ALASKA LEGISLATURE COMMITTEE FILES 1985-1986 8072

4159 SLAB INSURANCE INFORMATION

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monitoring the degree and comprehensiveness of reporting by the insurance industry. We would like to propose such measures at the forth-coming Legislature but stand ready and willing to help in supporting any affirmative effort directed toward a true solution to the insurance crisis.

For the reasons stated at our meeting the other day, we do not believe that taking away the rights of innocent victims is such a solution. The insurance industry has not promised reductions on a quid pro quo basis, based upon certain specific changes in the tort law. We believe they never will do so, and that the threat of the insurance industry pulling out of the state is a hollow one that they are making in all states. As pointed out by Mr. Hunter this is a national problem, that the insurance industry never had it so good as they have it in Alaska. They have made double the profits here that they have made anywhere else and insurance companies are coming into our state rather than pulling out. As you know, we submitted data to that effect at the time of our conference.

Thank you very much for your interest in this matter.

Sincerely yours,

BERNARD P. KELLY & ASSOCIATES

BERNARD P. KELLY

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OMNIBUS REINSURANCE ACT OF 1985

Section -[1]-(a) Within 30 days after the receipt of an application by any manufacturer, service provider or any group or association representing such manufacturers or service providers, the Commission shall conduct a hearing on the reasonable availability and affordability of adequate commercial general liability insurance and other lines of insurance for that manufacturer or service provider or the members of any group or association of manufacturers or service providers.

(b) The Commission may in its discretion hold hearings to investigate the reasonable availability or affordability of commercial general liability insurance and other such lines of insurance as from time to time become unavailable or unaffordable thereby threatening the health, welfare or commerce of the United States and the various states by making some manufactured good or provided service unavailable or available only at an unreasonable cost.

(c) Within 30 days after the hearing required under subsection (a) or conducted under subsection (b) the Commission shall determine in writing, based upon the record of the hearing conducted pursuant to subsection (a) or (b), whether the insurance described in subsection (a) or (b) is , and will be, reasonably available or affordable to affected manufacturers, service providers or the members of any group or association representing manufacturers or service providers to cover anticipated claims. Such determination, and the basis therefore, shall be published in the Federal Register.

(d)(1) If the Commission determines at any time that:

(A) the insurance described in subsection (a) or (b) is not available or reasonably affordable from the private sector to applicants under subsection (a) or the affected parties described pursuant to subsection (b) to cover anticipated claims;

(B) in order for an applicant under subsection (a) or affected party described pursuant to subsection (b) to have regular operations in the United States, assistance under any of the programs authorized under sections [2] or [3] is necessary; and

(C) the availability of such goods or services from that applicant under subsection (a) or affected party under subsection (b) is essential to promote the public health, welfare or the general commerce of the United States, the Commission is authorized to implement the insurance pool described in section-[2]- and the reinsurance coverage described in section-[3]- with respect to such goods or services. If at any time the Commission determines that one or both of the programs provided for in section -[2]- or -[3]- reasonably assures the availability or affordability of such goods or services in the United States, the Commission may implement the operation of the programs described therein.

(2) to further the purposes of this act and in recognition of the critical situation facing both day care centers in insuring for the specific peril of child abuse and nurse-midwives in obtaining medical malpractice insurance, the Congress makes the necessary determination for the Commission to implement section [2],[3] or both and any other pertinent section under this title for these affected parties. Affected party eligibility under section [1](d)(2) shall not be subject to review by the Commission until 90 days after the enactment of this title.

(3) To the extent feasible, the programs provided for under this title shall be implemented in a manner to insure that:

(A) such programs will not act as a disincentive to improvements in product safety or safe service delivery, and shall operate to promote product safety and safe service delivery through the establishment of models for risk management as may be agreed upon by the Commission, the insurers and the insureds as a prerequisite for eligibility for any of the programs under this title.

(B) each manufacturer or service provider which benefits from such programs will agree that such goods or services shall remain available to the public during the period in which such product manufacturer or service provider or the insurer of such product manufacturer or service provider participates in such programs.

(C) each insurer which benefits from such programs will agree that such insurance as is written during the period in which such insurer or its insured product manufacturer or service provider participates in such programs shall have premiums which are based upon an experience rate.

Section-[2]-(a) After making findings under section [1], the Commission shall encourage and otherwise assist any insurance companies which meet the requirements of subsection (c) and any others set out in this title to form, or otherwise join together in insurance pools for the purpose of assuming, on such terms and conditions as may be agreed upon, such financial responsibility as will enable such companies and other insurers, with federal financial and other assistance under this title, to assume a reasonable portion of responsibility for the adjustment and payment of claims arising from product or service induced injuries, disabilities, illnesses and deaths.

(b) Funds from such insurance pools shall be available only to pay claims resulting from product or service related actions in excess of such amounts as are established each year by the Commission. The Commission may establish differing amounts for each manfacturer or service provider or insurer and each good or service based upon the needs of the manufacturer or service provider or insurer and other relevant factors.

(c) any insurer licensed to operate as such by any state, territory or possession of the United States shall

be eligible for participation in such insurance pools.

(d) Such insurance pools may be funded by premiums paid by manufacturers or service providers to insurers approved by the Commission. If the Commission finds, after notice and public hearing, that the premiums charged by such insurance pools make the insurance from such insurance pool unavailable for manufacturers or service providers, the Commission may amend the terms and conditions of reinsurance under this title to lower premiums to be paid by such manufacturers or service providers.

Section [3](a) In order to further the purposes of thi title, the Commission may take such action as may be necessary to make available,to the insurance pools forme otherwise created under section [2], reinsurance coverag under this section to any insurer or pool for losses assumed by such insurers or pools in accordance with the agreements entered into under subsection (b).

(b)(1) Following the date of enactment of this title, the Commission is authorized to enter into any contract, agreement, treaty, or any other arrangement with any insurer or pool for reinsurance coverage, in consideration of payment of such premiums, fees or other charges by insurers or pools which the Commission deems to be adequate as required under Section-[5]- of this title to obtain aggregate reinsurance premiums and charges for deposit in the Omnibus Reinsurance Fund established under Section-[5]- in excess of the estimated amount of insured product or service induced losses in 1985, and thereafter the Commission may increase or decrease such premiums or charges if it is found that such action is neccessary or appropriate to carry out the purposes of this title.

(A) Reinsurance offered under this title shall reimburse an insurer or pool for its total proved and approved claims for covered losses resulting from product or service induced injuries, disabilities, illnesses and deaths during the term of the reinsurance contract, agreement, treaty, or other arrangement, over and above the amount of the insurer's or pool's retention of such losses as provided in such reinsurance contract, agreement, treaty, or other arrangement entered into under this section.

(B) Such reinsurance contracts, agreements, treaties, or other arrangements may be made without regard to section 3679(a) of the Revised Statutes of the United States (31 USC 665(a)), and shall include any terms and conditions which the Commission deems necessary to carry out the purposes of this title. The terms and conditions of such contracts, agreements, treaties, or other arrangements with insurers or pools, throughout the country, in any one year shall be uniform: Provided, that where necessary to further the purposes of this title, pro rata and other such forms of reinsurance may be include[illegible] such terms and conditions.

(C) Such rei[illegible]ce shall be provided upon such terms and conditions [illegible] subject to such deductibles

and other restrictions and limitations, as the Commission deems appropriate, but no reinsurance shall be available to a product manufacturer, service provider, insurer or pool of insurance which the Commission determines to be uninsurable or to any product manufacturer, service provider, insurer or pool of insurance with respect to which reasonable protective measures to prevent loss, consistent with standards established by the Commission under section [1](d)(3)(A), have not been adopted.

(D) Any contract, agreement, treaty, or other arrangement for reinsurance under this section shall be for a calendar year.

Section 4(a) The Commission shall take such action as is necessary or appropriate to make reinsurance available directly to insurers which participate in pools created under this title for that portion of their business which is related to any distressed line as determined under section [1](d) which is written and not within a pool created pursuant to section [2] of this title.

(b) Such reinsurance may be made pursuant to contract, agreement, treaty, or other arrangement, and pursuant to such regulations as may be reasonably prescribed by the Commission.

DRAFT

Section 5(a) To carry out the programs authorized under this title, the Commission may establish in the Treasury of the United States an Omnibus Reinsurance Fund which shall be available without fiscal year limitations--

(1) to pay reinsurance claims under the reinsurance coverage provided under section [3]; and

(2) to pay reinsurance claims under section [4]; and

(3) to pay such administrative expenses as may be necessary or appropriate to carry out the purposes of this title; and

(4) to repay to the Secretary of the Treasury such sums, including interest thereon, as may be borrowed from him for purposes of such programs under section [5](b).

(b) The reinsurance fund under this section may be financed by:

(1) such amounts as may from time to time be advanced to the fund from the general fund of the Treasury in order to maintain the fund in an operative condition adequate to meet its liabilities; and

(2) premiums, fees, or other such charges which may be collected in connection with the reinsurance coverage provided under section [3]; and

(3) premiums, fees, or other such charges which may be collected in connection with the reinsurance coverage provided under section [4]; and

(4) such amounts as may be raised by the establishment of an uniform surcharge upon premiums paid to

property and casualty insurers.

(A) the Treasury shall, no later than 120 days after the enactment of this title, collect a .0025 (.25 percent) surcharge upon all premiums paid to property and casualty insurers which revenues shall go to maintain the reinsurance fund created under this section in an operative condition adequate to meet its liabilities.

(5) interest which may be earned on investments of the fund; and

(6) receipts from any other source which may, from time to time, be credited to the fund.

Section [6](a) If at any time the Commission makes the determinations described in section [1](d), the Commission may, in carrying out its responsibilities under this title, utilize—

(1) insurance companies and other insurers, insurance agents and brokers , and insurance adjustment organizations, as fiscal officers of the United States,

(2) officers and employees of the Federal Trade Commission, and such other officers and employees of any executive agency (as defined in section 105 of title 5 of the United States Code) as the Commission and the head of any such agency may from time to time agree upon, on a reimbursement or other basis, or

(3) both of the alternatives specified in paragraphs (1) and (2), or any combination thereof.

Section [7](a) The Commission may in the interest of furthering the purposes of this title delegate authority to administer any portion of this title to other appropriate officers and employees of any executive agency (as defined in section 105 of title 5 of the United States Code) as the Commission and the head of any such agency may from time to time agree: Provided that any action taken by any such agency officer or employee shall not be inconsistent with any portion of this title.

(b)(1) The Commission through its Bureau of Competition shall periodically review each plan under this title and the methods and practices by which such plan is actually being carried out in order to--

(A) Assure that such plan is effectively making commercial general liability and other essential lines of liability insurance readily available to such product manufacturers and service providers as is intended and is otherwise carrying out the purposes of this title, and in order to identify any aspects of the operation or administration of such plan which may require revision, modification , or other action to carry out such purposes.

(B) Report to the Congress at least once a year the findings of any such investigation under subsection b(1)(A), or from time to time as may be requested by the Congress to report on the current status of all programs under this title.

Section [8](a) Within 90 days after the enactment of this title and before implementation of the progr. s contained therein for the benefit of any applicant, affected party, insurer or pool of insurance, the Commission shall prepare and transmit a report to the Congress which shall—

(1) indicate the nature and extent of anticipated use of the insurance industry in the delivery under this title of reinsurance to product manufacturers, service providers, insurers, and pools of insurance.

(2) identify anticipated costs of provision of such reinsurance to product manufacturers, service providers, insurers, and pools of insurance under this title.

(3) identify any potential applicant which has made query to the Commission about such programs as have been authorized under this title and, in the case of affected parties, those which preliminarily might benefit from participation under the programs authorized under this title.

Section [9](a) The Commission, or any agency officer or employees which administer portions of this title as authorized under section [6] and [7], in a suit brought in the appropriate United States district court, shall be entitled to recover from any insurer the amount of any unpaid premiums lawfully payable by such insurer to the Commission or its delegated agent.

(b) No action or proceeding brought under this section may be brought for any amount in excess of that lawfully payable by any insurer to the Commission or its delegated agent and any such action shall be brought within five years of when the right to such payment accrued, except [Provided] where any false or fraudulent conduct warrants, the claim shall not be deemed to have accrued until its discovery.

(c) Any recovery had pursuant to any action or proceeding under this section shall be deposited to the credit of the reinsurance fund created under this title.

INSURANCE

BOTTOM-FISHING IN CARL LINDNER'S SWAMP

To most of its hapless creditors, customers, and equity holders, Mission Insurance Group Inc. is one big swamp. Its largest unit, Mission Insurance Co., is insolvent, under the conservatorship of California since Oct. 31, with no easy solution to its problems. Yet a couple of adventurous bottom-fishers have plunged into the muck—and hope to find a fortune there.

Martin J. Whitman, a specialist in securities of bankrupt companies who manages more than $200 million, is leading the expedition. He's drawn in Carl Marks & Co., a New York investment house that has dabbled in everything from venture capital to czarist bonds. Between them, the partners have acquired Mission notes and debentures worth only about $2 million—but enough, they believe, to get them in on a revival of Mission.

SIMPLE LOGIC. Whitman has also rallied some angry longstanding Mission bondholders with much more at stake. The biggest is Retirement Systems of Alabama, a $5 billion pension fund that holds $24 million worth of Mission bonds. Mission skipped two interest payments "without contacting anybody," complains David G. Bronner, the fund's chief executive.

The bondholders argue that as creditors they would be first in line in a Chapter 11 reorganization—something that everyone wants to avoid. But so far they aren't making much headway with Cincinnati financier Carl H. Lindner, whose American Financial Corp. owns 49.9% of Mission. Lindner's preliminary agreement with the California regulators provides for a restructuring of the debt that would reduce the bondholders' stake. Dozens of large and small reinsurance clients are also waiting in line with claims on Mission's assets.

For Whitman, a part-time finance teacher at Yale University who eschews suits for work, dressing "only well enough to get into the Yale Club for lunch," the logic is simple. He claims that he and the bondholder group, along with unidentified potential backers, are ready to inject millions of dollars in new equity into Mission and maybe even take the reins. In return, they want a chance to profit from the turnaround they say can be engineered. This is substantially what Lindner would like to work out—but to AFC's benefit instead.

A turnaround won't be easy. Mission, traditionally a well-regarded vendor of workers' compensation insurance, expanded pell-mell into reinsurance in the late 1970s and has since seen claims run three times as high as premiums. The company lost $198 million in 1984 and $65 million more in 1985's first nine months. But Whitman has high hopes for the workers' compensation business and firming rates in property-casualty lines. "This could be another Geico," he predicts in his gravelly voice. "If there's one chance in ten of that, it would be well worth our while." Geico, threatened with insolvency in the mid-1970s, made a splendid turnaround under new management. Since then, the insurer's stock has blossomed 40-fold.

Whitman's group may face deeper problems in Mission, however. There are all those reinsurers waiting to be paid. "I'd be very surprised if after all the claims emerge there's anything left for the bondholders," says David O'Leary, an analyst at Fox-Pitt Kelt Inc. At Mutual Shares Corp., an inves ment firm similar to Whitman's, partn Michael F. Price says he "wouldn't tou it with a 10-foot pole."

But Whitman's team has a differe view. Since Mission's shareholder equi has evaporated—the shares were delis ed last December by the New Yor Stock Exchange—the bondholders fi ure that they already "own" the comp ny. That, they argue, should give the clout in structuring a reorganizatio They've proposed a solution in whic they'd put up cash and receive new equ ty and Lindner's group would continu running the company. But they sa Lindner turned them down.

In January the Whitman group file to push Mission's holding company into Chapter 11 proceedings. That would open the whole company for reorganization, although the fate o insurance assets would remain up to state regulators Mission has not yet responded. But California Insurance Commissioner Bruce A. Bunner was shocked: "I thought the bondholders would be the least of our problems, but they could destroy everything."

FINANCIER WHITMAN BELIEVES MISSION "COULD BE ANOTHER GEICO"

ROB KINMONTH

LAST RESORT. After all, Bunner and American Financial had been hammering out their own restructuring agreement. Lindner, who injected $75 million in new capital into Mission last year, would contribute at least $125 million more to back up part of its policy-writing business. But Bunner says there's at least a $169 million gap between assets and liabilities.

The tangle of payments Mission owes dozens of reinsurance clients may put it even deeper in the hole. For weeks, executives at these companies have been meeting with Mission officials and Bunner to settle their claims, which run into the hundreds of millions. If a settlement isn't reached, Bunner will move to liquidate the unit under his conservatorship.

Whitman depicts Chapter 11 as a last resort. Lindner's AFC won't comment. In the meantime, Mission is said to be suffering defections by customers and brokers. "I don't think Mission as an entity is viable," says analyst O'Leary. He wonders if the bottom-fishers will come away with anything but debris.

By Elizabeth Ehrlich in New York, Zachary Schiller in Cleveland, and Teresa Carson in Los Angeles

LAW

SEARLE: STARING AT SOME LONG DAYS IN COURT

When G. D. Searle & Co. withdrew the Copper 7 and Tatum-T intrauterine contraceptive devices from sale in the U. S., it said the products were safe. The move, it said, was meant to curtail mounting litigation costs. But lawyers for plaintiffs who are suing Searle, claiming that the devices caused pelvic infection and infertility, see the company's Jan. 3 action as an acknowledgment that it is in for a long, tough series of legal battles.

Searle, a subsidiary of Monsanto Co., has been fighting 775 lawsuits, 305 of which it says are still pending. The company says it spent $1.5 million to defend itself in just four of these suits. Searle says it has won 8 of 10 trials and that more than 150 other cases have been dismissed. "The financial burden is not created by payments to the plaintiffs but by payments to lawyers," says Tod Hullin, a Searle vice-president.

And there are sure to be more suits filed. Plaintiffs' lawyers say they are reviewing hundreds of new claims. And Ira J. Bornstein, a lawyer who represents Monsanto shareholders who have filed suit charging that Searle failed to inform them of the suits, believes that by taking the IUDs off the market, Searle is "acknowledging that there is tremendous potential liability out there."

BARELY A RIPPLE. All sides are closely watching a similar but unrelated situation involving A. H. Robins Co.'s Dalkon Shield. Robins filed under Chapter 11 last August after it had won 27 cases and lost 33. A court-ordered advertising campaign aimed at potential plaintiffs has resulted in an avalanche of new claims—11 years after the Dalkon Shield was withdrawn from the market. Searle's withdrawal of its product from the U. S. (it is still sold overseas) means "we are on the Dalkon Shield track," says Patricia Jo Stone, one of the plaintiffs' trial lawyers.

Searle maintains there are important differences. Unlike the Dalkon Shield, Searle's Copper 7 and its labeling were approved by the Food & Drug Administration. Moreover, the FDA has recently investigated allegations that Searle suppressed adverse findings and deflated the incidence of pelvic inflammatory disease in its test results. The agency continues to stand behind the products. "We found that Searle had reported adverse findings in a timely fashion. In our judgment, Searle did not mislead FDA," says Susan M. Cruzan, an FDA spokeswoman.

Discontinuance of the products will hardly cause a ripple on Monsanto's income statement. Last year its IUD sales in the U. S. were $11 million, a tiny part of Monsanto's $6.75 billion in sales. Searle's move, however, practically extinguishes the nation's IUD industry. Since Robins took the Dalkon Shield off the market in 1974, others have followed, and Alza Corp. of Palo Alto, Calif., is the only U. S. company that still produces an IUD. But the decision to stop selling the devices has not put a stop to the controversy about them.

By Ellyn E. Spragins in Chicago and William B. Glaberson in New York

EXECUTIVE SUITE

GM'S SHUFFLE: THE CALM BEFORE A SLAUGHTER?

A predictable shift in top management? That's how General Motors Corp. characterized the raft of promotions it announced on Feb. 3. But insiders believe the appointments mean much more: a new phase in the broad reorganization GM began two years ago. Its ultimate goal is to trim white-collar employment in auto operations by at least 25% within 10 years.

Staff cuts are a logical result of the new structure GM outlined two years ago (BW—Jan. 23, 1984). That plan aimed to reduce the auto giant's reaction time to market changes by arranging its five car divisions—Chevrolet, Pontiac, Buick, Oldsmobile, and Cadillac—under two groups. Each group now performs most of the staff functions once spread out through the company.

But critics say GM has been slow to reduce its executive ranks even after streamlining operations. That, they figure, contributes significantly to GM's production costs, which analysts agree are higher than any other domestic auto maker. "There's no question you could slash the fat in the middle of GM," confides one executive. Another insider predicts the company will begin to attack its manpower glut within six months in a "massive restructuring" of executive jobs. "The change is going to bring pain, but it has to come," he says.

GM's goal is to match the management efficiency of Toyota Motor Corp., the industry leader in that category, by eventually eliminating at least 25% of the salaried jobs in its carmaking business. The changes announced this month do not reduce the number of top GM executives. But they do restructure responsibilities so the chairman and president can concentrate on policy decisions. The shuffle was triggered by the decision of Alexander A. Cunningham, 60, to retire for health reasons. The affable Cunningham had been a board member and executive vice-president in charge of North American passenger-car operations. He has resigned both positions.

'NEW DAY.' GM sources describe Cunningham's departure as a tremendous loss for the company. But it has also prompted GM to unleash a younger management team. "It's a new day, as far as I'm concerned," declares pleased board member H. Ross Perot. "These guys are so competitive, they can't live with themselves until they beat anybody in sight."

Cunningham's duties will be split between two new executive vice-presidents. Lloyd E. Reuss, 49, will manage all U. S. auto operations. Robert C. Stempel, 52, will run the company's truck and overseas operations. Reuss formerly headed GM's "small-car" unit, the Chevrolet-Pontiac-GM of Canada Group, while Stempel ran the "big-car" unit, the Buick-Oldsmobile-Cadillac Group. Both men also become directors.

Reuss and Stempel are regarded as leading contenders to replace F. James

REUSS AND STEMPEL: WITH A NEW TOP-LEVEL TEAM IN PLACE, PINK SLIPS MAY FLY

PHOTOGRAPHS BY PETER YATES

JACOBS GOES DEEPER INTO THE OIL PATCH

Despite the threat posed by plummeting oil and gas prices, Irwin L. Jacobs is pouring more money into two big and seemingly ill-timed plays in the oil patch. The Minneapolis investor, impatient with efforts by Pioneer Corp. President C. David Culver to restructure the Amarillo natural gas producer, says he will launch a tender offer for the 86% of Pioneer he does not yet control. Jacobs is offering $23 a share, or $655 million—well below the roughly $26 a share he paid for his initial stake in late 1984 but at least 10% above the current market for Pioneer's gas reserves. Those reserves are being reappraised, and Jacobs may be betting on a big upward revision. He also has boosted, to 15.4%, his stake in Tidewater Inc., which services offshore oil rigs. Jacobs paid $26 a share for his initial 5% stake in early 1984; Tidewater stock is trading now at below 10. Jacobs also holds 9% of HNG-InterNorth Inc., a gas pipeline.

CHEWING TOBACCO FACES AN AD BAN

The House of Representatives passed a bill that would bar radio and TV advertising for snuff and chewing tobacco. The measure, which the Senate is expected to approve, also would require makers of the products to place on packages such warning labels as "This product may cause mouth cancer." The measure also calls for the Health & Human Services Dept. to set up programs to educate the public about the dangers of smokeless tobacco.

