cole, vice president and principal of Tillinghast, Nelson & Warren Inc., who hedged only a little, saying there is certainly a "restructuring of property casualty markets," which might not be a crisis but a "revolution."

James B. Stradtner, managing director of Alex Brown & Sons, investment bankers, never really joined the fray but, taking a third position, said the problem is that capacity is never quite "in sync" with what the industry needs and that insurance companies have never been able to cope with excess or even adequate capacity. "Given the rope," he said, "they will succeed in hanging themselves," but he said he is optimistic about the future of the industry.

The speakers made up a panel discussing "New Capacity, New Players" at a seminar at the annual "I" Day meeting of the New York Chapter of the Society of CPCU. The panel was moderated by Joseph S. Diamond, executive editor of the National Underwriter Co.

Mr. Corcoran said he feels he has been patient with the industry, but is losing his patience. He said the legislators are "furious" and feel that the industry has "overplayed its hand."

Difficult position

"Now I'm in the difficult position of trying to make sure that we dont' get reactive legislation," he said.

But, he added, such legislation may come about, "and it is what the industry has created."

"When you talk about new players and new capacity," he said, "you are talking about an essential and permanent change in the way this industry does business. I don't agree that this is a cycle. I think it is a natural change."

He said the capacity shortfall the industry is experiencing now is the worst it's been in 50 years and "it's not going to be solved by the stock market investing new capital." He said, "We're not sure where that capital is going to go. We're concerned about the financial guarantee products that we're going to see. It might well attract new capital but is it going to go into lines of insurance that we think are essential for the marketplace?"

While adverse court decisions have contributed to the crisis, he said, if there had been adequate pricing of products over the last 10 years, the situation would not exist today.

He warned the industry that some of the new players and new capacity "might well not be what they want."

To ease the crisis in his jurisdiction, he said, he will look into granting greater underwriting authority to the state insurance fund; creating joint underwriting associations for coverages required to operate a business when such coverage is not available in the voluntary market; and encouraging self insurance pools and reciprocals.

He said life insurers do not appear to have a capacity problem at this time and perhaps they can be encouraged to form property casualty subsidiaries to fill the void.

"Otherwise," he said, "that void might well be filled by the banking industry. Banks have the resources available to write property/casualty insurance and the governor supports allowing banks to write all lines of insurance." He added that "banks would certainly add new players to the marketplace to write business currently being avoided or overpriced by the property casualty insurers."

He accused property/casualty insurers of "irresponsible behavior" and said that this behavior will possibly

Cont'd on Page 58

Cont'd from Page 6

serve as the "linchpin for enactment of those recommendations."

After this cycle is over, he said, "there won't be a return in the marketplace to business as usual." He said, "A lot of these companies will find themselves in a very difficult time reentering the market when things are 'good'."

Mr. Kramer said the current crisis is a "period of dislocation," caused by price changes but that capacity would return when returns on equity improve but for the present the industry is going to suffer.

He observed that in recent Congressional hearings on capacity, Consumerist Robert Hunter made headlines when he talked about the "conspiracy of the industry." But, Mr. Kramer said, "no one seemed to ask the question of Mr. Hunter of how the industry managed to conspire to lose $3.5 billion last year. That never made the press."

He said much of the problem today is a lack of capital. Some of the reasons for this, he said, are that it is no longer as easy to enter as it was in the past, citing such difficulties as needing a creditworthiness rating and admissibility. He added that foreign reinsurers will not fund letters of credit for IBNR (Incurred But Not Reported), that letters of credit are harder to obtain because banks have been burned by the recent failure of offshore insurance companies, that domestic companies are less willing to reinsure abroad and that Lloyd's has lost its retrocessional market.

"Someday," he said, "when returns on equity improve, there will be capacity back in this industry, but during this period of dislocation we're going to suffer through a period when reinsurance rates are going to escalate dramatically, as the premiums on which the reinsurers base their reinsurance go up and as the rates the reinsurers charge for the premiums go up. We're going to have a dramatic increase in reinsurance demand without necessarily an increase in reinsurance capacity until some form of profitability returns. When it does the capacity will be there."

Mr. Stradtner's view of capacity is somewhat different, though also somewhat more optimistic. "Capacity is fluid," he said, "always in motion, thus leading to an industry with overcapacity or under-capacity...never perfectly in sync with its needs."

Scenario is simple

Today, he said, the "scenario" is relatively simple. "Excess capacity produces underwriting losses. Underwriting losses drive out capacity. Property/casualty stock prices rise because institutional investors believe the time to buy the shares is when the earnings are at their lowest level. Higher stock prices enable insurance companies to sell securities to investors on very attractive terms. Prosperity returns, more capacity comes in. The additional capacity raised will bring back price competition, underwriting losses and a diminution of capacity."

EXHIBIT G

RAPID RETURN TO LACK OF PRICE DISCIPLINE SEEN

PIA Convention Report

By ALFRED G. HAGGERTY

RENO, Nev.—"The property-casualty insurance industry today is in a stronger capital and surplus position than it has ever been in and it clearly has enough capital and surplus to meet the needs of the insurance industry today and in the near future," a specialist in insurance research said here.