'REAL MOMENTUM' FOR NORFOLK'S BID

The Senate approved, 54 to 39, Norfolk Southern Corp.'s proposal to buy the government's 85% stake in Consolidated Rail Corp. for $1.2 billion. The vote gives Transportation Secretary Elizabeth H. Dole, who favors the sale to Norfolk Southern, an expected victory in the battle over Conrail's fate. The Senate support, she said, will "send this to the House with some real momentum." But the sale faces greater opposition there. House Energy & Commerce Committee Chairman John D. Dingell (D-Mich.) promises to resolve the issue this year, but first he wants to examine documents from the Justice Dept.'s review of the deal and from all bidders for Conrail. Another key representative, James J. Florio (D-N.J.), said that all the bids for Conrail are "woefully deficient" and must be improved.

BEATRICE APPROVES A REVISED BUYOUT

Directors of Beatrice Cos. approved a modified buyout offer from Kohlberg Kravis Roberts & Co. The offer facilitates out-of-court settlements of more than a dozen shareholder suits challenging the compensation plans for Beatrice executives and the proposed takeover of the Chicago-based conglomerate. Kohlberg Kravis still will pay $40 in cash and $10 in preferred stock for each Beatrice common share under the new agreement, but the preferred's dividend will jump to 15.25% annually from the 14% announced in January. Golden parachutes for Beatrice's six top executives will be reduced from $23.5 million to $20.1 million. Beatrice also agreed to consider terminating the deal should the board receive a better offer.

MICROSOFT: CAPPING A SUCCESS STORY

William H. Gates III dropped out of Harvard in 1975 and started a company to write software programs for then-new microcomputers. Now his company, Microsoft Corp., in Bellevue, Wash., is going public. Chairman Gates, 30, the son of a prominent Seattle lawyer, will sell 80,000 shares, worth from $1.3 million to $1.5 million at the proposed offering price of $16 to $19 a share. That will leave him the owner of 44.9% of Microsoft shares with a worth of about $200 million. Co-founder Paul G. Allen, 33, will own 25.2% of Microsoft. It earned $17 million on revenues of $85 million in the first half, ended Dec. 31. Microsoft is trying to overtake Lotus Development Corp., which had $225 million in revenues last year, as the largest personal computer software company.

GATES: HOLDING A STAKE OF $200 MILLION IN MICROSOFT

UNDOING STEEL'S WAGE UNIFORMITY

The United Steelworkers opened negotiations on separate contracts with three of the nation's six major steelmakers. In exchange for early bargaining, LTV Steel, Bethlehem Steel, and National Steel agreed to join with the union in a campaign to persuade Washington to give major relief to the industry. The union also gave a special exemption to ailing LTV by allowing it to defer a wage and cost-of-living increase due on Feb. 1. Inland Steel and Armco are expected to join the union campaign, but U.S. Steel, the nation's largest and healthiest producer, has yet to set a date for early talks. The six producers are seeking concessionary pacts to replace contracts that expire on Aug. 1 and cover 145,000 workers. The negotiations are expected to result in the end of wage uniformity in the industry.

IBM WILL REBUILD UNITED AIR'S SYSTEM

United Airlines Inc. said the bulk of the $1 billion rebuilding of its Apollo reservations system will be spent on a computer network to be developed by International Business Machines Corp. The new system will improve the ability of travel agents to service large corporate accounts. It will also handle the internal business tasks of travel agencies, in effect providing an automated office for each. The system will use IBM hardware, communication networks, and software.

THREE INSURERS BOLSTER RESERVES

Three insurance companies admitted they underestimated future claims on property and casualty policies issued before 1985. Philadelphia-based Cigna Corp. charged $1.2 billion against fourth-quarter earnings to boost its property and casualty reserves by 28%. The charge, by far the largest taken by an insurer, will result in a 1985 operating loss of $853 million. After Wall Street reacted favorably—Cigna stock fell less than $1—Continental Corp., in New York, unveiled a $220 million charge against fourth-quarter earnings to bolster reserves. USF&G Corp., in Baltimore, followed with a $100 million charge against fourth-quarter earnings to prop up its reserves 23% to $3.2 billion. The charges reflect higher jury awards in liability suits, broader legal interpretations of policy coverage, and industrywide failure to set aside sufficient loss reserves. The industry is just now recovering from years of price competition and lower underwriting standards that also punished earnings.

The open season on insurance companies in courtrooms all over the country has gone on so long that the insurers can no longer afford to play. Are you ready for . . .

A world without insurance?

By Jill Andresky with Mary Kuntz and Barbara Kallen

A 41-YEAR-OLD bodybuilder entered a footrace with a refrigerator strapped to his back to prove his prowess. During the race, he alleged, one of the straps came loose and the man was hurt. He sued everyone in sight, including the maker of the strap. Jury award: $1 million.

Two Maryland men decided to dry their hot-air balloon in a commercial laundry dryer. The dryer exploded, injuring them. They won $885,000 in damages from American Laundry Machinery, which manufactured the dryer.

An overweight man with a history of coronary disease suffered a heart attack while trying to start a Sears lawnmower. He sued Sears, charging that too much force was required to yank the mower's pull rope. A jury in Pennsylvania awarded him $1.2 million, plus damages of $550,000 for delays in settling the claim. (Sears appealed but eventually settled out of court.)

Isolated cases of absurdly generous awards? Far from it. Last year the average product liability award in the U.S. was $1.07 million—up from $345,000 ten years earlier—and the average medical malpractice award was $950,000. In 1983 alone 360 personal-injury cases were settled with million-dollar awards or more, an incredible 13 times the number in 1975.

Americans now seem to look on a civil suit against a corporation or municipality as a kind of lottery—a lottery to be played whenever they can. Last year there was 1 private civil lawsuit filed for every 15 Americans. An estimated 16.6 million private civil suits were tried in state courts last year. Another 150,000 private civil suits were tried in federal courts, which is nearly twice the number ten years ago.

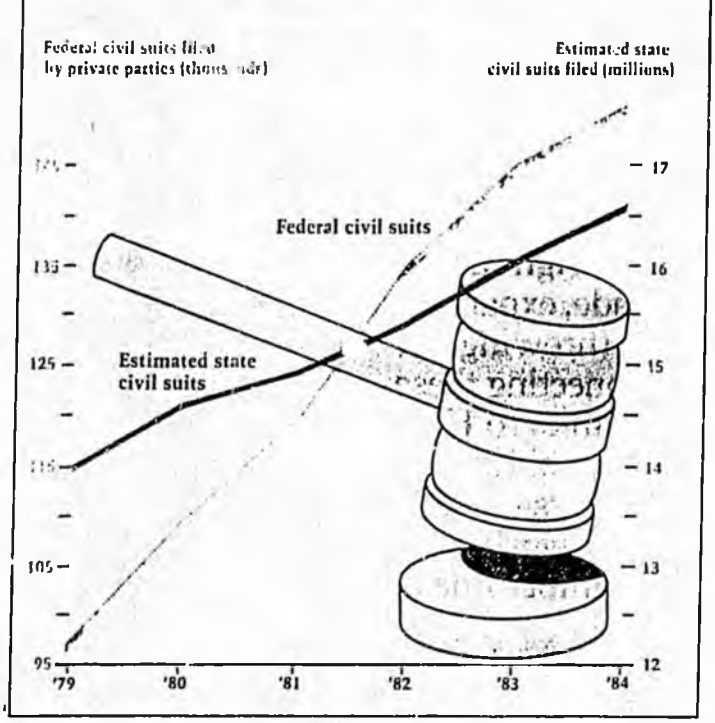
Just handling the paperwork probably cost taxpayers over $360 million on all these actions last year. It cost insurance companies far more. In 1984 the property and casualty insurance industry as a whole paid out $116.10 for every $100 received in premiums—the worst numbers since the San Francisco earthquake and fire. Reinsurers, who take the brunt of the unpredictable risks, paid out nearly $141 for every $100 in premium income.

No industry can keep that up for long. "It's impossible for insurance companies to price liability products when they have no idea what the settlements and risks are going to be," says David O'Leary, a Hartford-based insurance analyst with the London brokerage firm of Fox-Pitt, Kelton. "Courts have expanded the definitions of liabilities for accountants and other industries to such an extent that insurers have started saying, we don't need the business."

For example, obstetricians can now be sued for "wrongful birth" if, for instance, a sterilized woman conceives. Accountants can be sued under "third party liability" by anyone who might reasonably have relied upon numbers they audited. The list goes on and on, and why not? Insurers have been picking up the tab and covering costs in part through their investment income for so long

The litigation burden

There was 1 private civil lawsuit last year for every 15 Americans. And the beat goes on: Federal civil filings by private parties are up 50% since 1979, while state filings are up 20%.



that the system has taken on the look of natural law.

But insurers are not in the business of losing money. Their losses have become so appalling that at this point they are either raising their rates out of sight or getting out of the business. In April, Utica Mutual Insurance informed some 229 New York State municipalities that it would not renew their policies. Transit Casualty, a large carrier for restaurants in Connecticut, canceled most of that group's liability coverage. Mutual Fire, Marine & Inland Insurance announced it would not renew the malpractice policies of about 1,300 midwives as of July 3.

"I can't get any kind of coverage for sand-and-gravel and cement companies," says David Brennan, president of the Insurance Management Center, a Manchester, Conn. agency. "I've got one client who is a distributor of frozen chickens. Last year he paid $25,000 for coverage. This year I can't get anyone to even give me a quote. It's the same thing with an insulated-wire manufacturer, a fish distributor and even a group of nuns who own real estate as investment properties."

If they are willing to pound pavements, most business people can still find insurance. But they are paying vastly more for much lower coverage. One supermarket chain, for example, saw its average rates go from $8,000 per store a year and a half ago to $40,000 per store. Florida Power & Light's premiums for general liability coverage doubled in 1984 over 1983. The coverage provided was halved, $200 million instead of $400 million.

Pricey, but at least it got protection. For industries that have been especially hard hit by lawsuits, prospects have gotten much worse. Consider Acmat Corp., a $50 million (sales) asbestos-removal firm based in East Hartford. According to the firm, Cigna notified Acmat last December that all its coverage was being canceled because of its asbestos exposure. When Acmat protested, Cigna agreed to renew—so long as Acmat pulled out of the asbestos-removal business entirely. Acmat agreed, even though it meant "cutting our revenues in half overnight," says Henry Nozko Jr., executive vice president. But even that drastic measure failed to satisfy Cigna, which canceled the company's account on Apr. 1.

Nozko approached over 30 carriers, including Lloyd's of London. All turned him down. Finally, he convinced Great American Surplus Lines and three other firms to give him coverage. The price, assuming last year's volume of business: $6 million to buy $6 million of general liability coverage, including only $1 million of asbestos protection. That compares with $300,000 last year for $10 million of coverage. Why didn't he just bank that $6 million instead? "The policy gives us a worthless amount of protection, but we couldn't bid on public jobs without it," says Nozko.

A note on retributive justice: Now that legal-malpractice suits are becoming trendy, even lawyers are having a tough time finding coverage. Reuben & Proctor, an 80-member Chicago law firm, lost its coverage on July 1 from Crum & Forster's International Insurance.

The flight of insurers and reinsurers is most visible where the risks of winding up in a courtroom are great—both gradual and sudden-and-accidental pollution, directors' liability, municipal liability, medical malpractice and accountants' malpractice. "Our agent notified us a couple of months ago that everybody in our business was being canceled," says Irwin Singer, president of Atlas Oil Co., a fuel distributor. "They didn't care how good our safety record was. In fact, the very company that canceled our coverage complimented us on it."

In some cases, the retreat can be gradual. "Our normal general liability policy used to exclude all pollution, unless it was sudden and accidental," says Chuck Henry, a second vice president at Travelers. "Then the courts started saying in some cases that if the insured did not intend to cause damage, it was 'sudden and accidental'—even if it took years for the stuff to seep out." Now Travelers completely excludes pollution coverage on its general liability policy and will underwrite environmental hazard coverage only at restricted levels and only for customers who also buy Travelers' general liability policy.

Even such restrictions aren't enough for some insurers. Since the beginning of the year frightened insurers have been pulling out of property and casualty lines like the British army at Dunkirk.

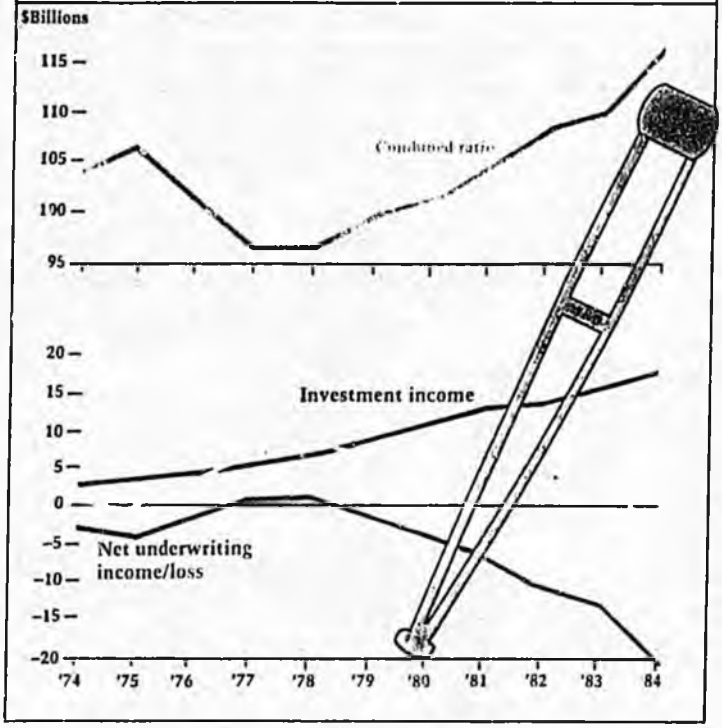
Property and casualty insurance has always been a boom and bust business, but the bust has never been this bad. Blame part of it on greed. After five years of cash-flow underwriting—that is, pricing products at a loss in underwriting terms in order to bring in extra dollars to invest at once-tempting interest rates—the industry has hit rock bottom. Last year it recorded a pretax loss of $3.8 billion.

Face it: There's no way that the insurance industry can fully recover from its current downswing until Congress—or state legislatures—step in and impose order on our self-destructive legal system. Pennsylvania has already made a start with legislation that curbs pain and suffering awards from municipalities. But it's only a start. Remedies in law will not become effective overnight.

In the meantime, property and casualty insurance is going to become much tougher to get, at any price. For example, insurance agent David Brennan expects that by September none of

A road to disaster?

For 8 of the last 11 years, property and casualty insurers have paid out more than they have gotten in premium income. Investment income had offset that worsening combined ratio until last year.



13 insurers he does business with will be willing to write new commercial policies for anyone.

Companies will have to scramble for any type of coverage they can find. By far the most common strategy is to accept limits on coverage—higher deductibles, lower protection levels and, increasingly, exclusions for items such as legal defense costs and pollution liability. "We're paying more than double what we used to pay and we still haven't been able to replace all the coverage we lost," says Singer of Atlas Oil Co.

Insurers have also started pushing "claims-made" policies, which pay off only those claims filed during the policy term. Supporters of these insurance straitjackets argue that they will help insurers define their legal risks better and thus enable them to keep selling their products. But many are dubious. "Claims-made policies just postpone the problem," says Jon Harkavy, director of governmental affairs at the Risk and Insurance Management Society.

The last resort, of course, is self-insurance, either setting up a reserve fund to cover uninsured costs or, more commonly, paying them out of operating expenses. "Corporations of our size can afford to self-insure up to certain levels," says General Foods' risk manager Peter McDonough. "But that's not going to solve any of the major problems with the system."

Some companies are again setting up insurance captives, as they did in the mid-1970s. But captives are not very attractive from a tax standpoint (FORBES, *Nov. 19, 1984*), and they are risky to boot. Says O'Leary of Fox-Pitt, Kelton: "Many companies that set up captives ended up losing so much money that they have for the most part withdrawn."

But some see self-insurance as a curb on litigation. "I hope we're moving to the age of self-insurance," says Irving S. Shapiro, former chairman of E.I. Du Pont and now a partner at Skadden, Arps. "Once lawyers realize they're suing a defendant who doesn't have an insurance firm with deep pockets beyond them, they'll sue somebody else." Unless, perhaps, the company is as big as Du Pont.

For companies that aren't as big as Du Pont—and even for some that are—self-insurance today carries the risk of being pushed into Chapter 11 tomorrow. Shapiro's solution: a federal disaster-insurance fund for corporations, similar to the federal flood-insurance program. But wouldn't such a pot of gold be even juicier bait for plaintiffs' lawyers?

Marsh & McLennan is testing its own version of disaster relief—a stock insurance company for big firms known as ACE, for American Casualty Excess Insurance. ACE will provide the final $100 million in coverage—excess of at least $100 million in self-insurance or policies. Eleven firms have jumped at the opportunity to join up—but that's out of the reach of many companies.

Industry insurance pools are popular with utilities, lawyers, accountants, fuel distributors and others. Of course, the exposure for any insurer of a single high-risk industry is enormous, even when only claims-made policies are sold. So some companies, instead, try to spread their risk by setting up multi-industry insurance pools. Result: High-risk companies, again, are out of luck.

The fact is, the problem cannot be dealt with solely from the insurance side of the equation. It must be approached from the legal side. So long as judges keep expanding the definition of liability and juries keep handing out astronomically high awards, the chilling prospect of a world without insurance draws ever closer.

One simple but unpopular solution would be to prohibit—or at least severely limit—the contingency fee system that encourages lawyers to seek the highest possible damages. "You don't see any other country having the kind of insurance problems that we have, because none of them have the kind of jury awards or contingency system we've got," says James Corcoran, New York State's superintendent for insurance.

But there are problems with such a move. "We may be the only country that really has a contingency fee system," says F. Lee Bailey, a member of the three-lawyer consortium representing the Bhopal victims. "On the other hand, in most of the world, poor people go without any relief."

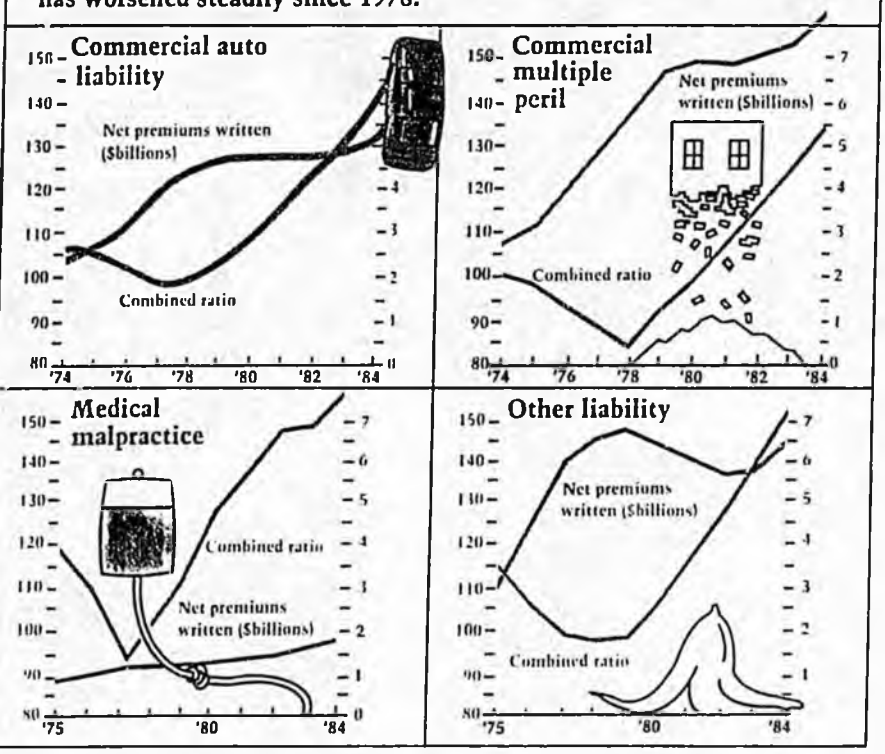
In the long run, maybe the only practical solution is legislative action to define liabilities and cap them at a fair and reasonable level. In New York, where obstetricians and neurosurgeons are turning away patients because of high malpractice insurance rates and where municipalities are scrambling for coverage, legislators have debated bills that attempt to cap liabilities for doctors and municipalities. Congress has contemplated a proposal by Senator Robert Kasten (R–Wis.) that would put a limit on corporate liabilities.

No longer do we have the luxury of pretending that the monster we have created will just go away.

It won't. ■

Losing propositions

In four big commercial liability lines, insurers paid out from $135 to $160 for every $100 of premium income taken in last year—a trend that has worsened steadily since 1978.



Seattle Post-Intelligencer
THE VOICE OF THE NORTHWEST SINCE 1863

EDITORIALS

Hold horses on insurance

There's no question that this state's insurance-liability or tort laws need revision to put the brakes on runaway damage awards and out-of-court settlements. Insurance rates have soared to astronomical heights in some areas of coverage, such as medical malpractice, and in some categories have become prohibitive.

The problem is described as a crisis. That may be no exaggeration, but the legislative response ought to be carefully considered, not rushed, and based on solid and reliable data.

While a formidable liability-reform coalition — composed of local government agencies, physicians, child-care organizations, school districts and large corporations — is pressing the new session of the Legislature for immediate legal revisions, a new state task force was named this week to gather more information and to review the many factors involved including insurance company profits and losses.

Retired King County Superior Court Judge Francis Holman, a widely respected jurist and lawyer, is chairman. Members, appointed by State Insurance Commissioner Dick Marquardt, are three lawyers who specialize in defending against liability suits and three whose speciality is representation of plaintiffs or damage claimants. Creation of the task force was suggested by a bipartisan legislative committee last year after a series of hearings throughout the state. It was decided that more hard information is needed, before state laws are revised, and the task force was proposed as the vehicle for obtaining it.

Key issues the task force will address are limits on non-economic damages — awards for such nebulous items as pain and suffering and mental anguish; the payment of awards over time rather than in lump sums; limits on the proportion of damages that can be assessed against secondary defendants, such as cities and counties, when primary defendants are unable to pay, and limits on contingency fees charged by claimants' attorneys.

It may be that this session of the Legislature can begin the process of reform by correcting the most glaring deficiencies in state laws, although some lawmakers have expressed dismay over a lack of credible data on which to base their decisions. Before sweeping changes are enacted, the Legislature would be wise to await recommendations of the newly appointed task force.

by MORTIMER B. ZUCKERMAN
Chairman and Editor-in-Chief of *U.S.News & World Report*

THE NATIONAL LOTTERY

An epidemic of costly litigation is sweeping the country, and the time to halt it is now.

Witness the efforts of lawyers after any disaster, such as an airplane crash or the tragedy at Bhopal, India. They rush to the scene and descend upon the distraught survivors and relatives. They rent movie houses and auditoriums to make their pitch for clients. In law offices all over the country, lawyers are hard at work finding and convincing people to file suit. It used to be that lawyers tried to persuade their clients to settle disputes. No longer.

The pot of gold for lawyers is a huge fee or a participation of up to 50 percent in court awards. Staggering court awards in cases whose results seem to violate common sense have made it worthwhile for the lawyers. Recently, a man attempted suicide by jumping in front of a New York subway train. He sued the Transit Authority because the train stopped in time to save his life but not quite soon enough to avoid some physical damage to him. He collected more than $600,000.

And what about the tenant, celebrating his birthday on a Sunday afternoon, who drowned when he drunkenly tried to walk along the bottom of his apartment-house swimming pool in the full view of his wife and 15 close friends? His wife successfully sued the landlord's insurance company.

The result? Soaring premiums for liability insurance to cover this increased and indeterminate financial exposure. Legal costs and insurance have become an increasing component of the price of goods and services. Even the availability of some consumer services is being curtailed.

Personal-injury awards, especially jury awards, are out of touch with reality. They are often based on estimates of how much money the defendants have rather than whether they are at fault. The awards have become a means to redistribute wealth rather than a measure of fault or a deterrence to undesirable conduct. It may appear to a jury that an insurance company, individual, corporation or government with "deep pockets" is paying the claim. The truth is that millions of "little pockets" are actually paying the cost either through higher prices for products and services or through higher insurance bills.

It is time to re-examine the manner in which the nation's judicial system deals with injured parties.

First, a method must be developed to tilt the judicial system against increased litigation. One approach would be to compensate a successful defendant for the cost of the defense against an unsuccessful plaintiff. The obvious benefits would be a more serious and thoughtful analysis of a claim prior to bringing a lawsuit and a reduction in the number of frivolous claims. It would also bring pressure to bear on achieving a reasonable settlement of the matter prior to running up large legal fees.

Second, the states should follow the example of California in limiting contingent fees to lawyers. These fees theoretically balance economic power for those who cannot afford the cost of bringing a case on an hourly basis. In practice, however, contingent fees have fostered an atmosphere of a no-cost lottery for clients. The California bill caps the contingency fees at 40 percent of the first $50,000 of the settlement, ranging downward to 10 percent of any award above $200,000.

Third, damages awarded for "pain and suffering" and other noneconomic losses should be capped. California has set a limit of $250,000, controlling the awards in medical-malpractice suits for such vague matters as grief, mental distress, etc.

One of the great principles of American jurisprudence has been access to justice through the court system. But the right to swing your arm stops at the point of another man's chin. The right to access to the courts must not be permitted to bury our society under a mountain of legal pleadings that raise insurance bills for all. To permit this abuse is to turn the courts into a national lottery in which the winning names are the lawyers and certain plaintiffs who are picked by judges and juries, while each of us, every day, is the loser. ■

MALPRACTICE BATTLES
Surgeon Donald Stewart has fought off six suits

BARTENDER RISKS
High premiums forced Washington, D.C., bar owner Jim Stiegman to go without insurance

HOMEOWNER WOES
Helene Harris's pet nearly cost her insurance coverage

Sky-high damage suits

The impact on consumers, business and professions

■ A seriously injured California gymnast wins $14.7 million in a suit against an exercise-mat manufacturer.

Half of the 10 doctors doing obstetrics work in Montrose, Colo., stop delivering babies when insurance rates soar.

A New Jersey couple must pay $72,500 to a woman hurt when a man who had been drinking at the couple's home smashes his truck into her car.

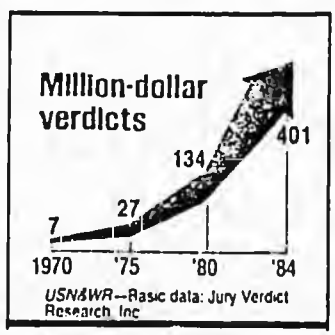
In Minnesota, a farmer cancels a live Nativity scene when an insurer asks a $540 premium in case someone is injured by a donkey and horses carrying Mary and the Wise Men.

It seems that everyone is liable these days. Juries return costly verdicts against homeowners, million-dollar awards against professionals and huge assessments against manufacturers. A new national study by Ohio-based Jury Verdict Research, Inc., reports the dollar amount of awards in personal-injury cases up 15 percent in 1984. Courts issued 401 verdicts exceeding $1 million that year, the latest for which statistics are available. A sampling shows liability suits filed in state courts jumping by 20 percent or more over seven years, according to the National Center for State Courts.

"We are in the midst of an unprecedented liability crisis," says Barry Bauman of the U.S. Chamber of Commerce. To cope, insurance firms have been raising premiums sharply since 1984—sometimes by 1,000 percent or more at a clip—drastically reducing coverage and sometimes pulling out altogether. Companies in turn are abandoning lines of business, operating without insurance or hiking prices of products to cover premium costs. "Companies don't pay the cost of product-liability suits—consumers do," says Martin Connor, Washington, D.C., attorney for General Electric Company. Manufacturers say 20 percent of the cost of a $25 stepladder goes to insurance. A similar proportion in the airplane industry was one reason Beech Aircraft Corporation quit making a small training aircraft.

Meanwhile, o' sietricians and surgeons are walking away from their practices rather than paying insurance premiums of up to $50,000 or more a year. States, cities and school districts spend large sums to satisfy judgments and drop risk-laden services such as recreation programs.

The turmoil springs from changes in the law and society. No longer is the decisive question whether the party sued—the defendant—negligently harmed someone. The question now centers on how much the plaintiff ought to be compensated for injuries. Judges constantly expand "common law" to create new grounds for suits, and citizens in a more impersonal world look to courts to solve problems. They are aided by a corps of 700,000 lawyers—roughly 1 for every 350 Americans—who collect some $55 billion a year in fees. The spread of liability insurance also has led to a mind-set that no one really gets hurt by the barrage of suits since insurers will pick up the bill.



Critics contend that the system has gone out of control. Richard Willard, chief of the Justice Department's civil division, charges that some judges and lawyers are utilizing the courts in such a way as "to restructure

◄ Dr. Daniel O'Keeffe, far left, no longer deliv ers babies and com- plains about "practicin with a gun at your hea

◄ Consumer advocate Ralph Nader says rate hikes for liability insurance amount to a "ripoff"

► Doctors, trying to avoid litigious patients can check computer fil of malpractice claims

society and administer a massive scheme for the redistribution of wealth."

Trial lawyers and consumer spokesmen such as Ralph Nader argue that the problems spawned by expanded liability have been exaggerated. The real villains, they say, are property and casualty insurers who are trying to use an attack on the courts to line their own pockets. "What we are witnessing is a manufactured crisis, intended to bloat insurer profits and reduce victim rights," contends J. Robert Hunter, president of the National Insurance Consumer Organization.

Some consumers argue, too, that the spurt of damage claims serves as a warning that providers of goods and services must maintain high standards—or suffer the consequences. "The liability system ought to hurt. It ought to encourage people to modify their behavior," says Gary Schwartz, a law professor at the University of California at Los Angeles.

Whichever side is correct, liability will be a major issue this year in Congress and many state legislatures.

Liability's lengthening shadow

Anyone from Uncle Sam to Uncle Harry is open to suit, now that the mood of society is to seek a culprit for all of life's mishaps.

A New Jersey court said merchants could be held liable if a customer's dog bit another patron, and a Philadelphia insurer, fearing legal action over an allegedly vicious dog, threatened cancellation of Helene Harris's homeowner's policy. A Maryland court held that handgun makers could be forced to pay damages resulting from a shooting. A California policeman agreed to pay damages when the woman who bought his house complained he hadn't disclosed five murders committed there 12 years earlier. After a man flying on a charter flight made a mock announcement that the plane would crash, a passenger won damages in Minnesota for emotional distress.

Employes injured on the job, no longer satisfied with workers' compensation, now often sue not only their employers but also the makers of the equipment involved in the accident. Companies complain that they are caught in a bind when faced with a claim over machinery made years ago that may have been altered or poorly maintained. "How do you design something to last forever?" asks Gary Bell, product-safety administrator of Toledo-based DeVilbiss Company.

Lawsuits over industrial machinery are just a tiny part of a vast arena of litigation. The number of product-liability suits filed in federal courts has jumped from 1,600 in 1974 to 13,554 last year. A major source of product-liability cases is chemicals and drugs said to cause harm that may not be detected until years after exposure. More than 30,000 damage claims for lung ailments and cancer allegedly caused by asbestos have piled up around the country. Millions of dollars in damages already have been paid out, and the threat of other pending cases has sent the huge Manville Corporation into a bankruptcy reorganization.

Filing a similar bankruptcy claim was Virginia-based A. H. Robins Company, which has set aside $1 billion to satisfy claims by 15,000 women over damage caused by the intrauterine contraceptive device called the Dalkon Shield.

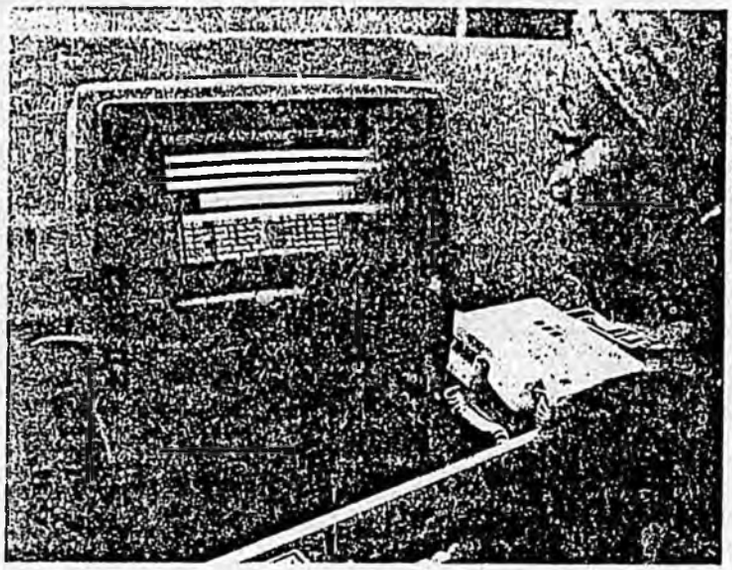
For professionals: A malpractice meat grinder

Major corporations usually have vast resources to draw upon in combatting the litigation wave, but few doctors, lawyers, accountants or other professionals dragged into court have that cushion. Malpractice claims against physicians have more than doubled in a decade, reports the American Medical Association. Although more than half are dismissed, there have been 367 verdicts of a million dollars or more against doctors over the years, and the average settlement costs defendants $330,000. Malpractice-insurance premiums exceed $2 billion annually.

The irony is that improvements in the quality of care can encourage lawsuits. Defense lawyer James Ludlam of Los Angeles notes that "infants with severe brain damage who would have died three years ago now live, but the parents—or society—are faced with lifelong care. I can't think of anything more expensive."

Obstetricians in New York State saw their malpractice premiums increase by an average of $21,635 last year, amounting to 16 percent of their gross income. Some have decided to quit. After four suits were filed against him, obstetrician Daniel O'Keeffe of Glens Falls, N.Y., said enough was enough. He hasn't lost a case, but, O'Keeffe says, "I decided that at age 64 I did not wish to expose my personal assets and life savings to a mishap that would wipe me out. There is also the emotional factor: Practicing with a gun at your head."

Syracuse neurosurgeon Donald Stewart has successfully defended six suits in 15 years. He is dismayed by the expectations of today's patients, recalling one 16-year-old boy who remarked to his father during an examination, "Think how much money you'd get if he screws up."



To sniff out proclivities toward suing, some doctors are attempting to screen their patients. In Los Angeles, some now use a computerized service called Physicians' Alert to identify patients who have filed malpractice claims. Tit for tat, lawyers are setting up a hot line warning patients about the lawsuit records of doctors.

Trial lawyers argue that malpractice litigation reflects rising medical negligence. But a recent study by a Pennsylvania committee comprising doctors and lawyers laid the problem to a combination of things, including an inability by the medical profession to discipline repeat offenders and excessive damages awarded in a few cases.

When lawyers aren't suing other professionals for malpractice, they may be defending themselves against it. In October, a court affirmed a $26 million judgment for actress Doris Day in a suit accusing her former attorney, Jerome Rosenthal, of an investment and legal-fee swindle. More-typical suits allege foul-ups such as failing to pursue worthy cases and missing deadlines for filing court papers.

No profession seems immune, from accountants and architects to teachers, therapists and even clergymen. The Big Eight accounting firms paid nearly $200 million in the past five years in malpractice suits and face $2 billion more in claims. A San Jose, Calif., minister faces a $5 million suit by a woman who charges that he violated her privacy by disclosing her confession that she had embezzled church funds. Last year, the Vermont Supreme Court held a therapist liable for the burning of a barn by a patient who had told her he wanted to get back at his father. The court said she had a duty to protect third persons.

Legal theory opens the floodgates

The big verdicts stem almost in equal measure from a loosening of standards for proving liability and the ever growing resourcefulness of lawyers in finding new places to collect damages. Rules that shielded defendants from liability have eroded as judges have given persons filing suits the benefit of the doubt. At the same time, the growth of insurance has encouraged juries to award huge sums in the belief that someone else will end up paying the bill.

Plaintiffs now win damages by linking products to health problems even when there is no proof that the products caused harm. Thousands of Vietnam War veterans charged

NEIGHBOR VS. NEIGHBOR

From playmate to plaintiff

Staten Island, N.Y.

What started as a pleasant summer day of child's play in 1972 at Morris and Rosalyn Friedman's house turned into a nightmare of lawsuits that lasted a decade.

Neighborhood children had a standing invitation to play with the Friedmans' five children in the back yard of their modest, ranch-style home. One of the visitors—9-year-old Sylvia Ashwal—was being pushed on a swing by playmates Deborah and Lisa Rosenberg when somehow she broke her leg. Rosalyn Friedman took her to a hospital and thought the episode would be forgotten.

But three years later, the Friedmans were surprised to be cited in a lawsuit. "We were shocked," remembers Morris Friedman. "We had thought things were over and done with."

The Friedmans weren't the only ones sued. The Rosenberg children also were named, as were Sears, Roebuck, which sold the swing, and Turco Manufacturing Company of Illinois.

From the vantage point of Joseph and Eva Ashwal, seeking recompense for their daughter's injury became the logical option when the fractured leg stopped growing. Even an operation on her good leg couldn't prevent a limp and back problems.

"I was in pain all the time," Sylvia says. "I still can't sit or stand very long. I get fidgety and have a lot of back pain."

The pretrial maneuvering dragged on. Sylvia's legal team—led by New York trial lawyer Fred Queller—contended that the swing was so poorly designed that Sylvia's leg easily became caught between the seat and a platform below.

Turco and Sears both countered that the accident was Sylvia's fault: She was standing up when she shouldn't have been and fell down. The Friedmans and the Rosenberg children maintained that they didn't cause the mishap.

In the end, an accident that occurred in seconds took three weeks to sort out before a jury in November, 1984. The verdict: $2.5 million for Sylvia, mostly to cover medical care. Turco was ordered to pay 80 percent, Sears 20 percent. The neighbors were cleared. To avoid a long and costly appeal process, the companies chose to settle the matter last summer by paying the Ashwals $1.35 million—a third going to attorney Queller.

Suit over backyard injury shocked the Friedmans

The defendants regard the ordeal as Exhibit A of modern-day litigation run amok. Friedman, who worried about losing his home if a verdict exceeded his $100,000 insurance policy, says, "I now carry a $10 million policy. I don't take chances any more."

James Lysaught, attorney for the Rosenbergs, says they had to endure "the horror of the incident and the horror of being sued."

Harold Berel, Turco's lawyer, believes the many years it took to bring the case to trial made jurors sympathetic to the injured plaintiff. As for Sears: "It was an outrageous verdict," says attorney Suzanne Hyer.

by Dan Collins

that the defoliant Agent Orange had caused birth defects in their children. Chemical firms agreed to pay $180 million even though the judge noted that there was no conclusive evidence that the chemical was responsible.

Others are found at fault, in effect, just for being in a particular line of business. In Michigan, for example, 16 drug firms have agreed to share in payments to 240 women who suffered abnormalities because their mothers took a drug called DES years earlier. Too much time had elapsed to determine which firm made the DES taken by any individual, so all the companies were dragged in. "The plaintiff can sue the bunch, and it's up to them to prove they weren't involved," says Detroit lawyer Charles Nichols.

Workers in chemical plants are winning claims based solely on the fact that the risk of becoming ill has increased. Employes of firms where asbestos was prevalent have won cases alleging that their chances of contracting serious lung ailments are much greater, even if they do not suffer now. Some lawsuits charge that the fear of becoming ill is so terrifying that recompense is warranted.

A statute aimed at organized crime—called the Racketeer Influenced and Corrupt Organization Act, or RICO—provided litigation fodder when lawyers discovered its language is so broad that suits can be filed against just about any corporation if they claim a pattern of illegal activity such as fraud. Triple damages are authorized—a payoff that has encouraged thousands of claimants to march into court. Few judgments have yet been awarded, but suits are pending against such firms as Shearson Lehman Brothers and Price Waterhouse.

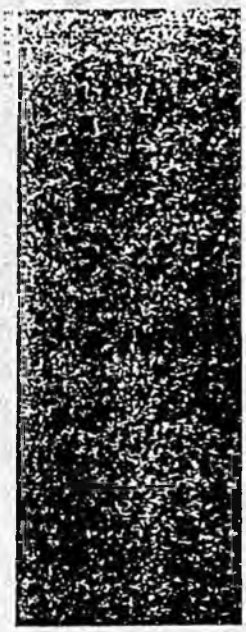
Personal-injury lawyers also are adept at finding "deep pockets" with resources to pay big judgments. With a campaign against drunk driving gathering steam, the number of cases being pursued against bars and restaurants over damage caused by intoxicated patrons has gone up 300 percent in the last year, reports Massachusetts lawyer Ronald Beitman. Laws in 35 states hold liquor purveyors liable for such injuries. Last year, insurers of a Clarkston, Mich., café agreed on a $1 million settlement to families of three teenagers killed in an auto accident with a cafe patron. Noting that insurance costs have tripled in the last year, café owner Don Hayes says he now cites the case when refusing drinks to tipsy customers.

Supreme courts in Iowa and New Jersey have gone a step further by holding private hosts liable for injuries caused by guests, and the Michigan Supreme Court held a bar responsible for a patron's death in a car crash.

High crime rates have spawned suits by victims against hotels, apartment landlords and stores blamed for providing inadequate security. Spurred by the $1.5 million award that singe nie Francis won from a motel where she was raped, s cases are so widespread that they produced more tha million in damages in the last three years, reports V lawyer Frank Carrington.

Whenever new concerns develop in society, they end up in court. The latest example is AIDS. An lover of the late actor Rock Hudson has sued his es the ground that Hudson failed to disclose that he h deadly disease. Suits also have been brought against p for spreading herpes and other infectious ailments.

Another rapidly expanding tactic is to go beyon pensation for actual harm—such as payment for m bills and missed work—and to demand damages fo tional distress. States for years have allowed money



Agent Orar

Before you file suit . . .

Another motorist hits your car, sending your child against the windshield. The bill for medical care: $6,500. Your lawyer promises a hefty recovery, but discussions with the other party's insurance representative go nowhere. You're tempted to go to court, but your child may be in college before you recover a penny. Then, too, because of legal costs involved, it often does not pay to pursue in court a claim of less than $10,000. Just what are the alternatives?

In 22 states, no-fault auto insurance eliminates most auto-injury litigation and provides more compensation faster. In 16 states, your case, as well as other civil disputes in which damages are under $15,000-$25,000, probably would go to an arbitration proceeding with your right to trial preserved if you didn't accept the award.

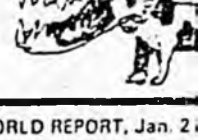
If the other driver were uninsured, your policy might call for a hearing by the American Arbitration Association. The group also promotes mediation of auto-injury disputes and reports settlements in 90 percent of such cases. In other states, such as Illinois, court-appointed mediators steer both sides toward a settlement.

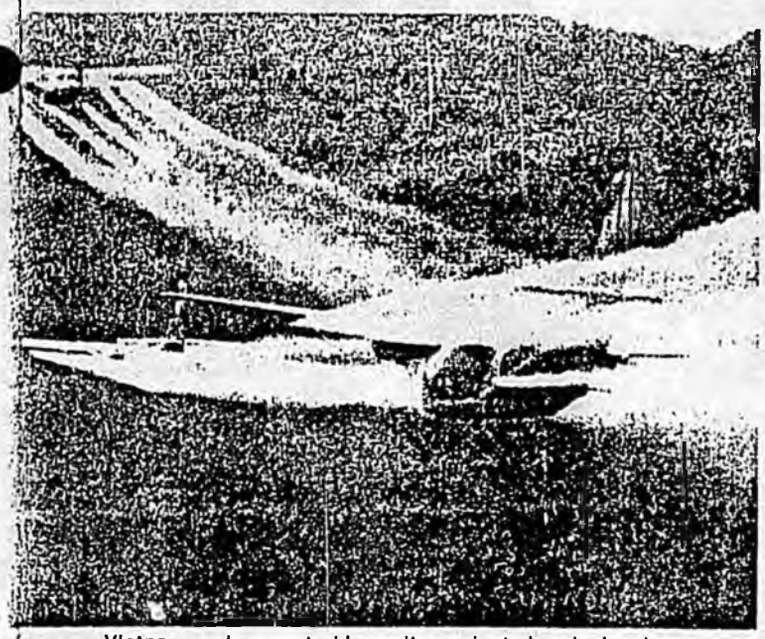
Private firms, such as EnDispute of Washington, D.C., offer another option. For a $200-to-$425 fee per party, the company will help arrange a private, voluntary settlement conference before a neutral adjudicator, usually a retired judge. Federal District Court Judge Thomas Lambros of Cleveland has designed the "short jury trial"—copied elsewhere—featuring a half-day trial before six jurors, who hear arguments from both sides with no live testimony by witnesses. Most parties settle on the basis of the jury's advice.

If you get sued . . .

As often as not, people are caught by surprise when a liability suit hits. Some guidelines for action:

- Call your insurance agent immediately, since your auto or home coverage is your first line of defense.
- Don't talk to the plaintiff's lawyer. You could make mission damaging to you Report any contacts by t er side to your insurer.
- Keep any notes or that you may have taken time of the incident lea the suit. If it was an aut dent, get as much infos as you can about the and cars.
- If you have no insura your insurance does not the matter for which you ing sued, you need to hi own lawyer. Ask friends a sociates for their recomm tions and interview you spective lawyer, disc





Vietnam and prompted lawsuits against chemical makers

for "pain and suffering," a term encompassing a victim's anguish that is not reflected in a doctor's bill.

Now, it is common for lawsuits to make claims for mental harm resulting from a mishap even if the plaintiff was not injured. Family members are suing over the trauma of witnessing an accident in which a loved one was killed or injured. The Ohio Supreme Court ruled that a claimant need not even be at the scene. Suffering distress over a family member's fate may be enough to sue those responsible.

A change of attitudes in society

Why do new theories win such support? One reason is that Americans have become more insistent on finding remedies whenever anything goes wrong. "People want to get back at whoever they perceive is the cause of injustice," says Bruce Wackowski of the Research Institute of America.

In years past, people tended to resolve disputes informally, whether the argument was with the corner dry cleaner or the family doctor. In today's more complex and more mobile society, there are more demands that the law settle disputes in all facets of life. Big damage awards and new remedies create fresh demands. "At the end of the process, what people come to expect is a higher level of justice—social justice, life justice," says Prof. Lawrence Friedman of Stanford University Law School in a new book, *Total Justice*.

In situations where many used to accept adversity, the first move now is to call a lawyer. Legal help is easier to get these days than ever. With an explosion of the lawyer population has come a scramble for business that often includes newspaper and broadcast advertisements or mail solicitations. Also, notes Professor Schwartz of UCLA, "the ability of plaintiffs' lawyers to prove their cases has greatly improved, and in mass injury cases they have learned how to collaborate."

Leading the campaign for expanded liability concepts is the Association of Trial Lawyers of America, a Washington-based organization of 60,000 attorneys for plaintiffs. The group helps lawyers exchange tips on promising subjects of lawsuits and techniques to win them. A convention the group is holding in late January features such programs as "the expanding responsibility of hospitals" and "enforcing landlord's duty to protect tenants from crime."

The largest legal group, the American Bar Association, also supports the way courts handle personal-injury suits. An ABA committee last year praised the "resilience" of the law in responding to social change, a development credited in part to "imaginative lawyering."