Dr. Michael E. Hogue, president and managing director of Philadelphia Insurance Research Group, also predicted a quicker than expected return to "a period of a lack of price discipline" in his remarks to the annual convention of the National Association of Professional Insurance Agents.

Dr. Hogue said A.M. Best reported consolidated policyholder surplus of $64 billion as of Dec. 31, 1984, and then in a July 15, 1985, report indicated an adjusted surplus of $92 billion. Thus, he said, Best saw an equity in the balance sheet of $28 billion, which he said arises out of undervalued assets and overstated liabilities. He said it comes primarily from the unearned premium reserve for that portion already paid out in acquisition costs and from the estimate of the loss reserves on a discounted basis.

"In general, what that means," he said, "is that the property-casualty industry, if it were put into a runoff situation and assuming the reserves are accurate, when the period of runoff is completed, not only would there be $64 million in capital and surplus, but there would be another $28 billion left over."

Even assuming a reserve deficiency of as much as 20 percent, he said, after the period of runoff, the industry would have not only the $64 billion of reported surplus, but another $8 billion or $9 billion of undisclosed profits.

"It is for this reason," Dr. Hogue said, "that we believe the property and casualty insurance industry is overcapitalized; and that, frankly, is going to be a detriment, not an advantage."

He said his firm studied a group of seven companies representing about one-third of policyholder surplus and concluded that by the end of 1985 they would be writing at slightly over 1.25 to 1.4 times their surplus position.

"It's for that reason," he continued, "that we maintain that the industry does not have a capacity problem. It clearly does not have the same problem it had in 1974 and 1975, when at this time in the cycle we were at about 1.4 to 1.5 times surplus."

What it does indicate, he said, is that the insurance industry is not pleased with the profitability of the market and is unwilling to release the capacity in search of taking risk. "There lies our major concern," he said.

"When the profitability appears in the financial statements of the carriers, particularly in the regional and other small companies that have not had the extent of problems that many of the larger carriers have had, they will begin to release the surplus in anticipation of growth of market share."

Dr. Hogue said Chubb and Ohio Casualty recently released nine-month results showing that earnings per share have already doubled in 1985.

"It is our concern," he said, "that we're going to find a more rapid release of that surplus in search of market share than is otherwise being predicted relative to when the markets will turn. It is our belief that that is going to result again in a period of lack of price discipline.

"We believe that the requirement to allocate the surplus because of the necessity to leverage that surplus against returns to meet the target return on investments of many of these corporations, we will begin to start the process of market competitiveness."

He called it "gross mismanagement" of a property-casualty insurance company to attempt to increase market share unless there are indicators available showing where the price and relative exposure are at any point in time. He said it has been his experience that there are few insurance companies in the U.S. market which are fully aware of the current price and exposure relationship in their portfolio on a recurring basis and, therefore, any move to begin to increase their prices is done so without an eye to what the effect is going to be on their financial statements or surplus.

"In other words," he said, "I expect to see the same effectiveness in dealing with excess capacity that took place coming out of the 1964 and 1974 pricing turns." ◆

This situation, he said, is in place today, only the length of the capacity cycle is open to debate.

Capacity, he said, is "innocent" or "dumb" but it can be gathered at just the times when it is needed most, but that insurance company management has never been able to cope with excess or even adequate capacity.

He added that excess capacity did not completely disappear in 1984, it just diminished.

"Add to this," he said, "the new money raised through securities sales and you are well on the way to restoring excess capacity in the next two to three years. Remember, future earnings will be tax free, thanks to substantial tax loss carryforwards, and we have been blessed with reasonably good stock and bond markets."

Because of his optimism for the industry, he said, he hopes for a return to stable economics producing a typical cycle of three good years followed by three poor, but not devastating years.

"The industry," he said, "in my opinion, is prepared to live prosperously under this type of scenario."

Mr. Mathis discussed some of the ways the present capacity shortfall is different from previous ones such as a lack of an alternative market to Lloyds, the litigious atmosphere surrounding the U.S. casualty business, the withdrawal of the retrocession market, the shortage of underwriting talent, and the slowness of the positive impact on the bottom line of changes in price and terms

Therefore, he said, he sees the following as a "likely scenario" for the industry: continued equity investor interest in experienced companies, on the assumption that the industry is on the road to recovery, but little interest in new ventures unless they are staffed with proven management; a sort of "back to basics" philosophy—emphasis on underwriting profit resulting in not only higher prices, but restricted contract terms; more net line underwriting for insurer and reinsurer alike; and a longer period of tight market conditions that has been typical of the past as companies not only improve the profit picture, but also make up for deficiencies of the past.

Mr. Cole said that while it is unclear whether the current situation is a crisis or a revolution in the way corporations, health care institutions, philanthropics and governmental entities buy insurance, "if the unavailability and unaffordability of insurance persists, it is my contention that one-third to nearly one-half of all commercial insurance premiums will be financed by non-traditional sources."

He said he predicts that by year-end, self-insurance will represent slightly more than one-third of all commercial insurance premiums which will increase by 44 percent to 50 percent by 1987, that self insurance will play an even more important role in this market than it did in the recovery of 1976-77 and "it may well revolutionize the way insurance is purchased."

He said, "The industry needs to heed the warning that this significant expansion of non-traditional capacity and determine how it can co-exist with these new players and capacity." ◆