To critics, some of this innovation is reaching absurd proportions. They cite a suit by a California tree trimmer who charged that eating Hostess cupcakes and similar products had given him "toxic-junk syndrome." A Pennsylvania mother whose baby choked on peanut butter alleged that the makers should have warned of the danger to infants.

Legal scholars note that what may seem farfetched now may be routinely accepted later. "A black's

your case and the fees. Lawyers typically charge $50 to $150 an hour to defend personal-injury cases. If the case goes to trial, expect to pay upward of $10,000.

An ounce of prevention, however, can save you a fortune. For example:

- Consider buying "umbrella" liability insurance that would kick in after your auto or homeowner's policy limits have been reached. Such coverage is relatively inexpensive—$80-$120 annually for a million-dollar policy—and covers both home and auto-related incidents.
- Use vigilance and common sense. Inspect your property for hazards. If your child invites friends over, you're responsible for their safety. If you serve cocktails to guests, you could be liable if they drive drunk and have an accident. And keep your animals under control. The "one free bite" allowed by law in many states is fading fast.

Take a bureaucrat to court

Gloomy reports of government red ink haven't stopped many people from viewing the bureaucracy as a rich target. Here are three recent cases.

- A disabled weather buoy off Massachusetts failed to send a storm warning. A judge ordered the U.S. to pay $1.2 million to families of fishermen lost in the maelstrom.
- Police in Torrington, Conn., didn't step in to prevent an estranged husband from beating his wife. She sued the city and won nearly 2 million dollars.
- A speeder in Antioch, Calif., hit a light pole. An injured rider argued that the pole should have broken on impact and won a $400,000 settlement.

A key reason for the trend is a series of court rulings and laws reducing immunity from suits that government long has enjoyed. As a result, states and cities face huge insurance-premium increases. Oak Park, Ill., schools now pay $24,303 annually, four times the price two years ago. Plymouth, Calif., closed its swimming pool and fired its two-person police force for fear of lawsuits.

In the face of premium hikes as high as 1,100 percent, 32 California cities now insure themselves. Cities in nine states have organized insurance pools to share the risk.

At the federal level, claims against agencies total $277 billion, including thousands of cases of World War II shipyard workers exposed to asbestos.

Liability insurance bills

Typical annual premiums—

- Big Eight accounting firm in New York, $5 million
- Wisconsin dairy, $1.5 million
- Illinois bank, $1 million
- California law firm, $700,000
- Georgia engineer, $24,000
- Maryland surgeon, $17,000
- Pennsylvania auto-body shop, $13,000

charge in 1950 that segregated schools were unconstitutional would have been considered frivolous," remarks Prof. Ronald Allen of Northwestern University Law School. Others point to the asbestos cases, regarded as questionable when they were first filed two decades ago. Now, they are threatening the financial health of major corporations.

Lawyer Melvin Belli has earned fame in injury cases

In the jaws of a money machine?

Defendants are quick to scoff at any notion that a higher justice is being served by the liability crunch. They see themselves as victims of a system geared more to encourage giant verdicts than to weigh fault. The public seems to agree. A new Roper survey found that nearly half of Americans believe that courts tilt toward injured persons. About one third believe the system is fair to both sides. Only 5 percent say defendants have the edge.

Most businesses and professionals insist they will compensate persons they harm. But they assail unpredictable behavior of judges and juries, and a costly and time-consuming legal system that may force them to settle cases even when blameless—driving up insurance rates.

At dozens of White House conferences around the nation on small business, liability has emerged as "just about the biggest issue," reports coordinator Robert Leitao. In Willard, Ohio, Glen Ward was forced to run his Thundering Wheels Skating Arena "bare" after his insurance expired in December. Although Ward has never been sued, the lowest rate he could obtain was for $17,000, more than seven times his old price. In Des Moines, Iowa, Dwayne Van Oort reports that profits in his Northwest Erection Services construction business have been "wiped out" by a $250,000 increase in insurance premiums. Van Oort is tacking 5 percent onto current bids to cover the added costs. "Liability insurance is not a luxury item but a necessary expense," says Frank Swain of the Small Business Administration, who predicts that some firms will reduce payrolls or limit expansion to pay the bill.

Are these big bills warranted? Many consumer advocates contend that they are not. "It's a staggering ripoff," says consumer activist Nader, who insists that when items such as capital gains and tax credits are factored in, the industry made a $5 billion profit in 1985, a year in which insurance stocks rose by more than 50 percent.

Insurers declare that the increases are justified, pointing out that property and casualty firms reported record pretax operating losses of $5.5 billion last year. The industry is in "rather fragile financial condition," contends Mavis Walters of the Insurance Services Office.

To keep big verdicts from driving rates still higher, defendants are fighting lawsuits with a variety of tactics, chief among them an aggressive stance in court. For example, a Tennessee judge and a California jury were convinced that cigarette makers were not to be held accountable for smokers' illnesses.

Losers often appeal and get big verdicts tossed out. A Yale University study found that U.S. appeals judges void lower-court judgments in nearly half the cases. Over all, reversals do away with 51 percent of verdicts favoring plaintiffs but only 20 percent of defendants' verdicts.

Another tactic is to sue insurers for "bad faith" in jacking up premiums or refusing to pay claims. In one such case, insurers wouldn't pay off after a fire at the MGM Grand in Las Vegas killed 87 and injured hundreds. The hotel and victims recovered $76 million in a settlement.

More businesses and professionals are forming their own "captive" insurance companies. Nurse-midwives, whose underwriters abandoned them, will open one such firm in April. A consortium of 33 corporations, including IBM, General Electric and Shell Oil, is doing likewise. But success is not guaranteed. Some "bedpan mutuals" created by doctors in a malpractice crisis a decade ago are now close to insolvency.

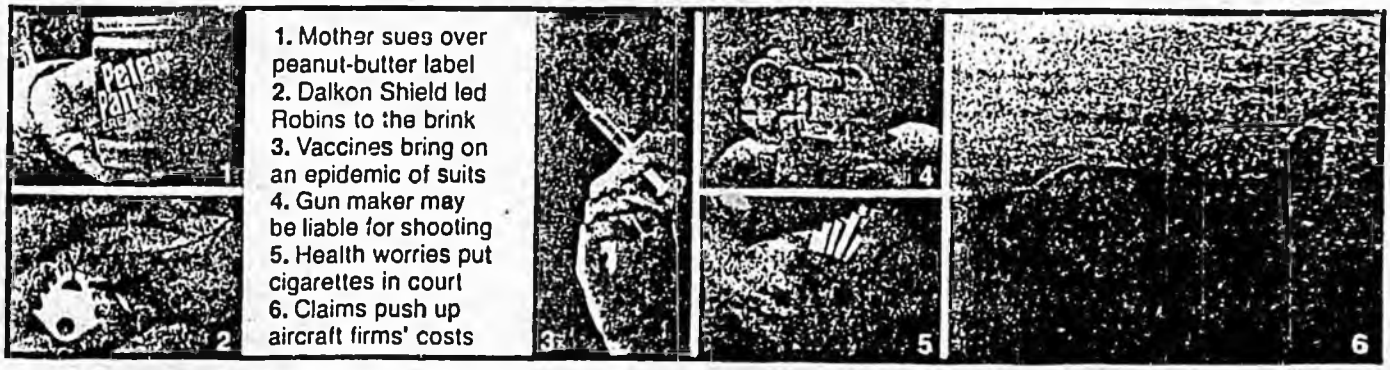
The search for solutions

When insurers, businesses and professionals aren't litigating, they are lobbying. They have massed to storm Congress and statehouses, seeking an array of changes in the law.

Capitol Hill debate centers on a plan to set national rules for product suits. A Senate panel deadlocked over the bill last year after trial lawyers opposed it. A new version stands a better chance. It gives victims the option of collecting damages out of court without proving a firm at fault and is backed by consumer groups who say the first bill favored business.

Most of the furor is erupting in the states. Says Colorado

Targets of legal opportunity



1. Mother sues over peanut-butter label
2. Dalkon Shield led Robins to the brink
3. Vaccines bring on an epidemic of suits
4. Gun maker may be liable for shooting
5. Health worries put cigarettes in court
6. Claims push up aircraft firms' costs

Senate President Ted Strickland: "It affects every walk of life."

Among remedies being considered by states are ceilings on jury awards and fees of plaintiffs' lawyers. The U.S. Supreme Court upheld California laws dating from the 1970s. The Court affirmed a limit of $250,000 on damages in malpractice cases for anything beyond out-of-pocket expenses, as well as limits on legal fees. Montana limited "punitive" damages—assessments by juries to punish defendants for wrongful acts and to serve as deterrents. Other reforms under study:

- Calculating interest on damages from the day a case is filed to discourage defendants from stalling.
- Forcing losers of cases that judges consider weak to pay the winner's legal fees and court costs.
- Fining those who pursue frivolous cases. The Supreme Court ordered an Indiana lawyer to pay a $500 penalty for backing a worker's challenge of salary withholding for taxes.
- Stopping payments for medical care when a victim dies. A Virginia doctor is appealing a $2.5 million award for the care of a brain-damaged girl who died a month after the verdict.

Insurance practices may also be overhauled. Some states will regulate insurers more carefully to keep rates sound.

Interest groups are increasing their activities. Insurers have helped set up "civil-justice reform" drives in a dozen states to build support for new laws, and a coalition of groups hardest hit by lawsuits announced a national campaign on January 16. Defendants are expecting help from the Reagan administration, where Atty. Gen. Edwin Meese has named a panel that is likely to offer proposals this year that coincide with many being circulated by business owners.

Lawyers, who have the most to lose from changes in the legal system, are becoming more involved, too. They fear that the increasing number of "horror stories" about big verdicts and canceled insurance may turn the tide against them. To counter anecdotes suggesting never ending liability, lawyers cite a new study for the American Insurance Association showing that overall costs in personal-injury cases over the last 50 years have risen at about the same rate as workers'-compensation payments and health-care costs and less than half as fast as Social Security.

Despite such moves, no one expects quick solutions to a crisis that took decades to build. In the meantime, juries will continue issuing verdicts that make millionaires of some Americans while sending others into bankruptcy. ■

by Ted Gest and Clemens P. Work with the magazine's domestic bureaus

Should lawyers' contingency fees be limited?

PRO — Interview with Grant DuBois, chairman, National Coalition for Litigation Cost Containment

Q Mr. DuBois, why limit the contingency fees that lawyers receive in liability suits?

Contingency fees, which can amount to 40 percent or more of the money awarded to plaintiffs, are principally responsible for the explosion of huge verdicts and the logjam in our courts. The principle of strict liability allows lawyers to collect hundreds of thousands of dollars for what often amounts to very little work.

We run the risk of creating an insuranceless society because the threat of liability suits has caused insurers either to drop coverage or charge sky-high rates.

Q What reforms is your group proposing?

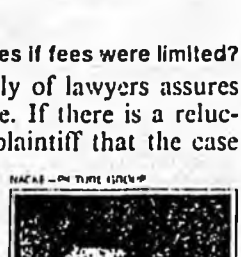
One example is a California law on medical malpractice, recently upheld by the U.S. Supreme Court. The statute provides a scale of maximum fees a lawyer can collect—40 percent of the first $50,000, 33 percent of the next $50,000, and so on.

Q Would lawyers refuse to take cases if fees were limited?

Some would, but the oversupply of lawyers assures that someone would take the case. If there is a reluctance, it might be a sign to the plaintiff that the case does not have sufficient merit.

Q Aren't chances for limiting lawyer fees rather slim?

Reform won't be easy, but the public has finally awakened—thanks to the publicity surrounding such developments as U.S. lawyers traveling to India in search of big fees in the Bhopal case.



CON — Interview with Peter Perlman, president, the Association of Trial Lawyers of America

Q Mr. Perlman, why do you oppose limiting the amount of fees that lawyers can earn in damage suits?

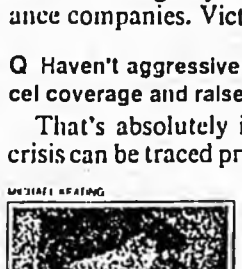
The contingency fee is the victim's key to the courthouse. It allows the person suffering from a tragedy to get a lawyer with the same abilities as the well-paid attorneys who represent the wrongdoer—often a rich and powerful corporation or special-interest group. Some cases require much expense and preparation. When you consider the chance of losing, in which case the lawyer gets nothing, the one-third contingency fee is most reasonable.

Q Why not go to a system, as in California, where the lawyer's percentage of the money awarded a victim decreases as the amount gets larger?

It denies severely injured people the right to the most effective counsel. It is not the victim who complains about contingency fees; it's the wrongdoer and insurance companies. Victims see the system as fair.

Q Haven't aggressive trial lawyers forced insurers to cancel coverage and raise rates tremendously?

That's absolutely incorrect. The so-called insurance crisis can be traced primarily to the drop in interest rates, which limits the investment income of insurance firms. There was no claim of a crisis in the late 1970s, when interest rates were high. Insurers were reducing their premiums to get a bigger market share. Rather than basing premiums on expected losses, they based them on expected investment return, and now that's come back to haunt them.



COMMENTARY

Editorials

Restoring balance to the liability system and to federal budgets.

Civil Justice Reform: The Way Out Of The Liability Crisis

A legal system that works hardship on those who have done no wrong is obviously in need of correction. That is why individual businesses and the organizations that represent them are pressing for major reforms in the civil justice system based on tort law.

Traditionally, an individual who suffered from the actions of another could ask the civil courts to order the person at fault to pay money damages and/or stop the actions.

But something different has been happening in recent years. Lawsuits seeking money damages have been initiated more on the basis of the defendant's ability to pay than on the basis of responsibility for causing an injury.

This month's cover story, beginning on page 22, documents what is happening in the liability insurance field. Companies with little or no responsibility for injuries, rather than the parties directly responsible, are being subjected to costly lawsuits. Those companies and their insurers are, in too many cases, being ordered to pay enormous damage awards.

ILLUSTRATION: MICHAEL PIERUT

The result has been major increases in premiums for virtually all types of liability insurance, curtailment of coverage and, in some cases, inability of businesses to obtain liability insurance at any price.

As one business leader quoted in the article puts it, "Businesses in every region of the country have experienced extreme hardship." And, he adds, "small businesses are bearing the brunt of the present crisis" in liability insurance.

Though other factors, such as changes in the investment climate, have affected insurance company earnings, the explosive increase in the number of massive damage awards remains the major factor in the liability crisis. Courts and juries are holding companies responsible for actions far beyond the scope of insurance coverage and, indeed, of the principle of tort law.

Richard K. Willard, an assistant U.S. attorney general, asks a question being widely echoed these days by business people hard put to find liability coverage at reasonable rates: "How did we get in this mess?" He also offers this explanation: "Increasingly, tort law punishes those who have done nothing wrong, simply because they often have the resources to compensate the unfortunate."

The answer, he says, is "a return to a view of tort law premised on a concept of fault."

Businesses seeking insurance at affordable rates, and the insurance industry itself, support that view strongly and are pressing for relevant reforms to the civil justice system.

Realization of those goals would bring about a liability system that works much more effectively on behalf of companies that need liability coverage and companies that provide it.

The Right Strategy For Winning This Budget-Cutting Battle

President Reagan faces one of the most difficult domestic challenges of his tenure as chief executive in the fiscal 1987 budget he sends to Congress early this month.

The budget must offer enough spending cuts to meet the constraints of the newly enacted Gramm-Rudman-Hollings law, which was enacted late last year with strong support from business. The law to impose long-needed fiscal discipline on Congress requires elimination of the federal deficit over the next five years.

But the proposals to curtail or eliminate federal programs must be presented in a manner that is both fiscally and politically realistic.

Suggesting budget actions with little or no chance of enactment would not meet that test. Congress might refuse to consider seriously, for example, a budget reduction plan that exempted major spending areas, like defense and agriculture. Advocates of programs targeted for cuts would have a ready-made claim of unfairness if the administration approach to eliminating the deficit is not evenhanded.

It would be a major strategic mistake for the White House to send Congress a narrowly focused plan that kept major spending areas out of consideration. That could shift the emphasis of the deficit elimination debate to the one area the administration wants to avoid—tax increases.

The administration will surely be mindful, in its approach to implementing the Gramm-Rudman-Hollings law, of the fact that some members of Congress do not see the law as an ultimate source of fiscal discipline. They see it instead as a way of demonstrating that higher taxes are the only way the federal deficit can be eliminated.

Franklin W. Nutter, president of the Alliance of American Insurers, says the availability of affordable insurance depends on a climate of "legal and regulatory stability."

PHOTO: T. MICHAEL KEZA

rent, fragmented product liability laws are viewed as the principal pressures on insurance rates, insurance companies concede that part of the problem represents a delayed reaction to early 1980s pricing and investment policies. Interest rates were so high that the companies competed intensely for funds to invest. To attract premiums that could be used as investment capital, the entire industry engaged in what was termed "cash-flow underwriting." A former marketing vice president with one of the 10 largest property-casualty insurers says, "The theory was that, if you could sell a dollar's worth of risk protection for 50 cents and still end up with a dollar and 5 cents after investments, you'd be ahead of the game."

But, in 1984, as losses overtook investment returns, insurers became far more careful about what risks they would take at what price, and premium increases, limitations and even cancellation of coverage followed.

Another factor that put pressure on premium costs was the shrinkage of the reinsurance market, where underwriters spread risks they have insured. Andre Maisonpierre, president of the Reinsurance Association of America, told a congressional hearing recently: "Insurance policies and reinsurance contracts written in the 1950s and 1960s for relatively low premiums are now responding—pursuant to court decisions or retroactive legislation—to claims which were never anticipated under the contracts. The resulting impact on reinsurance has been traumatic."

Maisonpierre says the withdrawal of foreign reinsurance capital has reduced the property-casualty industry's capacity by about $5 billion, or approximately 7 percent. "We can foresee that 1986 will be much more difficult for U.S. reinsurers than 1985, simply because the funds are not going to be available," he adds.

Some critics accuse the industry of overreacting to its revenue problems. J. Robert Hunter, president of the National Insurance Consumer Organization and a former federal insurance administrator, joined with Ralph Nader at a recent press conference to argue that industry loss reports were "misleading and fraudulent." They held that the $5.5 billion loss cited for last year did not reflect tax credits and the increased value of investments and listed dividends as expenses.

Franklin W. Nutter, president of the Alliance of American Insurers, replied that the criticism was based on "voodoo accounting." He said the reports were based on requirements of state insurance regulators who, among other things, specify that dividends be carried as expenses. Hunter said insurance companies do not willingly withhold coverage: "We are not in the business of not selling insurance."

Resolution of the problem is not expected to come quickly. The insurance industry still faces difficulties. Final 1985 figures are expected to show a premium/cost ratio of 116 for the year, compared with 118 for 1984. (The ratio uses a base of 100, meaning that for every dollar of premiums in 1985, the industry paid $1.16 in costs and claims.)

At the same time, the dimension of the problem and business demands for action are getting attention. Mary Jane Fisher, Washington-based correspondent for the insurance industry publication, *National Underwriter*, says, "The members of Congress are getting heat from their constituents who want something done about availability and pricing of liability insurance."

Though the campaigns for civil justice reform and a uniform product liability law continue to be pressed, and the insurance industry is working its way out of its financial problems related to investment policies of recent years, many individual businesses worry that they will sooner or later face the dilemma of Maynard Weaver of Omaha's Elliott Equipment Corporation:

"We'll go broke if we pay the premiums. If we go bare, we risk product liability suits shutting us down. We're just sitting here bleeding to death." NB

To order reprints of this and the following article, see page 77.

Insurance Industry Gains And Losses

The U.S. insurance industry collects $249 billion a year in premiums. That is 6.9 percent of the gross national product and an average of $972 for every man, woman and child in the country.

There are 5,600 insurance companies, with nearly 2 million employees (a third of them agents and brokers) and assets of $985 billion.

The Insurance Information Institute says that 48 percent of the world's premiums are collected in the United States, followed by Japan, 13 percent, and West Germany, 8 percent.

Property-casualty insurance in this country, most of it written by 900 companies, takes in $118 billion in premiums, about half of it in personal auto and homeowner policies and half in business lines.

For two years, property-casualty insurers have had net operating losses. In 1984 the total loss was $3.8 billion; in 1985, $5.5 billion. Critics charge that those losses are overstated, but the industry denies that accusation, stating that 1985 was the worst year for insurance since the San Francisco earthquake of 1906.

The companies have been paying out $1.18 in claims settlements and expenses for every $1 they collected in premiums.

Of the payout, 88 cents goes for claims and adjustment expenses, 25 cents for sales and administrative expenses, 2 cents for dividends to policyholders and 3 cents for taxes.

Losses in some lines were much larger than the overall loss. General liability policies cost the companies $1.51 for every $1 they got in premiums. Commercial auto liability cost $1.42. Medical malpractice cost $1.61.

Liability: Trying Times

Ski resort operators have more than weather to worry about. They are paying liability insurance premiums that have increased up to 500 percent in a year.

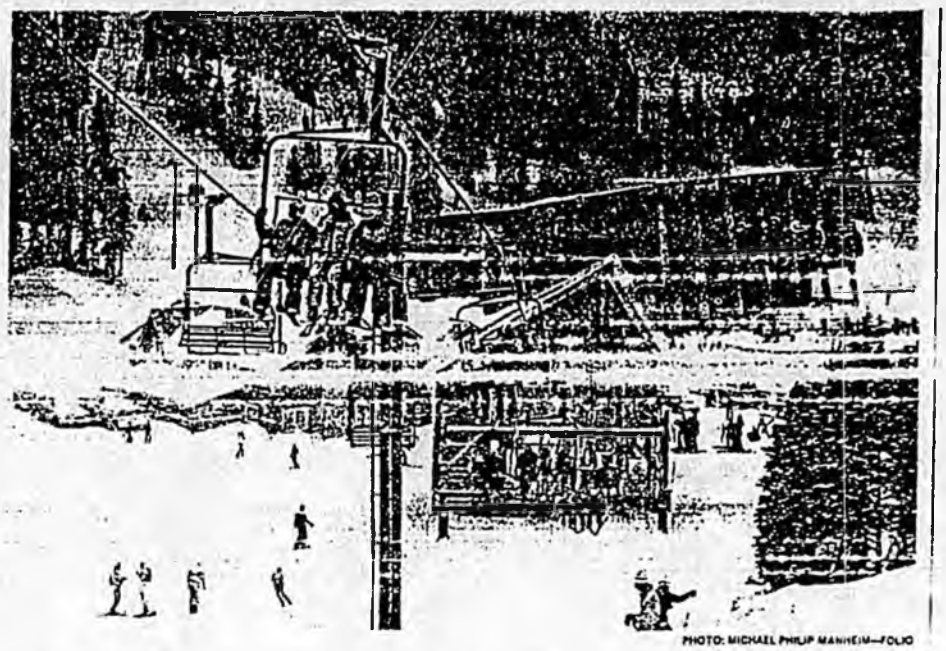


PHOTO: MICHAEL PHILIP MANHEIM—FOLIO

liability areas like cleanup of hazardous waste and asbestos removal.

- Engineers and architects are writing contracts that require clients to share the risks or indemnify them against claims.
- Organizations are establishing special programs to help member companies and individuals curtail exposure to risk. The American Medical Association, for example, is showing physicians how to avoid or correct situations that might invite lawsuits. The National Restaurant Association is teaching members how to lower their vulnerability to lawsuits stemming from later conduct of customers who have been served drinks.

In addition to such specific steps, there is the drive by many business organizations for long-term reforms in the civil justice system and in basic laws on liability.

The National Association of Independent Insurers, American Insurance Association and Alliance of American Insurers have joined in supporting three tort system reforms they say will improve the affordability and availability of liability insurance:

1. Fair application of the "several liability" doctrine, which assigns damages based on the defendant's determined share of negligence, rather than on ability to pay.

2. Abolition of punitive damages in civil liability litigation on the ground that they excessively drive up settlements and awards.

3. Adoption of "state of the art" rules that will limit product, professional and municipal liability claims to standards prevailing at the time a damaging act takes place, rather than at the time of litigation.

In addition to the Steering Committee, the U.S. Chamber of Commerce is establishing a Blue Ribbon Civil Justice Action Group to recommend legal system changes that would reduce the extent and cost of litigation and would increase the availability and affordability of liability insurance.

One area of top concern to those seeking reform of the civil justice system is the practice of compensating lawyers through contingency fees, which are based on the amount of damage awards they win for their clients. Critics say that policy encourages lawyers to encourage clients to file lawsuits on a no-lose basis—the client incurs no costs if the lawyer does not win an award.

Tim Reath, chief executive of the eastern division of Jardin Insurance Brokers and past president of the National Association of Insurance Brokers, says, "Within a couple of years, we're going to see some serious reform activity in this area. We definitely need to get off the contingency system."

There is a division within the legal profession on the system. The American Bar Association published in its journal recently a debate on the contingency approach, with one lawyer terming it an "indispensable delivery device ... for the use of the civil law as a hammer in support of consumer interests." But another attorney asserted that "the pro-plaintiff trend of the last 25 to 30 years" has made the contingency fee a luxury that "must be controlled or modified in some way if the American system of justice is to be preserved."

Peter Perlman, president of the Association of Trial Lawyers of America, argues that the contingency fee system cannot be blamed for the surge in personal injury suits.

"Under the contingency fee system," he argues, "victims may have an incentive to bring weak claims, because they risk nothing. But, conversely, the contingent-fee lawyer has no such incentive, because the compensation for a weak claim is likely to be zero."

What about the argument that sharply increased advertising by lawyers seeking clients has been a factor in the litigation explosion? Joel Hyatt, whose 30-second television commercials have made him one of America's best-known lawyers and his law firm the nation's second largest, says advertising by lawyers has contributed little to increasing case loads of damage claims.

"The injury area of the law was already being served by the legal profession," he says. Hyatt, whose firm has 575 attorneys in 200 offices, says their work is mostly in divorce cases, bankruptcies and probate law. Less than 5 percent is in injury cases, he says.

But he does have a recommendation for the insurance industry. The current problem, he says, is not the large jury awards that receive much attention, but "the far greater number of small cases that should never have been brought to court."

Hyatt says some lawyers created "a whole frivolous lawsuit industry" after insurance companies made the "bad mistake" of deciding "that, if the cost of litigating a case was greater than the amount insurers could settle for, they would make the economic decision to buy those cases off—pay $5,000 to settle rather than $8,000 to fight the case." He says insurers should take the long view by fighting the bad cases regardless of the expenses involved.

Some insurance companies have begun to do that and to defend themselves in other ways. Increasingly, they are writing policies to cover only claims made during the life of the policy, excluding retroactive claims. Some are also limiting how much they will pay for legal defense of the insured company and for punitive damages.

Though the tort system and the cur-

Of the 13 U.S. firms making football helmets a few years ago, only three are still in production. The others dropped out because of insurance costs.

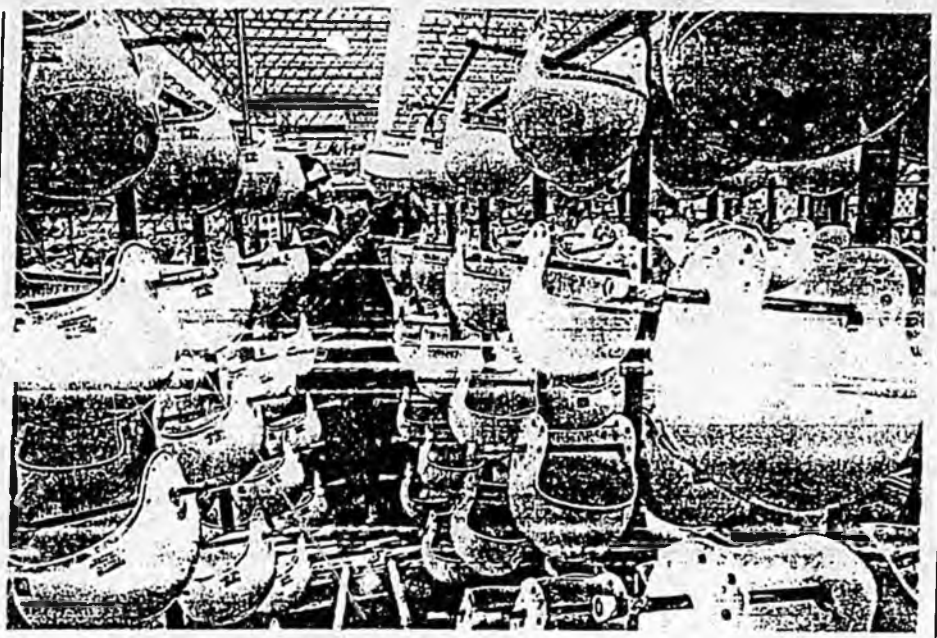


PHOTO: JON RILEY—FOLIO

Rick Berman, of Dallas' S&A Restaurant Corporation, heads a business group seeking state changes in the legal tort system and uniform product liability standards.

PHOTO: C. THATCHER

Malpractice awards against physicians reached an average $950,000 in 1984, and the costs of liability insurance for medical practitioners generally are changing the way many of them approach their patients. The trend to defensive medicine involves additional—and often costly—tests and procedures by physicians concerned that failure to go those extra lengths could lead to allegations of negligence.

But the combination of higher insurance costs and defensive medicine is raising the nation's medical bills an estimated $2 billion to $4 billion a year, an expense being felt mainly by employers who provide health insurance to workers.

Consumers can no longer purchase the drug Bendectin, which had been the only safe and effective treatment for persistent nausea in pregnant women. The manufacturer took it off the market when liability insurance reached $10 million a year, more than 80 percent of annual sales. A nationwide shortage of vaccine to protect children from diphtheria and whooping cough developed when all but one of several companies manufacturing it halted production in the face of mounting liability insurance costs.

Insurance rate boosts are showing up in the price of goods. Twenty percent of the cost of a stepladder now represents the manufacturer's expenses for liability insurance. There is also an effect on employment. Of the 13 U.S. firms making football helmets a few years ago, only three still are. The others dropped out because of insurance costs.

Owners and managers of smaller businesses could face problems beyond the immediate question of insurance coverage, says Jan E. Smith, president of a Bradenton, Fla., business-investment firm. "If banks find a company has lost its liability insurance, they may start asking, 'What about those operating loans we made to that company?' And they may not renew those notes. Banks may require liability insurance before they will make a loan."

Each day, we learn firsthand of another segment of our economy which has been affected. Small businesses are bearing the brunt of this [liability] crisis.

—William C. Wyer, president, Delaware State Chamber of Commerce

In his testimony to Congress for the U.S. Chamber, William Wyer said: "Perhaps this crisis will reserve ultimately its harshest consequences for American consumers. When obstetricians withdraw from their profession, it is the quality of health care for all of us which suffers. When sporting goods manufacturers go overseas, it is the American worker who becomes unemployed.

"And when ... firms announce price increases primarily to cover rising insurance costs, it is all of us who will pay more through higher prices."

The actual and threatened problems of the liability crisis have spurred a wide range of reactions by those most affected—individual business and professional people, their trade organizations, the insurance industry and the legal profession.

These are among steps being taken on the business side:

- Business people in all fields are shopping more aggressively for coverage by obtaining quotes from several brokers. They are also accepting higher deductibles and are self-insuring when they can afford to.
- Many businesses are hiring consultants to conduct risk audits and help them analyze their insurance needs more carefully. Consultants are also showing companies how to minimize exposure to large damage awards by keeping detailed records on product-safety management programs with an eye toward impressing juries if they ever face them.
- Some companies unable to meet massive premium increases or even to obtain coverage are, like Vernon Hayes of the Fort Worth machinery-manufacturing company, taking the ultimate step of "going bare"—operating without liability insurance and hoping for the best.
- Contractors are setting up subsidiaries without assets to work in [illegible]

Liability: Trying Times

David and Ruth Hampe—paying bills for their Somerset, Pa., auto salvage yard—needed a bank loan after their liability insurance premium nearly doubled.

PHOTO: LYNN JOHNSON—BLACK STAR

ance agent who is also current president of the Independent Insurance Agents of America, says, "My customers think I'm nuts suggesting they are lucky to renew at double last year's premiums."

It is becoming more and more apparent, he says, that "price is no longer the issue. It's a question of availability, of just finding the coverage."

Joseph Prendergast, American Ski Federation president, says ski resort operators are facing premium increases ranging to 500 percent. He adds that companies that sell roller skis—which have wheels and are used on nonsnow surfaces—are unable to obtain any coverage.

David Hampe had filed no claims under the liability insurance on the wrecker and dump truck he uses in his auto salvage business in Somerset, Pa., but recently received notice his premiums had nearly doubled. He did not have the cash needed to pay the bill and took out a bank loan so he could.

Edward Cone, chief executive officer of Graco Children's Products, Elverson, Pa., says the deductible on his basic-coverage policy went from $25,000 to $150,000 in 1985, and he had to canvass five sources to get the $500,000 coverage he needed before anyone would sell him an excess risk policy. And that provided one fourth the coverage at a cost five times greater than his previous policy. "We have not had any large claims," he says. "Our claims experience does not nearly justify those rates. But, because of the cost, we will have to evaluate our product lines, and we may get out of some." One of those lines is children's car seats.

All 50 states require use of special car seats for tots, Cone notes. "They have to meet federal standards," he says. "It is not a product that is likely to be used for any other purpose than the one it's designed for. Yet, in our court system, that won't mean a thing to a jury. They see an injured child, and they say, 'Somebody has to pay.' "

He cites a $10 million claim against another car-seat manufacturer resulting from an accident in which a passenger not wearing a seat belt was thrown against a baby strapped into a car seat.

Long-range trends, as well as awards in specific cases, spotlight the connection between the litigation explosion in the nation's courts and the insurance crisis.

In 1984 there was one private, civil lawsuit for every 15 Americans. The number of personal injury cases with awards of $1 million or more is now more than 13 times the 1975 total. A record 12 million lawsuits were filed in state courts between 1978 and 1983. The average product liability award has increased from $345,000 to more than $1 million in 10 years, and the number of product liability suits filed in federal courts alone has tripled since 1960.

There are three times as many lawyers practicing now as there were in the 1950s, and it costs 37 times more to run the tort system than it did then.

Chief Justice Warren Burger says the American public "has an almost irrational focus—virtually a mania—on litigation as the way to solve all problems."

Richard K. Willard, an assistant U.S. attorney general, asks of the fast-growing insurance crisis that is affecting more and more businesses: "How did we get into this mess?" He continues: "I believe the answer lies in recent legal movements by activist judges and tort lawyers who see no bounds to the ever increasing expansion of tort liability."

The traditional basis of tort liability is fault—one individual's actions have caused harm to another individual, who seeks recompense. But under the current trend, Willard says, tort law is increasingly invoked to punish those who have done nothing wrong but have resources to pay damages.

Rick Berman, executive vice president of Dallas' S&A Restaurant Corporation and chairman of the Liability Crisis Steering Committee recently created by the U.S. Chamber of Commerce to coordinate lobbying and other efforts in behalf of reform, says that curbing tort system abuses "is the main road to solution of this problem."

The Chamber committee, he explains, was established as a catalyst to bring together the many interested groups seeking a solution to the insurance crisis. Among other activities, he points out, the committee operates a clearinghouse "to share information and to inform the public of the dimensions of the liability problem."

And the impact of the problem on the general public is much greater than is generally realized.

Huge jury awards and a patchwork of laws are principal reasons for a scary insurance crisis into which business has been plunged.

sis at a recent congressional hearing, the U.S. Chamber of Commerce declared:

"A preliminary survey ... indicates that businesses in every region of the country have experienced extreme hardship. In fact, there have been business closures due to the dramatic increase in premium payments. Each day, we learn firsthand of another segment of our economy which has been affected by this crisis. There seem to be no boundaries."

Testifying for the business organization, William C. Wyer, president of the Delaware State Chamber of Commerce, added: "Small businesses are bearing the brunt of the present crisis."

Evidence from businesses across the country supports that statement:

Maynard B. Weaver, president of Elliott Equipment Corporation, an Omaha manufacturer of man-lift cranes, reports that his liability insurance payments are $18,000 a month, up 500 percent from 1984, though his coverage has been reduced. "We are reaching the point where we can no longer afford product liability insurance," he says.

The Amigo Company, a family-owned manufacturer of motorized wheelchairs, has never had a successful insurance claim brought against it. But General Manager Alden Thieme says that, because of the insurance crisis, he does not know whether the company can stay in business.

Amigo, which has offices in Albuquerque, N.M., and a factory in Bridgeport, Mich., was told last year that its insurance premiums were being raised from $30,000 to $150,000.

Though Thieme obtained coverage from a Bahamas broker for $45,000, Amigo expects its 1986 liability insurance costs to be $100,000 to $120,000. "The liability crisis is getting completely out of hand," he says. His company experienced the problem firsthand when it had to face a type of lawsuit becoming increasingly common—those in which the defendant is chosen on the

Alden Thieme manages a company that manufactures motorized wheelchairs in Bridgeport, Mich. Although it has never lost a liability suit, its insurance premiums are skyrocketing. Thieme blames a legal system that encourages litigation and allows huge jury awards.

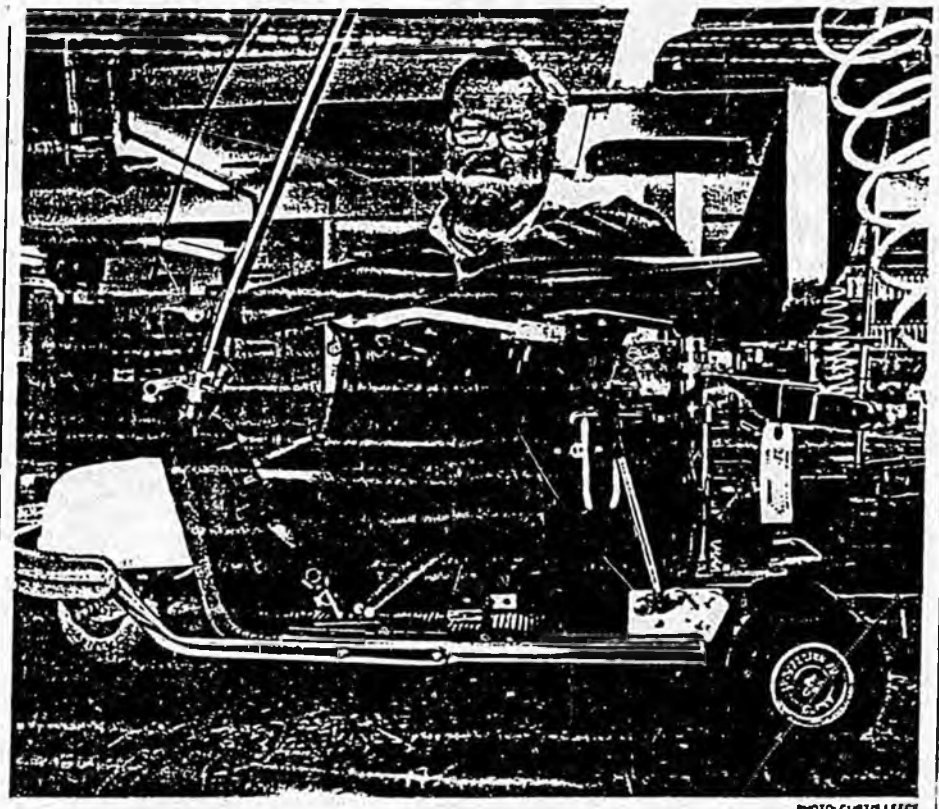


PHOTO: CURTIS LEECE

Thieme recalls that a woman in a wheelchair, accompanied by her husband, was killed when struck by a car that had run a red light on a California street. "The driver had no insurance, so the husband sued us," Thieme says. "The case dragged on for two years before we won. But it cost us $170,000 to defend ourselves."

The company, founded by Thieme's brother, Allen, has 120 employees, does $10 million a year in sales and is the leader in its field. Allen Thieme was named national Small Business Person of the Year in 1981 for successfully launching the firm. His brother and general manager now says that if insurance premiums continue to soar, "it will wipe us out. If we keep adding to our costs, we will price ourselves out of the market."

Vernon Hayes, president of Hayes and Stolz, which makes grain-processing machinery in Fort Worth, Tex., operated without insurance for several weeks last year after his primary policy was canceled. "What do you do?" he asks. "Everybody in America can't shut down. And it's hard to put 70 people out of work." By paying an 800 percent premium increase, he finally obtained a new policy, but it did not provide as much coverage as the canceled policy.

Dick Taylor, a Salt Lake City insur-

COVER STORY

Liability: Trying Times

By Harry Bacas

An overweight man with a history of coronary disease has a heart attack while trying to start a lawn mower. In a suit against the manufacturer, he argues that pulling the starter rope required excessive effort. A jury awards him $1 million in damages—plus interest.

A drug dosage administered by hospital personnel to a child who then suffers brain damage exceeds the manufacturer's specifications. The child's parents nevertheless sue the manufacturer—and are awarded $22 million.

A motorcyclist, injured when he runs off the road into a parked truck, sues the truck's owner. A mediation board, citing the motorcyclist's own role in the accident, limits a damage award to $20,000. The case goes to a jury, which increases the award to $4.2 million.

Those examples of recent damage awards are not isolated instances but are part of a cycle that is pulling more and more businesses, particularly smaller and medium-size ones, into what has become one of the most serious problems facing business today—the liability-insurance crisis.

The crisis begins with damage awards in cases that are frequently based on thin legal grounds. It moves to the insurance companies that raise premiums—or limit or deny coverage—to stem losses caused by the swollen awards. It ends up with the businesses that face massive cost increases or are unable to obtain coverage at any price.

For that reason, reform of the civil justice system is a key goal of business organizations that want to ease the liability crisis. A second goal is adoption of a federal product-liability law to replace the present patchwork of individual state laws that require manufacturers and retailers to comply with many different and often conflicting statutes or face lawsuits.

In discussing the overall liability cri-

Jack Hayes, a free-lance writer based in Roswell, Ga., also contributed to this article.

"We are reaching the point where we can no longer afford product liability insurance," says Maynard B. Weaver, president of an Omaha company that makes man-lift cranes. He saw his insurance payments rise 500 percent in one year and his coverage limits go down.

PHOTO MAX WINTER—PICTURE GROUP

Lucrative contingent fees for attorneys and increasingly expansive court rulings on legal liability have combined to harm not only insurance companies, but all who purchase and depend on liability insurance.

A Lawyer Looks at Liability Law

BY JAMES G. FRIERSON

Consider the following. A restaurant's $25,000 liability insurance premium jumps to $80,000 in one year. A neurosurgeon in New York pays $101,000 in annual malpractice premiums. Twice as many liability lawsuits are filed in 1984 as were in 1978. Small child care centers go out of business due to their inability to obtain liability insurance. Huge underwriting deficits cause liability insurance companies to lose $3.8 billion dollars in 1984, their first operating loss in 78 years. American lawyers appear on TV from India within hours of the Union Carbide disaster. A U.S. Senate committee finds that product liability claims produce 77 cents in legal costs for every 66 cents that successful claimants receive.

The City of Sykesville, Md. receives a liability insurance premium increase of 700% in one year. More than 500 Ohio schools have their liability insurance canceled in 1985. The A.H. Robins Co., facing 3500 separate punitive damage claims, files for bankruptcy. Attorneys fly halfway across America to solicit the victims of a hotel collapse in Kansas City. Relatives of those killed in an airplane crash in Dallas endure the solicitation of attorneys as they attempt to identify the bodies of their loved ones.

These are but a few of the numerous examples that illustrate the legal liability disaster in America. Lucrative contingent fees for attorneys and increasingly expansive court rulings on legal liability have combined to harm not only insurance companies, but all who purchase and depend on liability insurance. Attempts to reform the system have been unsuccessful, primarily because of the political power of trial attorneys, the only group that consistently benefits from the present system.

Drastic problems call for drastic solutions. Three major changes in our legal system of liability lawsuits would go far in curing the present mess, while retaining fairness to deserving claimants. These changes would require substantial revision of the way we treat pain and suffering judgments, punitive damage awards and the payment of attorneys' fees.

Judgments for pain and suffering and for punitive damages are a major cause behind the huge increase in court judgments, as well as the extreme contradictions in the amount of money awarded in similar cases. The large amounts that may be paid under these categories cause some lawsuits to go to trial that otherwise might have been settled voluntarily. They are a major reason why attorneys' fees are so lucrative in personal injury cases.

VARIATIONS IN AWARDS

Pain and suffering awards and punitive damages often cause differences in lawsuits that make little or no sense. Recently Merrell Dow Pharmaceutical was sued in New York and California because of problems caused by an anti-cholesterol drug they distributed. The court in New York ordered punitive damages of $250,000 to be paid to the plaintiff, while the California court found that no punitive damages were justified. The facts were identical; only the courts were different.

A personal injury claim in Michigan might bring a $1 million pain and suffering award, while an identical case in Tennessee might result in a $50,000 pain and suffering award. Some plaintiffs win huge amounts based upon

JAMES G. FRIERSON, J.D., is a professor of management at East Tennessee State University, Johnson City, Tenn.

these nebulous categories, while similar plaintiffs receive absolutely nothing for pain and suffering or punitive damages. The result appears to depend upon which attorney was used, which court heard the case, which jury was selected—and pure luck.

While there have been heavily publicized cases of huge judgments, which sometimes make the plaintiff and his lawyer rich, many more unpublicized cases result in such small compensation that the plaintiff receives less than the financial losses incurred, after paying the attorney the typical one-third of the judgment, plus costs.

Most lawyers know the real reason for seeking pain and suffering and punitive damages in the typical cases: the award of these nonfinancial losses may be enough to pay the attorney's fee and costs, leaving the plaintiff full reimbursement for his real losses, including lost salary, medical expenses and property damage. However, this is a hit-or-miss method that rarely works perfectly. Plaintiffs normally win too much, or too little, for an exact reimbursement of their economic losses, after attorneys' fees and costs are paid. The examples shown in the accompanying chart are based upon actual lawsuits (attorneys' fees are assumed to be a one-third contingent fee and costs are estimated).

The last two cases shown in the chart involved almost identical fact situations, although one caused the plaintiff a net loss of $50,000, while the other produced a net gain of $182,000. It seems obvious that awarding the plaintiff all the economic losses caused by the defendant's actions, including attorney's fee and costs, would be a reasonable trade-off for no longer awarding pain and suffering and punitive damages.

AWARDS RECEIVED BY PLAINTIFFS

A Libel Case:

$6,700,000	Compensatory Damages (loss of business)
2,500,000	Punitive Damages
$9,200,000	Total
-3,066,666	Attorney's Fee
- 50,000	Costs
$6,083,334	Net Recovery; $616,666 less than the actual loss to the plaintiff

A Medical Malpractice Case:

$1,000,000	Compensatory Damages
1,000,000	Punitive Damages
$2,000,000	Total
-666,666	Attorney's Fee
- 10,000	Costs
$1,323,334	Net Recovery; $323,334 more than the actual loss to the plaintiff

A Products Liability Case:

$247,000	Lost Salary, Medical Expenses, Money Loss
50,000	Pain and Suffering Judgment
$297,000	Total
-99,000	Attorney's Fee
- 1,000	Costs
$197,000	Net Recovery; $50,000 less than the actual loss to the plaintiff

Another Products Liability Case:

$45,000	Actual Financial Loss
50,000	Pain & Suffering Judgment
250,000	Punitive Damages
$345,000	Total
-115,000	Attorney's Fee
- 3,000	Costs
$277,000	Net Recovery; $182,000 more than the actual loss to the plaintiff

ARBITRARY AWARDS

Awards for pain and suffering, by definition, are arbitrary and unreasonable. Since it is impossible to place a correct dollar figure on a specified amount of physical pain and mental suffering, it is unreasonable to do so. The law should provide for full restitution to a wronged plaintiff by full payment of all economic losses caused by the defendant, but it should not attempt the impossible, and it is impossible to decrease one's pain by the payment of money. The payment of pain and suffering damages will, at most, give the plaintiff (and his lawyer) some mental satisfaction, but this seems to be a minor benefit for such a major expenditure.

As citizens of a modern, technological society, we must all endure some pain and suffering at some time. It is simply a risk we all face. Money does not solve, or even affect, the problem. Many other countries recognize this fact, and as a result, they do not award money for pain and suffering. There is little valid reason to support America's policy of pain and suffering awards.

An even stronger argument can be made against punitive damage claims. As with pain and suffering awards, punitive damage judgments are a major cause of the inconsistency of court judgments. They are a misguided attempt to impose society's penalty for wrongdoing in an inappropriate forum. The entire theory of assessing punitive damages in a personal, individual lawsuit is a contradiction in terms.

Punitive damages are assessed for a defendant's "outrageous conduct" or "reckless action" against society. The private plaintiff, under this concept, acts for society in claiming a penalty for the defendant's wrong. But why should a private person bring an action based upon a wrong to society? And why should this private person (and his attorney) benefit personally when a penalty is imposed?

If a person or company does an outrageous or reckless act that is a

wrong against society, the representative of society, the government, should be the one to prosecute the case, and the government should be the one to benefit financially when penalties are imposed. The penalties should not result in a windfall profit to a private plaintiff and the lawyer.

Private lawsuits allowing punitive damages also can cause the defendant to be punished many times over for the same wrongful act. After paying hundreds of claims, the A.H. Robins Co., as mentioned earlier, still faced 3500 different lawsuits claiming punitive damages. Is it really fair for a company to be punished thousands of times for the same act, such as in the Robins case where all the lawsuits involve the same defective birth control device?

European countries and four American states prohibit punitive damages. There is little or no evidence that companies and other potential defendants act any more recklessly in those jurisdictions than they do in the rest of the United States, where punitive damages are allowed.

TOWARD A JUST SOLUTION

Since pain and suffering awards and punitive damages have been used, indirectly, to pay attorneys, it would be unfair to eliminate such judgments without providing deserving plaintiffs with an alternative method to pay legal costs. The law should provide for the payment of all economic losses caused to a deserving plaintiff. The attorney's fee and legal costs are just as much economic losses caused by the defendant as are the losses of medical bills, lost salary and property damages. A successful plaintiff deserves to win and keep the amount of money necessary to pay all economic losses.

> Radical changes, as long as they are fair, are the only method through which the problems can be solved.

Experience in other countries, almost all of which allow the collection of attorneys' fees, as well as experience in the United States where attorneys' fees are paid, such as in consumer law and antitrust law cases, proves that the payment of legal fees can be imposed fairly upon the defendant. If the parties cannot agree upon a fair atto fee, the judge can serve as a refer make the final decision. Alterna the law could provide that the l for the winning plaintiff be entit a predetermined amount, such per hour. The exact amount c based upon average time charges torneys, adjusted periodicall inflation.

At this point many lawyer argue that they should be paid than a standard fee per hour since will collect only if they win the as they do now with contingent They will argue that contingent fe necessary to allow people of li financial means to afford to use a torney in bringing a lawsuit. And will argue that large fees, even third of a million-dollar judgmen justified since the attorney tak chance of receiving nothing if the is lost.

These arguments have some v ty. However, it is hard to justify as high as $333,334 or more in a s liability lawsuit. The payment of fees by the defendant can be arra so that the lawyer is compensate the risk of losing the case. We can vide that, upon successful comple of a liability lawsuit, the lawyer w paid 150% of the normal hourly A 50% premium over a lawyer's s dard charges should compensate fully for the risk of losing. After all

attorney usually will not accept a case unless he feels he has a reasonably good chance of winning.

Another method, often used in antitrust cases, is to allow the judge to add a multiplier based upon the difficulty of the case. For example, in a simple, obvious case the attorney might receive 120% of the standard hourly rate, while in a landmark case that created new law, the rate might be set at 200% of the hourly rate. Such a scale should provide sufficient incentive for lawyers.

Eliminating pain and suffering awards and punitive damage judgments, while adding a requirement for the payment of attorneys' fees, would have several definite advantages. First, plaintiffs would collect what they deserve in all cases. No longer would they have to hope to collect enough in pain and suffering awards or punitive damages to pay their attorneys. Second, attorneys would be compensated fairly.

Third, the opportunity to make a profit on a lawsuit by receiving huge pain and suffering or punitive damage awards would be eliminated. This would not only reduce many of the huge liability judgments, but it would also encourage plaintiffs to settle without a trial whenever insurance companies offer a fair settlement covering the plaintiff's economic losses. And finally, the reduction of huge judgments, while still treating fairly all concerned, would lead to the reduction of liability insurance premiums, thus benefiting all segments of society.

These changes, however, can be accomplished only by overcoming the opposition of trial lawyers, who have a vested interest in the present system of liability lawsuits. Changing these concepts state-by-state is an impractical goal. In addition to the problem of dealing with 50 different legislative bodies, lawyers often have great power in the state legislatures. The only practical course of action is a federal law.

Those who are familiar with the lack of success in reforming product liability law, which was to be accomplished by the so-called Kasten proposal, might doubt the ability of Congress to change the law in this area. However, the original Kasten proposal had several provisions that were validly opposed by consumer groups as well as trial lawyers. That bill would have changed the basic standard for finding liability from one of strict liability to one of negligence, resulting in many valid claims not being paid. Other provisions of that proposal would have seriously limited the period of time in which a lawsuit could be filed. Reported revisions of the Kasten bill will not attempt to change the method of handling attorneys' fees, punitive damages and pain and suffering awards.

However, the elimination of pain and suffering awards and punitive damages, while requiring payment of attorneys' fees, is necessary if we are to assure that successful plaintiffs win exactly what they deserve. These ideas are so reasonable, in fact, that only those with vested interests to protect should oppose them. A movement not only of insurance companies and trade associations, as is now under way, but also of city governments, day care center operators and all the millions of others faced with unreasonably high liability insurance premiums could be successful in creating one large lobbying effort to create a national law that would improve the system for everyone's benefit.

Those in favor of change in the manner in which we award damages in liability lawsuits should not be content with minor changes that might do little to solve the basic problems that have caused the liability mess we now face. Radical changes, as long as they are fair, are the only method through which the problems can be solved. In dealing with the reform of liability claims and lawsuits we should remember the advice of Henry George, who said, "There is danger in reckless change, but greater danger in blind conservatism." □

National Safety & Re: News – Januar:

Aviation Product Liability

A house subcommittee held hearings on aviation product liability and its effect on technology applications. Clifton von Kann, president, National Aeronautic Association, testified that "product liability may be slowing down the adoption of technological improvements and discouraging small, innovative aviation business." He said that "from the standpoint of aviation, product liability is a perfect example of a socio-economic trend that has run amuck, and must be reversed. Product liability litigation has created an insurance crisis; punitive damages need to be limited." He warned that "there is not enough insurance capacity in the U.S. to cover the expanded risk. Meanwhile the reinsurance market in Eurpoe has dried up, and will remain so until the product liability picture in this country makes more sense than it does today."

Milton R. Copolos, senior analyst, The Heritage Foundation, testified that "despite a safety record that is above reproach, the cost of liability insurance for small planes is literally threatening the existence of the general aviation industry in the U.S. today; if some action is not taken soon, it may be too late for America's general aviation industry. The real solution to the problem, of course, is a sweeping reform of the tort law system in the U.S." He proposed:

1) "A restoration of the requirement that a tangible linkage exist between an alleged injury and the award of damages";

2) "The creation of a statute of repose, *i.e.* a time limit after which a product's manufacturer could no longer be held liable for accidents resulting from that product's use";

3) "The concept of contributory negligence must be reintroduced into the law";

4) "Introduction of new or improved safety devices or equipment should not be admissable in court as evidence of an inherent defect in an *earlier version of the product.*"

For the Aerospace Industries Association of the United States, Malcolm T. Stamper told the subcommittee:

"Because claimants are innocent in virtually every air crash and clearly due compensation from some source, it would make sense to establish a system under which the aviation community automatically and promptly compensates the victims or their beneficiaries. Such a system would avoid the costs of protracted litigation, speed-up compensation payments, and restore balance and justice to the currently confusing and increasingly complex procedures of determining liability and awarding damages. Claimants could still have access to a jury trial, if desired, but compensation would be accelerated by deferring fault-finding until later.

"Therefore, we recommend the establishment through legislation of a relatively simple procedure that would require, in the case of an air crash, for example, only the filing of a plea that damages were sustained. No fault would have to be alleged or proven. Damages would be determined by rules established by the new law, but generally limited to "economic losses." Without contest on the issue of fault, settlement could be reached either between the plaintiffs and the aviation defendants, or the plaintiffs — as I have already suggested — could seek trial by jury on the amount of damages. In any event, the process would be much faster and fairer than the present system without elimination of the adjudicatory system altogether.

"Such legislation could also consider the question of catastrophic events, including crashes resulting from acts of God, acts of war, or terrorist attacks. The legislation might also address the highly unlikely, but mathematically possible, catastrophic type of air accident where multiple planes and buildings might be involved, with the best interests of the flying pulic in mind."

Dealing with the Insurance Disaster

There are several new remedies for Congress to consider

By Susan Pollack
Staff Writer

A disabling accident aboard a fishing vessel, the nation's most hazardous work place, can leave the affected crewman little recourse outside of suing to recover lost wages and pay medical bills. The number and size of personal injury settlements in recent years has created a crisis for both the insurance and the commercial fishing industries.

After months of study, congressional hearings and consultation with fishing industry leaders, insurance company representatives and government agents, the National Council of Fishing Vessel Safety and Insurance (NCFVSI) has issued recommendations to help combat the country's marine insurance crisis. The proposals, drafted by marine insurance specialist Dennis W. Nixon, with input from several other insurance analysts, are included in a preliminary report that was issued this past October. A final report is due in January 1986, though Congress is not expected to take any action on the proposals until later in the winter, following further discussion and at least one more congressional hearing.

During the past five years, marine insurance rates both for hull and for protection and indemnity (P&I) coverage have risen 100% to 300% and more, according to Nixon.

Nixon, who is a professor at the University of Rhode Island, offers these examples of escalating costs:

- A Massachusetts or Rhode Island vessel owner who previously paid $1,100 per crewman for P&I insurance is now likely to be paying $3,000 to $3,500 per man.
- A New Englander with a well-maintained vessel less than 10 years old and with no record of accident claims or lawsuits today faces a more than twofold increase in hull and P&I coverage. Last year, this boat owner paid $19,000 for the combined coverage; thus far the best quote he has received for renewed coverage is $41,000.

In today's tight insurance-underwriting market, companies have become increasingly reluctant to underwrite the nation's most hazardous occupation — commercial fishing.

Aggravating matters are substantial vessel losses in both Gloucester, Mass., and in the Alaska crab fleet in recent years. Even more worrisome is a recent dramatic increase in the number and size of personal injury settlements, according to Nixon.

"The major complaint of insurance companies . . . is that with wildly varying awards for the same injury, they have no way to predict their losses and adjust their premiums on a sound, actuarial basis. An award for a fractured arm can be as low as $5,000 or as high as $500,000."

Some insurance companies have boosted premiums to levels that are virtually prohibitive to commercial fishermen. Others have canceled their policies or pulled out of the fishing business altogether. This has left vessel owners with the option of paying through the nose for insurance — if they can get it — fishing without it or tying up at the dock.

James Costakes, general manager of the New Bedford, Mass., Seafood Producers' Association, warns: "It's a question of survival. The insurance companies are falling by the wayside. If we don't get some sanity back into the system to entice them back, the vessels and crews in every salt-water state will be out of work."

Costakes is also president of NCFVSI, whose study was underwritten by a $76,000 Saltonstall-Kennedy grant. The 35-page report, "Fishing Vessel Injury Alternative Compensation Analysis," offers some fresh solutions to the P&I problem, say fishing and insurance industry representatives. However, the report has drawn vigorous opposition from personal-injury lawyers and some union representatives, since it recommends limiting liability under the Jones Act, a 65-year-old federal statute guaranteeing seamen's rights (see sidebar).

Nixon's recommendations are based on

Proposal draws mixed reaction from industry

Fishing industry leaders from the East, West and Gulf coasts have voiced support for Dennis Nixon's proposals for alleviating the nation's marine insurance crisis and improving medical and disability coverage for injured fishermen, although a few say the measures do not go far enough.

Jim Salisbury, president of the Maine Fishermen's Cooperative Association, expresses a common view: "It seems like a viable strategy," he says, adding that members of his association have shown "a fair amount of enthusiasm for it." Members support "the idea of providing a crewman with ready access to medical coverage and wages without suing," Salisbury says.

Similarly supportive sentiments are voiced by Lucy Sloan, executive director of the National Federation of Fishermen; Kris Vehrs of the Texas Shrimp Association; and Thorn Smith, executive director of the North Pacific Fishing Vessel Owners' Association.

Insurance industry representatives like Ward Mauck, president of the American Institute of Marine Underwriters, and Howard Candage, a Rockland, Maine, broker, agree that the proposals represent a good start and are worthy of serious consideration.

Dave Burney, executive director of the U.S. Tuna Foundation, disagrees. After considering the testimony of insurance brokers for the U.S. tuna fleet at a hearing in San Diego, Calif., in October, he said: "The only way underwriters will be in a position to lower premiums would be through a compensation scheme similar to the state workmen's compensation programs. That would lend predictability to the amount of awards."

Sam Parisi, executive director of the Gloucester, Mass.-based Cape Ann Vessel Owners' Association, agrees. "In my opinion, the insurance companies are not going to come back into the market as long as people can sue for $1 million for a back injury. Why not establish guidelines under the Jones Act for the amount that can be awarded for each kind of injury?"

Nixon says he originally supported the idea of developing a federal workman's compensation program for fishermen. But an investigation revealed that awards for the same injury varied radically from state to state. He says the only consistent schedule of payments he found was under the national Longshoremen's Act, and "the award scale was so high, it would end up costing more than current P&I coverage. It would be like jumping from the frying pan into the fire."

The Association of Trial Lawyers of America has taken no stand as yet on the Nixon recommendations. But two of New

(Continued on Next Page)

an examination of 500 P&I cases from 1980 to 1984 and an analysis of current troubles facing both the fishing industry and the liability-insurance industry, along with a review of past proposals to remedy the P&I dilemma — including a 1975 bill that would have created a federal program for fishermen similar to the one for workmen's compensation.

His investigation reveals that the most significant problem involves cases of temporary but total disability. Some 80% of the claims filed under the Jones Act during the past five years were for injuries involving disabilities whose duration averaged 14 weeks, Nixon found.

One objective is to reduce attorney involvement in such cases. Nixon claims, "There has been a likely causal relationship" between increased awards and attorney involvement in recent years. According to his findings, the attorneys' fees amount to 33% of the total award in cases settled before trial and 50% in those that go to trial.

On another front, the 1981 closing of the nation's longstanding Public Health Service program for seamen aggravated the medical insurance crisis, according to Nixon. He recommends amending the Jones Act to bar claims by fishermen for a disability that lasts for less than a year. (Fishermen could due for compensation related to long-term injuries.)

Secondly, he proposes reducing an injured fisherman's incentive to sue by establishing an immediate no-fault remedy consisting of total medical coverage and full compensation for lost income for up to a year.

To achieve this remedy, Nixon proposes raising P&I maintenance pay to $30 a day. It now ranges from $8 to $30 a day. The $30 a day would amount to $11,000 a year, or roughly half the average fisherman's annual income of $24,000 a year.

To supplement this, Nixon calls for the creation of a disability-income insurance program similar to one in effect in the United Kingdom (see sidebar). Under such a program, a vessel owner would buy policies for his crew at the beginning of the year and deduct the premium from their shares.

Nixon contends that this proposed program would:

- cover the vast majority of injury cases fairly, predictably and without need for an attorney to demonstrate fault;
- be affordable to vessel owners, since the most abusive cases would be eliminated and the crew would be sharing in the insurance costs, as a legitimate independent contractor should; and
- make more sense to the insurance companies, since their liability would be limited to medical expenses and lost wages in the vast majority of cases.

Nixon concedes, "There is no guarantee a reduction in claims will mean an automatic reduction in premiums."

In his view, the renewed health of both the fishing and the liability insurance industries is also critical to turning the P&I problem around. "The reason the health of the fishing industry is so important is that fishermen don't get hurt as often in profitable fisheries. When a vessel's profits have been low or nonexistent," Nixon observes, "fatigue of both personnel and equipment becomes a major factor . . . maintenance is delayed and equipment is more likely to fail and cause injury." □

United Kingdom's system kills incentive to sue

Sunderland Marine Mutual Insurance, the major insurer of fishing vessels in the United Kingdom (U.K.), has expressed interest in extending its 30-year-old program of personal accident coverage, or disability insurance, to U.S. fishermen. So reports Dennis Nixon, the U.S. insurance specialist who drafted the report for the National Council of Fishing Vessel Safety and Insurance (see main story). Nixon says that Ocean Marine Underwriters, a Warwick, R.I., firm, and a West Coast broker appear to be interested in making Sunderland's program available to U.S. fishermen.

How does the U.K. program work? The vessel owner buys personal accident insurance for his whole crew, skipper included. The policies do not bear the names of individual crewmen; thus, if there is a change in crew, all the men remain covered. Some vessel owners "charge out the costs to crewmen; others bear the costs themselves," explains Tom Watson of Sunderland Marine. The annual cost of a policy amounts to a week's wages.

The policy provides 24-hour coverage to a crewman, Watson notes, "whether the insured is at work or not. It would, for example, cover the insured in the event of a car accident and also when on holiday." Apart from immediately compensating an injured fisherman with what would amount to lost wages, the U.K. policy covers up to 15% of medical expenses. The remainder of those expenses are picked up by the government, since the United Kingdom has a national health insurance program.

Despite the personal accident policy, the United Kingdom does not bar an injured fisherman from suing an vessel owner. "But why should he?" asks Watson. "There is no incentive to sue; also, the court awards for industrial injuries are much lower in the United Kingdom than they are in the United States."

— Susan Pollack

Reaction

(Continued from Page 3)

England's leading personal injury lawyers, Michael Latti of Boston and Joseph Orlando of Gloucester, have voiced strenuous objections to the proposal to limit liability under the Jones Act.

"To deprive a fisherman of the right to sue is a simplistic and dangerous solution that places money over men," says Orlando. "Let's reduce injuries. The safety of men should be the No. 1 priority. The only way to reduce claims is to reduce injuries." He urges that consideration be focused on the creation of a mandatory vessel safety inspection program, instead.

Latti does not think removing temporary disability claims from the Jones Act would do anything to lessen litigation. Moreover, he argues that it would be "unconstitutional to take away one right without replacing it with something equal to or greater than it." Although Nixon's proposed remedy guarantees an injured fisherman full medical coverage and wages, "it totally ignores his right to compensation for pain and suffering and mental anguish," Latti says.

"East and West coast representatives of the Seafarer's International Union offer opposing views. Jack Tarantino, the union's vice president on the West Coast, calls attention to the fact that in the port of San Diego alone, a half-dozen 250' tuna clippers are tied up and 100 men are out of work because of canceled Protection and Indemnity (P&I) policies. He suggests revamping the Jones Act so that an impartial government board would preside over cases of sickness or injury.

> *"The insurance companies say, 'Don't bother us . . . If you got a problem, take it to court.' So that's what a lot of guys are doing."*

On the other hand, Mike Orlando, the union's East Coast vice president and attorney Joseph Orlando's father, maintains that the proposal to limit a fisherman's right to sue smacks of the "bias of boat owners and insurance companies. It's a way to economize on the people who work on the deck, the people whose lives they're gambling with."

Some fishermen say they would be willing to bear the costs of a disability-income insurance program; others say they would not. A crewman on an Alaska joint venture boat says, "I'm against having to pay for any insurance myself. I think that's more the responsibility of the boat owner. I understand the problems of the boat owners, but the insurance protects them." He adds, "The guys I know that have been hurt have been seriously hurt and deserve to be paid off. I haven't seen any of the abuses that are being discussed these days."

Another view is offered by a crewman on a Gloucester boat. Julio Pumar, who works on the dragger Peter and Linda, says he favors the creation of a no-fault plan. "The skipper on this boat is my friend. Now how do you think I'm going to feel if I get hurt and the only way to get any help is to sue my friend?" Pumar says he does not mind bearing the cost of what would probably be a $300 annual premium, but he says it would be easier if it were deducted from his crew share on a weekly, rather than an annual, basis.

In Pumar's view, the insurance companies are mainly responsible for the rise in lawsuits because, he says, they frequently have not been willing to pay a man's lost wages when he's injured. "They say, 'Don't bother us . . . If you got a problem,' they say, 'take it to court.' So that's what a lot of guys are doing."

— Susan Pollack

urance 'drought' threatens every facet of American life

Note: Across the country, liability insurance l protection from the economic ruin of is drying up. When it is available, its cost is ne customers feel lucky to be paying premi- s of 500 to 1,000 percent. In the first story of series, "Insurance Drought," AP national ·d Bayles outlines the crisis and its several

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By FRED BAYLES
The Associated Press

In Albany, N.Y., closes its doors. A Miami n goes out of business after 60 years. The small Pennsylvania town orders police off

mon denominator in each case is a sudden g "drought" in liability insurance.

PART I

Once routinely purchased by business and government as protection against the economic ruin of lawsuits, liability insurance has become scarce and expensive. The growing list of those left out in the cold includes municipalities, professionals like engineers and architects, day-care centers and businesses ranging from large chemical companies to small manufacturers.

This crisis is more pervasive and has occurred more suddenly than the well-publicized rise in medical malpractice insurance rates that have hobbled hospitals and doctors. The drought also has different causes.

Roger Singer, Massachusetts' deputy insurance commissioner, says his office is flooded with calls from people who can't get insurance or who face rate increases of 300 percent and more.

"It's everybody from some of the biggest companies in the state to an individual chimney sweep who can't get coverage," he said.

The crisis touches all society. The New Mexico Retail Liquor Dealers Association estimates 75 percent of its membership can't get or afford insurance. South Carolina officials are trying to persuade an insurer to continue coverage for hundreds of churches.

"I would expect the churches to be the better risks, and if the company starts canceling the better risks, then other companies would follow, and we would have chaos," said state Insurance Commissioner John Richards IV.

Businesses large and small are affected. Steve Scammell, risk manager for GAF Corp., a chemical company in New Jersey, expects a 400 percent increase in insurance costs.

Herbert Smoot, owner of Southern Missouri Towing, is selling his six wreckers and going out of business because of a 300 percent rate increase.

"I just flat had to shut them down," he said. "It's not feasible when it's a losing proposition."

The drought's impact is widespread. When Mission Insurance Co., a carrier in California, dropped its specialty day-care insurance, the ripples reached across the country. Hundreds of day-care centers went hunting new policies.

In Michigan, premiums for day-care policies increased an average 400 percent. "Parents are being

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Insurance...

Continued from Page 1

priced out of the market," said Bill Hankins, a spokesman for the state Department of Social Services.

It affects everyday life. Northeast ski operators will raise the price of lift tickets a few dollars to cover the cost of higher insurance. Denver Girl Scouts may have to cancel summer camp for want of coverage.

The Chicago suburb of Mount Prospect leveled its popular toboggan run after its insurer threatened to cancel the town's policy.

The insurance drought follows the worst year in the liability insurance industry – a loss of $3.8 billion.

Insurance executives blame the red ink on the steady increase in the size and scope of lawsuits. Laws expanding the definition of liability and court interpretations of policies have left insurers with hefty judgments on claims they say they never intended to cover.

The industry points to a $15.8 million judgment in Jackson Township, N.J.

Two insurers were ordered to pay damages for the slow contamination of town wells by chemicals from a landfill even though its policy excluded pollution coverage, except for "sudden and accidental" incidents.

"The courts have interpreted our contracts to such an extent that we no longer know what is covered," said Warren Levy, a spokesman for the Insurance Information Institute.

Insurers and their customers also are paying for nearly seven years of "interest rate underwriting" – a time when companies sold policies at bargain basement prices while bolstering profits through investments paying 14 percent or better.

Some say insurance rates fell below realistic levels as competition raged for the premium dollars. When interest rates dropped abruptly, insurance companies were caught between shrinking investment income and soaring legal judgments.

"The companies are not making the investment return that had helped prop up the bad underwriting," said James Chastain, a professor of insurance at Howard University's School of Business and Public Administration.

The losses have cut into insurance reserves – the money set aside to cover future claims. They have also scared away money invested by reinsurance companies, foreign carriers like Lloyd's of London that basically insure the insurance companies.

Insurance: An industry full of ups and downs

PART II

Editor's Note: Insurance people agree there is a business of ups and downs, reacting to income-producing interest rates by either raising or lowering premiums. But the current dip is the insurance roller coaster ride is surprisingly deep. This second story in a four-part series, "Insurance Drought," explains the reasons.

By FRED DAYLES
The Associated Press

In 1980, the MGM Grand Hotel in Las Vegas, partly gutted by fire and reeling from the deaths of 87 guests and employees and injuries to 700 other people, was able to buy a unique retroactive insurance policy.

For just $38 million, a consortium of insurance companies sold the hotel a $170 million package to cover eventual settlements with victims and their families.

Five years later, times have changed. Dorothea Olsen of Kennewick, Wash., is faced with a 500 percent increase in insurance for her day-care center in Pasco, even though it hasn't had a claim in 10 years.

"We are faced with losing money that should go to teaching the children," she told state lawmakers.

The two cases illustrate the cyclic nature of the insurance business, a feast-to-famine industry that goes from periods of frenzied competition and low rates to tight markets and high prices.

But this latest cycle in liability insurance is unprecedented. Economic and social factors cost insurers a collective $3.8 billion in 1984 – the worst year on record – and dried up insurance for steady customers.

Those able to buy insurance face rate increases of 300 percent to 1,000 percent even when they have never filed a claim.

Consumer advocates like Ralph Nader say the industry has manufactured a crisis, but insurance executives say events are beyond their control. Twenty insurance companies have been declared insolvent this year, the highest number in 11 years.

"The mood is scared," said James Holland, an executive with The Travelers Cos.

The insurance industry has ridden a roller coaster of cycles since the 1970s. When insurance money is plentiful, rates fall as companies compete for premium dollars to invest in stocks, bonds and real estate. When rates fall too far and investment income can no longer support them, the cycle reverses and rates climb.

The latest cycle began in the late 1970s when insurers cut rates to lure additional dollars for high interest investments. Foreign insurers, banks and brokerage houses, attracted by the investment promise, entered the business.

"The industry is naturally competitive," said Warren Levy, a spokesman for the Insurance Information Institute. "With new money coming in and everybody looking to increase market share, companies cut rates."

Although the results looked good – the industry recorded a net gain of $7 billion in 1981 – experienced hands began to worry.

"We were very reluctant players under ground rules that we knew were wrong and were going to lead to disaster," said Holland of Travelers. "As long as the investment income was coming in, it was pretty hard to cry wolf."

The MGM Grand story was an example of the times.

The insurance companies, thinking it would take years to settle suits from the fatal blaze, counted on profits from high interest investments to offset the cost of claims.

Instead, the hotel startled its insurers by settling most cases quickly out of court. In addition, throughout the industry, interest rates fell faster than expected while the number of claims, and the damages awarded, rose.

John Jennings, an editor with National Underwriter magazine, said the industry was slow to react. "They knew this was happening to them and yet it took until 1983 for the market to turn," he said. "It should have turned in 1983."

Dramatic rate increases began last year, yet premium income is still below levels of six years ago. In 1979, insurers collected $6.6 billion in premiums from business customers.

"If you only allow for inflation, the premiums in that line should have totaled $9.4 billion last year," said Sean Mooney, an economist with the Insurance Information Institute. Instead, 1984 premiums totaled $4.5 billion.

But industry critics say recent rate increases have more than compensated for past mistakes.

"Prices are now going into extremely excessive areas," said Bob Hunter, head of National Insurance Consumer Organization. "The idea that every line of insurance in the country is falling apart is ridiculous."

But while income has remained static, losses have climbed. In 1980 the industry paid $70.2 billion in claims; last year, losses were $101 billion.

Richard Earley, an assistant vice president at Aetna Life and Casualty, said court rulings had saddled insurance companies with claims they never intended to cover.

In Jackson Township, N.J., for example, two insurance companies were ordered to pay $15.8 million to residents suing over water contamination from a leaky landfill – even though the municipal policy expressly excluded pollution incidents, except for "sudden and accidental."

"Traditionally we felt we could develop a contract that stated what our liabilities were and what exposures we were insuring," said Earley. "We found recently that even a very common understanding by us and our insured had gone away by the time we got in the courtroom."

This uncertainty has scared insurers away from potentially high-risk customers.

Insurance for day-care centers was once considered a "sleeper." Many home day care centers simply paid a few extra dollars for a rider on their homeowners policy. But when a California company dropped the line, other insurers shunned the business. They were concerned about reports of sexual abuse, even though no such claim has ever been filed.

The industry contends it has to be more selective about customers because it has less money for insurance.

Under most state regulations, insurers must hold $1 in reserve for every $3 of insurance sold. That means for every $1 of reserve lost, the companies have to cut sales by $3. Mooney, of the Insurance Information Institute, said the industry's surplus had fallen nearly $2 billion, reducing its capacity to write insurance.

The industry's capacity has also been reduced by cuts in reinsurance funds – money provided by reinsurers like Lloyd's of London and other foreign companies that underwrite the risks covered by insurance companies.

Andre Maisonpierre, president of the Reinsurance Association of America, said companies that rushed into the U.S. market five years ago now are cautious. He estimated American reinsurance companies had lost as much as $1 billion in foreign reinsurance funds.

"Lloyds is saying that 12 percent of its premium is U.S. business and that 12 percent has generated losses that have virtually wiped out its worldwide gain," said Maisonpierre.

Ironically, there are signs the industry's roller coaster ride already is heading up. Insurance stocks are considered a good investment. "Earnings should be excellent in 1986 and better in the next few years," said David Wells, an analyst for Goldman, Sachs.

Critics like Nader and Hunter say the stock market forecast backs up their contention that insurers are exploiting the situation. But Levy of the Information Institute said, "We have no qualms about saying the industry will be profitable again.

"The industry that comes out of this will be different – a tougher, smarter industry."

Big hikes in litigation add to insurance industry crisis

Editor's Note: U.S. courts have seen a growing tide of liability suits against manufacturers, municipalities and individuals. The cost of the litigation is being blamed in part for a severe insurance crisis. This third installment of a four-part series, "The Insurance Drought," examines this litigation.

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By FRED BAYLES
The Associated Press

PART III

Henry Lowd jokes about it. "People come from miles around to fall on our property," said the executive secretary for Randolph, Mass., a Boston suburb sued for $65,000 by a New Hampshire woman who fell at the town police station.

The threat of lawsuit is no laughing matter to growing numbers of municipalities, manufacturers, bars and others. The rise in litigation is a special burden to the nation's troubled insurance industry, which suffered a record $3.8 billion loss last year, a loss blamed in part on the constant drain of lawsuits.

Insurers recorded $101.1 billion in losses last year, up from $70.2 billion paid in 1980. As a result, insurers have raised rates and cut coverage. The impact is felt everywhere, from local government to child-care centers.

"People want to use the civil justice system to resolve the smallest dispute," said Richard Marrs, head of The Travelers Cos. claims department. "Neighbors who may have had a disagreement many years ago might have gotten together and worked it out. Today they want to get a lawyer."

Courts around the country have recorded an increase in the number and size of lawsuits:

• 1,580 product liability suits were filed in federal district courts in 1974. Last year, the number was 10,745.

• The New Mexico Public Liability Fund reported that of $8 million in claims paid since 1976, $6.2 million was awarded in the past two years.

• In 1975, New York civil courts handled 12,842 liability cases. Last year the number reached 19,613. New York City paid $46.5 million in liability claims in 1980; this year the figure is $87.9 million. Comptroller Harrison Goldin has warned the city's liability costs might soon rival expenditures for police and firefighters.

Mark Peterson, a senior researcher with the Institute for Civil Justice, an affiliate of the Rand Corp., said civil cases in San Francisco and Chicago involving automobile accidents and "slips and falls" were giving way to more expensive product and government liability suits.

"These are high-stake suits that are increasing in frequency," said Peterson. "That is meaningful because of the risks insurance companies face."

Peterson also notes jury awards have nearly doubled since the 1970s.

"There are a growing number of million-dollar awards," he said. "The typical jury awards have remained surprisingly stable over the past 20 years. But the big awards are driving up the average, and the insurance companies worry about the average."

Many point to court interpretations that have expanded the definition of liability.

"Joint and several," a legal concept rooted in English common law, says an injured party may recover losses from anyone with some responsibility for the injury.

In recent years, many courts have held that "deep pocket" defendants, government and businesses with large financial resources, can be held liable for all damages even if they are only minimally responsible.

The California Supreme Court, in 1975 and 1978 rulings, held that injured parties who shared the blame could still sue another responsible party that was only partially to blame.

San Diego County recently was ordered to pay $2.5 million to a man paralyzed when a friend's car missed a curve and rolled over. Although the two men were judged at fault for speeding, drinking and smoking marijuana, the county, judged 10 percent at fault for failing to install curve markers, had to pay all damages because the driver had no insurance.

Louisiana saw liability judgments go from $5 million to $55 million in a decade following a state Supreme Court decision that held government liable for defects occurring in anything under its jurisdiction, whether or not government officials knew.

Kevin Reilly, a state legislator from Baton Rouge, described a large award paid to a man whose car ran off the road and hit a tree.

"The record was clear that he was speeding and drinking, but the court said the tree was too near the highway," said Reilly. "We didn't know about that tree, but it didn't make any difference."

Reilly sponsored legislation that now holds the state liable only if it fails to correct a reported defect.

Social issues are also clamoring for their day in court. The national concern over drunken driving has brought rulings, like one from the Arizona Supreme Court, that liquor establishments are responsible for actions of patrons who become intoxicated and later are involved in accidents.

Hank Graham, president of the Arizona Licensed Beverage Association, said the ruling persuaded him to sell his share in a tavern and liquor store.

"I'd like to have an ice cream store," he said. "I haven't heard of anybody suing an ice cream store yet."

Plaintiffs now take alternative routes to sue state and local officials who are often protected against suits by state law.

Joe Seat, executive director of the Tennessee Municipal League, said police departments were routinely subject to federal civil rights suits over suspects' treatment, police shootings and other incidents.

"Anytime we get a slaying involving a policeman, no matter what the circumstances, I can guarantee we eventually will get a civil rights lawsuit filed," he said. "The officer may have been protecting his life, but he's going to get a civil rights suit."

A majority of defendants settle out of court. But some are beginning to fight back. William Fleming, general counsel for the Municipal League of Arkansas, said the group had established a legal defense program that has won dismissals for several cases.

"Most of the time we play hardball and fight it all the way," he said.

But even successful legal fights are costly. Randolph, Mass., won the $65,000 suit filed by the New Hampshire woman who fell in the police station. But the town's insurer spent $16,000 defending the suit. The company later canceled the town's insurance.

Some states are trying to limit the size of court awards.

Changes certain in troubled insurance industry

PART IV

Editor's Note: The crisis in liability insurance has many clamoring for change. Insurers want to revamp they way they write policies; consumer advocates talk of more regulation; state officials study ways of controlling fluctuating insurance rates. The final story in a series, "The Insurance Drought," examines what today's problems spell for the future.

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By FRED BAYLES
The Associated Press

The sudden, sweeping impact of the nation's insurance drought has raised a clamor for change.

Insurance executives, frightened by ledgers bleeding red ink, want major alterations in the way they do business. Consumers facing rate increases of 500 percent or more, cry for [illegible] controls. Elected officials study ways to better [illegible] the far flung insurance industry and assure high risk groups get coverage.

Everyone agrees the way America insures itself will be different in the future.

For Richard Earley, one of the top underwriters for Aetna Life and Casualty Co., recent events prove that "not all things are insurable."

Earley said the industry will be more cautious about who it insures. Even conscientious customers in high risk groups like municipalities, day care centers and chemical companies may suffer.

"You've got to view a risk with an eye that even the good guys are going to be left holding the bag," he said.

Warren Levy, a spokesman for the Insurance Information Institute, foresees a time when more insurance companies will limit business to specific areas. Where many companies once insured municipalities, one company may now sell insurance solely to a city's transit system. Another insurer may specialize in police liability.

"Fewer companies are trying to provide a market place across the board," said Levy.

Insurers are redefining what they will and will not cover. Some want legal costs included in liability limits. Tough new exclusions, such as environmental risks, are being tacked onto policies. But the biggest move for change involves the notion of time.

Most policies cover claims on an occurrence basis: a manufacturer sued today for a loss that happened in 1955 would be covered by whoever held the policy that year.

Insurers say this leaves them vulnerable to the past, pointing to asbestos suits that have been filed two to three decades after a policy was written.

The industry wants regulators to approve "claims-made" policies that hold insurers liable for claims filed only during the time a policy is in force.

This change allows insurers to look to the past and present, instead of the uncertain future, to set rates based on a more predictable risk.

Under the present system, a suit by a shipyard worker exposed to asbestos in the 1950s would fall on the shoulders of the company that wrote the insurance 30 years ago, when there was no knowledge of the potential problems with asbestos.

Under the change, the claim would be covered by the present insurer, who, knowing of the potential for asbestos suits, would have charged a higher premium to cover the higher risk.

But consumer advocates warn such a switch could leave customers and claimants in the cold if high risk customers can no longer buy insurance.

"All this is to get predictability," said Bob Hunter, head of the National Insurance Consumer Organization. "There's predictability for the companies, but much less predictability for the consumer."

Consumer advocates like Hunter and Ralph Nader say state regulators must be wary that insurers may be overstating today's problems to leverage an advantage in the future.

"State regulators must do some investigation and for once and all tell people the truth," said Nader.

Nader also thinks government should take a greater role in seeing that high risk groups can get insurance. He recommends federal backing for some high risk insurance pools. Ironically, some of his concerns are echoed by the insurance industry.

James Holland, head of The Travelers Companies' Casualty-Property Division, feels government must work with the industry to establish such insurance pools.

"Companies individually can't respond to this problem," said Holland. "It has to be some collective action and under some basis that will not expose us to antitrust allegations."

Such a business government partnership was recently formed in New Hampshire, where 24 insurers joined with the state to provide insurance to municipalities, day care centers and bars. The group pays premiums 30 percent above the market rate.

Other groups are looking for alternatives to private insurance. Many states, large cities and major companies are already self insured, having set aside funds to cover potential claims. Smaller municipalities in at least 11 states have formed insurance pools and more are considering them.

Such pools have had mixed reviews. David [illegible], mayor of Park Ridge, Ill., said the municipal insurance pool of 23 communities he helped form saved his city [illegible] in premiums. Harvey [illegible], an official with the North Carolina League of Municipalities, does not see savings for members of a pool his organization is establishing. "But it may be better than no insurance at all," he said.

While some look for alternatives to commercial insurers, state officials are hearing calls from consumers for closer scrutiny of the insurance industry.

Hunter, of the National Insurance Consumer Organization, said regulation of the industry was poor.

Insurance companies have been regulated at the state level since the end of World War II. In many states, Hunter said, the insurance departments, outnumbered and outgunned by the insurance industry, often rubber-stamp rate increases and changes in coverage.

"The states are clearly understaffed and without the experience to enforce the law," he said.

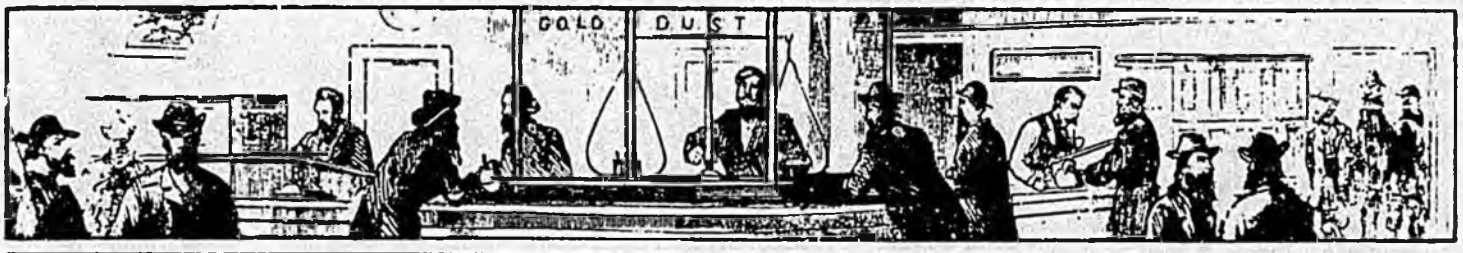
Maryland Insurance Commissioner Edward Muhl, an officer with the National Association of Insurance Commissioners, agreed the quality of regulation varied from state to state. To deal with that, he said his organization was setting up a computer network that will allow states to compare notes and create more common regulations.

Muhl acknowledged that regulation should have stepped in when insurance rates fell below realistic levels in the early 1980s, a fact that is blamed in part for the current problems.

But he cautioned that tighter regulation in the future might require state commissioners to demand higher rates if insurers drop them too low again.

"It is difficult to say to a business that you should pay more for insurance," he said. "But it is incumbent on the regulators to make sure the insurance is there. The alternative is that the company won't be there when people need it. It's a tough [illegible] but it's one we all have to take."

A Bi-Monthly Report on Government Finance Issues in the States



THE FISCAL LETTER

An Information Service of the National Conference of State Legislatures — Earl S. Mackey, Executive Director

Editors: Corina Eckl
Leann Stelzer

Vol. VII, No.6
November/December 1985

Contents:

LIABILITY INSURANCE: WRESTLING WITH A THORNY ISSUE

In the past year, states, local governments, and private businesses have found it increasingly difficult to obtain or afford liability insurance. Cities, states, physicians, and hospitals, among others, have seen dramatic increases in their liability insurance rates. North Dakota estimates that liability coverage for its Department of Human Resources will increase 219 percent, from $453,346 to $1,446,133 during the 1985-87 biennium, as compared to the previous biennium. Specialists in some parts of the country are seeing their medical malpractice premiums climb to more than $50,000 annually.

Small businesses, long distance truckers, directors and officers of corporations, owners of gasoline stations, grain elevator operators, and colleges and universities are examples of others facing huge increases in liability insurance premiums. Child care centers are finding it difficult to buy insurance in light of an increase in sexual abuse claims. And many waste dump operators cannot find a company to insure them--a serious problem, as insurance is usually a license requirement.

Roots of the Problem

Several factors in combination have led to today's "crisis" in liability insurance affordability and availability. While there is some difference of opinion on the extent to which each contributes to the problem, the following are the most frequently cited factors:

- A drop in the return on investments made by insurance companies. In the late 1970s, when interest rates were high, insurers eagerly wrote policies and invested the premiums. The competition for business

(Continued on page 2)

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drove down the price of insurance, but the claims continued. As the return on investment dropped with the rate of inflation, losses in the insurance industry have mounted. In the past two years, companies lost more than in the previous 25 years.

- Excessive damage awards. A small percentage of cases account for the bulk of dollar payouts. Whereas settlements for more than $1 million were rare just five years ago, such high settlements are somewhat more common today. For example, a swimmer who became paralyzed after diving in the surf at a town beach won a $6 million judgment against the city of Newport Beach, California, earlier this year. Large awards for pain and suffering often result in high settlements. Some also argue that the collateral source rule results in excessive awards. This rule forbids the introduction of evidence that the plaintiff is already receiving compensation from other sources. Thus, a patient may receive compensation from more than one source for a single element of loss, such as medical expenses.

- Increased uncertainty about the number and size of future claims and awards. In recent years, insurers have seen more and more plaintiffs successfully sue either for events which took place many years ago, whose harmful effects are only now coming to light (e.g., leaking toxic waste sites), or for which claims were once virtually unheard of (e.g., sexual abuse claims against operators of child care centers). As insurers find it increasingly difficult to accurately predict the nature of their clients' liability, they are more and more reluctant to assume such risks.

- High administrative costs. Estimates are that only 28-40 cents of each medical malpractice premium dollar ultimately goes to injured parties. Administration, claims evaluation, and litigation costs, including plaintiff attorneys' contingent fees and defense attorneys' hourly fees, absorb more than one-half of each medical malpractice insurance premium dollar. Similar figures apply for much of the liability insurance market.

Several additional factors have exacerbated the liability insurance problem for state and local governments:

- The doctrine of joint and several liability. This doctrine allows a plaintiff to sue any or all of the possible defendants for the full amount of his damage. Although a plaintiff cannot collect more than his legally determined damages, he may collect it from the defendant with the most resources or the "deepest pocket," irrespective of that defendant's degree of fault. This rule often works against governments because they are always considered deep pocket defendants. For example, a city which is found to be 10 percent at fault in an accident may have to pay all or most of the damages if the other defendants have no resources.

- Loss of sovereign immunity. Under the doctrine of sovereign immunity, which is derived from an ancient English common law, citizens cannot sue their own government. This doctrine has been eroded substantially over the years as a result of federal and state legislative and judicial actions.

Potential Solutions

Proposed strategies for dealing with the liability insurance problem fall into three categories: 1) those that involve tort law revisions; 2) those that require administrative reforms; and 3) those that may be taken independently by the states. Table 1 summarizes categories of insurance liability bills likely to be introduced in upcoming legislative sessions.

Under the heading of tort law revisions, the following proposals are frequently mentioned:

- Amend the joint and several liability rule to limit the liability of deep pocket defendants where their percentage of fault is relatively minor.

- Change the collateral source rule to allow evidence to be introduced that the plaintiff has received compensation from other sources.

- Establish pretrial panels to encourage early settlement and weed out frivolous claims.

- Place limits on the amounts recoverable; these limits may be placed on the total amount of an award or only on the amounts recoverable for non-economic losses, such as pain and suffering, disfigurement, impairment of quality of life, or punitive damages.

- Permit courts to allow structured damages--damages paid in installments throughout the plaintiff's period of disability, up to a lifetime--in lieu of lump sum awards.

- Regulate the contingent fee arrangements of plaintiff's attorneys.

Administrative reforms may include the following:

- Require insurance companies and self-insurers to submit basic information on their liability experience to give states a better understanding of the frequency and severity of claims and the adequacy of premiums, as well as provide feedback on the effect of enacted legislation.

(Text continued on page 4)

TABLE 1

BILLS DEALING WITH LIABILITY INSURANCE LIKELY TO BE INTRODUCED IN UPCOMING LEGISLATIVE SESSIONS*
November 1985

STATE	TORT LAW REVISION							INSURANCE REGULATION		NOTES
	Joint/Several Liability	Collateral Source	Prejudgment Interest	Caps on Damages	Structured Awards	Frivolous Suits	Sovereign immunity	Insolvency - Guaranty Fund	Administrative Action to Promote Access	
Alabama										
Alaska	•	•	•	•	•	•	•			May consider insurance code revision.
Arizona	•	•		•	•			•		Created special commission on property/casualty insurance.
Arkansas										
California	•	•	•	•	•	•	•	•		
Colorado	•	•	•	•	•	•	•	•		
Connecticut										Abolished collateral source rule for MedMal claims (1985).
Delaware										State has authority for joint underwriting.
Florida	•				•				•	
Georgia**										
Hawaii				•		•		•		Insurance code scheduled for revision in 1987.
Idaho**										
Illinois**									•	May propose citizen advocate for insurance board.
Indiana										
Iowa	•	•	•	•	•	•	•			
Kansas										Capped punitive damages in MedMal claims (1985).
Kentucky						•				
Louisiana										Awaiting court test of cap on damage awards.
Maine				•						
Maryland										Created MedMal and liability insurance task forces.
Massachusetts				•						
Michigan	•	•	•			•				
Minnesota								•		
Mississippi										
Missouri										
Montana				•						
Nebraska**								•		
Nevada										Insurance insolvency statute enacted (1985).
New Hampshire										
New Jersey**									•	Moratorium on insurance cancellations in place.
New Mexico										
New York	•									
North Carolina**								•		
North Dakota	•									
Ohio							•		•	Order prohibiting mid-term insurance cancellations.
Oklahoma										
Oregon	•								•	May prohibit mid-term cancellation or rate increase.
Pennsylvania										Currently reviewing insurance investment rules.
Rhode Island	•			•			•			
South Carolina	•		•	•			•			
South Dakota	•	•		•	•					
Tennessee										
Texas**										
Utah										Major rewrite of insurance code (1985).
Vermont										
Virginia		•					•			Insurance code may be recodified.
Washington	•	•	•		•			•		
West Virginia		•		•	•					
Wisconsin				•						
Wyoming**										Bill may give increased authority to Insurance Commissioner.

* Based on a survey of state legislatures conducted by the National Conference of State Legislatures, November 1985.

**Study of possible tort law revisions in progress.

Definitions:

Insolvency/Guaranty Funds: actions taken to protect claimants from insolvency failure of insurance companies.
MedMal: medical malpractice.
Prejudgment Interest: assessment of interest as of the date of the filing of the claim.
Structured Awards: allows defendant to pay a claim over a period of time.

LIABILITY INSURANCE (Conclusion)

- Prohibit midterm cancellations of policies unless the risk has demonstrably increased and direct companies to give policyholders more notice of intent to cancel.

- Allow insurance companies to write policies on a "claims made" rather than on an "occurrence" basis. Occurrence-based insurance holds the insurance company responsible for claims resulting from treatment rendered during the coverage period, regardless of when the claim was filed. Claims-made based insurance holds insurers responsible for claims filed only during the coverage year.

Independent actions that states may take to control their liability insurance costs include:

- Reassert, wholly or partially, sovereign/government immunity and extend this immunity to local governments.

- Improve risk management in order to reduce the likelihood of claims.

- Self-insure instead of buying liability insurance from third parties.

An Example from Medical Malpractice Insurance

A crisis in the availability of malpractice insurance inspired reform legislation in almost every state ten years ago. Many of the strategies outlined above were enacted at that time to deal with the crisis. These reforms were meant to encourage settlements before trial, to limit recoveries, to improve quality of care, and to alter the legal process.

State legislation was effective in solving malpractice availability problems, but the effect of tort reforms on claims and recoveries is far less clear.

Economist Frank Sloan of Vanderbilt University, who analyzed the reforms' impact on malpractice premiums, concluded that "the empirical results of this study give no indication that individual state legislative actions, or actions taken collectively, have had their intended effects on premiums."

Dr. Patricia Danzon of Duke University analyzed malpractice claims closed by almost all insurers in the mid- to late 1970s. Her conclusions were:

- Limits on the dollar amount of awards, including caps and provisions for periodic rather than lump sum payments, appeared to cut average settlements by 25 percent, to raise the proportion of cases dropped from 43 to 48 percent, and to reduce slightly the share of cases going to verdict.

- Relaxation of the ban on introducing evidence of collateral sources of compensation available to the plaintiff appeared to reduce settlements, although the statistical significance of this finding was low.

- Limits on attorneys' contingent fees cut average settlements by nine percent, somewhat raised the number of cases dropped without payment, and slightly reduced the percentage of cases going to verdict.

As legislatures tackle the thorny issue of controlling liability insurance costs during the upcoming legislative sessions, they need to carefully weigh the expected benefits of actions which may reduce the ability of defendants to sue, cap awards, limit attorneys' fees, or involve expensive or cumbersome administrative actions.

NCSL Contact: Barbara Yondorf, Denver.

Editors' Note: This is the first in a two-part series on the liability insurance problem. The second article, which will appear in the January/February 1986 edition of The Fiscal Letter, will take a closer look at the effectiveness of different strategies in controlling liability insurance costs.

A SPY IN OUR MIDST

Who was the most famous legislative fiscal staff member in the country in 1985? He was written up in the Wall Street Journal, the major news weeklies, wire service stories, and even had his name mentioned in Chinese newspapers. Many of his colleagues may not have realized that an apparently meek, mild-mannered economist who attended several NCSL meetings in 1984 was a notorious agent for the Russian KGB.

The person who received all of this attention was a 33-year-old revenue estimator for the Legislative Fiscal Office of New Mexico, Edwa 1 Howard. Late last summer, just as the FBI was about to arrest him, he managed to escape. He is now reported to be in Moscow.

It seems that Howard had been trained by the CIA to serve as a contact with one of our most valuable Russian undercover agents. When testing showed that Howard was taking drugs, the CIA fired him, but it reportedly helped him to obtain a position with the New Mexico Legislature. Press reports suggest that the CIA treatment of Howard led him to divulge secrets about their operations to the KGB.

During his two years with the Legislative Fiscal Office, Howard appeared to be just another employee. In retrospect his colleagues noted some strange behavior, such as a preference for using a public pay telephone in the capitol rather than his office phone. He sometimes disappeared for extended periods while attending meetings out of town, including the 1984 NCSL Annual Meeting in Boston.

Some people may think that legislative fiscal staffers tend to be dull, but the Ed Howard story suggests otherwise. The Fiscal Letter plans to report more human interest stories in the future as they come to our attention. Anyone with additional details about Ed Howard is urged to contact The Fiscal Letter and the Federal Bureau of Investigation, not necessarily in that order.

THE KIPLINGER WASHINGTON LETTER

Circulated weekly to business clients since 1923—Vol. 63, No. 9

THE KIPLINGER WASHINGTON EDITORS

1729 H St., N.W., Washington, D.C. 20006 Tel: 202-887-6400

Cable Address: Kiplinger Washington D C

Dear Client: Washington, Feb. 28, 1986.

At last, a little GOOD news on business liability insurance: Some relief is in sight. Not MUCH for the time being, but some, enough to indicate that the worst may be over...a shifting of the winds. The day of wholesale lawsuits over all kinds of "wrongs" may be ending.

We've been looking into the situation in a number of key states where the legislatures are already working up a wide range of remedies. Note that most of the activity is in the states. Congress isn't expected to vote anything, in spite of hearings and publicity in recent months.

New liability laws are coming in many places to curb the mania to file lawsuits...provoked by the huge awards dished out for injuries.

These are most active: N.H., Conn., W.Va., Mich., Ill., Colo. and Calif. But changes in current laws are now expected in 29 states. And legislatures in a few others will probably jump on the bandwagon.

Here are changes that top the list so far:

Joint liability. Repeal or easing of laws that require payment of all damages by someone who's only partly at fault...if other parties who are primarily to blame can't pay. Some 13 states working on this.

Limits on lawyers' fees. About 12 states are going to regulate contingency fees that sometimes eat up 40% of the awards or settlements. Legal fees are already regulated in one form or another by 22 states.

Limits on vague damages such as pain & suffering, anxiety, etc. Legislatures want to cap what can be paid for hard-to-measure injuries.

Same for punitive damages...require greater proof of fraud, malice, willful and wanton action. These are subject to abuse today.

Compensation from outside sources. Some 10 states are studying ways to reduce awards when an injured person is also getting something from another source such as job-injury pay. Make awards more realistic.

Tighter laws on negligence. Stricter definition...to curb suits.

Relief for bars & restaurants. A ceiling on damages against them to help such places buy insurance...now often unavailable at ANY cost.

Instalment payment of damages...rather than a required lump sum.

Plus other wrinkles to ease the current situation. Many states are likely to copy those around them, thus eventually fleshing out laws that will go a long way toward curbing abuses. But this will take time.

Meanwhile, this advice from several states...to those businesses having trouble on insurance: It isn't wise to "go bare"...run the risk of injury and damages with no insurance. Call your state commissioner. Frequently he can steer you to a firm that will supply liability coverage at a rate you can afford...or suggest some alternative to "going bare."

Premiums are high, and probably are headed higher before long. But relief IS ahead. And that's encouraging. We'll watch it for you.

The Tacoma
News Tribune
The Pacific Northwest's Leading Independent Newspaper—Established 1883

NOV. 13, 1985

Insurance firms blamed for rate crisis

By RICK SEIFERT
The News Tribune

OLYMPIA — Insurance companies are largely to blame for rising liability insurance rates and widespread insurance policy cancellations, according to a state legislative report issued today.

"In far too many cases, people are being victimized by a giant industry facing a crisis of its own making," concluded the bipartisan Joint Study Committee on Insurance Availability and Affordability.

The five-member group was chaired by State Insurance Commissioner Dick Marquardt.

The report comes on the heels of a committee hearing late last month at which insurance company executives complained about mounting legal costs, multi-million dollar court judgments and unpredictable coverage risks.

In its report, the committee, which made several recommendations for legislation, called the problems within the insurance industry a crisis, one which was expected to last through 1986.

But the committee laid the bulk of the blame at the feet of the insurance companies.

At six public meetings held around the state this fall, the committee heard from hundreds of people, scores of whom "told of being hit by sharply increased insurance costs or of not having insurance available at any price," reported the committee.

Among those testifying were child-care providers, doctors, nurses, restaurant owners, truckers, local public officials, installers of wood stoves and tow-truck operators.

Some are caught in a "catch-22" situation of being required by law to carry insurance but unable to buy it at any price, the committee reported.

And committee members learned that governments, which must stay in business regardless of insurance availability, "are forced to function with dangerously low amounts of protection or with no protection at all," the members said they discovered.

The root of the problem, the committee concluded, originated with insurance companies engaging in "cash-flow underwriting" in which they lowered rates to win premium dollars, which in turn were invested at the high interest rates of the early '80s.

"Sound underwriting and investment practices ... were either ignored or glossed over in favor of a quick return," concluded the committee. Insurance executives said they were forced to cut rates in order to remain competitive.

The report also cited the rising number and cost of court cases as contributing to the problem. One large company told the committee that in 1976, six doctors per 100 were being sued annually. By this year, the ratio had grown to 16 per 100.

The same company reported that legal costs for defending doctors has risen from $12 per $100 in claims in 1950 to $58 per $100 this year.

The committee made several recommendations for legislation, including:

- Expanding high-risk insurance pools to include liability insurance.
- Requiring companies to give 120 days' notice to agents and brokers prior

Continued on Page A-4

Insurance

Continued from Page One

to canceling agency contracts.

- Funding the insurance commissioners office in a way that would tie the amount of funding to the demands placed on the office. Presently the commissioner's office is underfunded, forcing it to rely too heavily on information provided by the companies, the committee concluded.
- Requiring insurance companies to tell commercial policy holders why policies are canceled or not renewed.

The committee also decided that some reform of the state's tort law "appears to be needed" but the group concluded the complex question needs further study.

A tort is wrongful act or damage which can be the subject of a civil court suit. A proposed change in the law might place a lid on the amount for which plaintiffs can sue for pain and suffering.

A REPORT TO THE LEGISLATURE of Washington

FROM THE

JOINT STUDY COMMITTEE

ON

INSURANCE AVAILABILITY AND AFFORDABILITY

November 13, 1985

Dick Marquardt
Insurance Commissioner, Committee Chairman

Senator Ray Moore
Chairman, Senate Financial Institutions Committee

Representative Gene Lux
Chairman, House Financial Institutions and Insurance Committee

Senator Alex Deccio
Ranking Minority Member, Senate Financial Institutions Committee

Representative Shirley Winsley
Ranking Minority Member, House Financial Institutions and
Insurance Committee

REPORT ON INSURANCE

AVAILABILITY AND AFFORDABILITY

November 13, 1985

INTRODUCTION

Six public meetings were held by the Joint Study Committee on Insurance Availability and Affordability to gather information on the current "insurance crisis" affecting Washington and the rest of the country. In the interests of readability, this report of the committee has been kept short. For readers wanting more detail, the appendices address various aspects of the problem in some depth. Copies of draft legislation, case histories and other reference materials are being prepared by the Insurance Commissioner's Office.

Five of the six meetings - held August 1 in Wenatchee, August 9 in Yakima, August 14 in Bellingham, August 21 in Spokane and September 11 in Seattle - were scheduled well in advance, to hear from people wanting to comment on any insurance problems. Testimony was sought specifically on day care liability, restaurant and liquor liability, insurance for long-haul trucking, insurance for local governments and insurance for non-profit agencies.

The sixth meeting, held October 21, was set after the insurance industry failed to offer substantive testimony at the first five sessions. Officials of 12 companies were invited to appear and give their views on the insurance crisis as well as on specific cases involving their firms. Eleven of the 12 companies invited sent representatives to the meeting. This report summarizes the committee's conclusions and recommendations.

REPORT OF THE SPECIAL COMMITTEE ON INSURANCE AVAILABILITY AND AFFORDABILITY

The Insurance Crisis - An Overview

The fact that a crisis does exist in the insurance market is apparent to anyone willing to even briefly examine the problem. The number of people directly affected by the rising cost of insurance or the lack of availability of certain types of coverage seems to grow every day.

While it is difficult to determine just how serious the problem will become and how long it will last, most industry observers feel it will continue at least through 1986. How severe its effects will be on our society, on our economy, will depend a great deal on what actions are taken, by legislation or regulation, to ease it.

The inability to obtain adequate, affordable insurance coverage deeply concerns many people. It is an emotional issue, one often colored by subjective viewpoints and misinformation. Insurance underwriting may involve speculation as well as science, and many factors in the current crisis are not easily measured or verified.

The greatest problems of cost and availability exist in the commercial insurance lines, which refers to property and casualty coverage provided to business, professional people and governments. The commercial lines are distinct from the personal lines such as auto or homeowner's insurance, which are property and casualty coverages provided to private individuals.

The Insurance Code states that the business of insurance is "affected by the public interest, requiring that all persons be actuated by good faith..." The public interest is not being served by the commercial insurance underwriters. It is clear that the property and casualty companies are not meeting the needs of business and government. In fact, the ability of business and government to function normally is being

severely curtailed, and in some cases their very existences are threatened. Many businesses and branches of local government are going without insurance coverage or are facing 200 to 300 percent increases in premiums for coverages with dangerously low liability limits.

How Did It Happen?

Property and casualty insurance goes through cycles, with competition during profitable times driving prices low and a tight market forcing prices high. The cycle often depends on outside factors, such as interest rates on investments or an unanticipated rise in the number or size of claims. The highs and lows are more extreme in the commercial insurance lines than in personal lines such as auto or homeowner's insurance.

During the past few years, insurance companies engaged in "cash flow underwriting" (see App. A), competing for every premium dollar. Lower premiums were used to get cash quickly and invest it at the high interest rates then available. Sound underwriting and investment practices, which are the bedrock on which the insurance industry was built, were either ignored or glossed over in favor of a quick return.

Price wars violate the Insurance Code (RCW 48.30.240), but policing the commercial underwriters to see that proper rates and forms are used is the job of the Examining Bureau. The Bureau, established by the Legislature (RCW 48.19.410) as a self-policing arm of the insurance companies, has been limited to property insurance. While rates must be filed with the commissioner's office before they are used, the "watchdog" role was assigned to the companies, acting through the Examining Bureau. From time to time, the commissioner's office has requested funding for field rate investigators so the commissioner could do his own rate examinations, but these requests have always been denied. The committee believes the commissioner's office should be authorized, and staffed with rate investigators, to be sure filed rates are actually being used.

During the height of the price war, so many filings came in that would have permitted even lower premiums than previously allowed, that the commissioner's rate analysts had to adopt a standard form letter of denial. For practical purposes, however, there is no policing mechanism to assure that only approved rates and forms are actually being used in the field.

The Capacity Crunch

The consumers are now paying the price for the insurers' drive for investment dollars. Today's comparatively low interest rates and new restrictions imposed by the "reinsurers," the international companies that in a sense "insure" the insurance companies, have forced a halt to cash flow underwriting. The commercial insurers now find their ability, or "capacity" to provide coverage, severely limited. The "capacity crunch" and the key role played by the reinsurers is described in Appendix B.

Growth of Court Claims

Compounding the current crisis is the long-term growth in the number and size of lawsuits companies must fight. One big insurance firm with long experience in liability coverage told the committee that in 1974, six doctors per 100 were being sued annually, but by 1985, the ratio was 16 per 100. Defense costs for that company rose from $12 per $100 in claims paid in 1950 to $58 per $100 in claims paid in 1985. Evidence given the committee pointed to court actions and legislation which increased the number of lawsuits and cases in which a defendant could be held liable. Significant growth in the size of jury awards during recent years was also shown.

The Need for Coverage

While the insurance market has been hit by such cyclical financial turmoil before, never has the "low point" been so low. The current crisis is the worst in the memory of those now in the insurance business. Unfortunately, the insurers seem determined to solve the problem, which they created, by sudden and drastic action that places often intolerable burdens on business and government.

For some businesses, insurance is an absolute necessity -- required by statute or regulation as with truckers, contractors and escrow companies. They are in a "Catch 22." The law requires insurance, but for some, insurance is not available at any price.

For most others, it is a practical necessity. Without insurance, or with inadequate protection against catastrophic loss, many businesses must severely cut back operations or simply close their doors. Governments, on the other hand, cannot "go out of business" but are forced to function with dangerously low amounts of protection or with no protection at all.

Resources of the Regulator's Office

While the insurance industry was going through the turmoil of cash flow underwriting from 1981 through 1985, more than one-fifth of the Insurance Commissioner's staff was cut. During the same period the number of authorized insurers increased by 132. More companies meant more premiums, more agents and brokers, more policy filings, more rate filings--a huge increase in paperwork. This required the commissioner to put proportionately more people onto the "paper pushing" end of the system (See App. C).

RECOMMENDATIONS

The committee unanimously adopted the following recommendations to enable the insurance commissioner to exercise more effective regulatory control of the insurance industry, to provide a means for guaranteeing insurance availability, and to prevent abusive marketing practices by insurers.

1. The Legislature should make sure insurance is available to those needing it by reauthorizing and expanding the FAIR plan. The FAIR plan, also known as the Washington Essential Property Insurance Inspection and Placement Program, would be expanded to provide liability insurance. The general idea behind the FAIR plan for fire insurance and the assigned risk pool for high-risk drivers auto insurance, both of which have been functioning for many years, is assuring that coverage is available for all.

2. The Legislature should adopt a new law requiring companies to give 120 days notice to agents and brokers prior to cancelling agency appointments. This would prevent insurers from arbitrarily and indiscriminatively cancelling contracts with agents and brokers, thereby eliminating coverage for large blocks of policyholders. This new law would give agents and brokers more latitude in getting cancelled policyholders new insurance (See App. D).

3. The Legislature should adopt a new method of funding the Insurance Commissioner's Office that would tie the amount of funding to the level of activity in the insurance industry. This would provide more stability for the regulatory staff, assuring staff cuts would not occur at the same time more industry control is needed. Funding should allow the hiring of six field rate investigators and two new rate analysts that are needed to enable better monitoring. With only three rate analysts and no field rate investigators, the commissioner now must rely on information supplied by the companies. Funding should also allow restoring six positions in the commissioner's consumer protection office lost during the budget cuts and provide supporting staff for the new personnel (See Appendices C and E).

4. The Legislature should require insurance companies to notify commercial policyholders of the reasons why their policies were cancelled or not renewed. Current law requires insurers to do this for policyholders in the personal insurance lines, and the law should be extended to cover all commercial policies.

5. The Legislature should amend existing law to improve the ability of insurance companies to comply with statutes on cancellation and nonrenewal of insurance contracts. This would involve limited changes to a bill adopted during the 1985 legislative session that required insurers to give policyholders more notice of cancellation or nonrenewal (See App. F).

In addition to the recommendations to the Legislature, the committee unanimously recommends or endorses the insurance commissioner's actions in the following areas:

1. The committee recommends that the commissioner return to "Prior Approval" on commercial rate filings. The committee recognizes that while the commissioner has the authority to do so, more staff is needed to implement it. This action would assure that the commercial insurance rates are fair and thoroughly "checked out" before they are used.

2. The committee endorses the current regulatory action by the commissioner to narrow from 40 percent to 25 percent the "judgmental" factor allowed companies in adjusting commercial insurance rates above and below the filed rate.

3. The committee endorses the commissioner's recent adoption of a regulation prohibiting insurance companies from cancelling, failing to renew or denying homeowner policies for the sole reason that day care facilities are being provided in the home.

- more -

In addition to the foregoing recommendations and endorsements, the committee is taking the following direct action.

The committee has begun setting up a Legal Action Task Force to review and collect data relevant to Washington's experience in tort law, and to recommend any changes needed to improve the availability and affordability of liability insurance. Based on testimony received by the committee, some reform of Washington's tort law appears to be needed. The committee, however, has neither the legal expertise to judge tort reform proposals, nor enough facts pertinent to Washington's experience to make informed recommendations of appropriate legislative action.

APPENDIX A

Cash Flow Underwriting.

Cash flow underwriting had its roots in the runaway inflation that peaked in the late 1970s and early 1980s. Federal deficits, the oil embargo, "guns and butter" financing of the Vietnam War -- whatever the reasons for inflation, they can also be assigned blame as the root causes of the current dilemma. The excessive inflation led to excessive interest rates, which in turn led to the excesses of cash flow underwriting which resulted in the excessive measures being taken now by insurers against policyholders.

In the latter half of the 1970s, inflation pushed interest rates to unprecedented heights. Insurers began moving away from their traditionally conservative investment philosophy in favor of the short-term high yields that became available during those years. This practice picked up momentum and, by 1980, the insurance industry was engaging in a mad scramble to obtain premium income for the primary purpose of reinvesting it at the high interest rates. Sound underwriting considerations were glossed over or ignored in the rush to increase the cash flow.

The day of reckoning arrived when interest rates moved down to today's levels. About the same time, the disregard for sound underwriting started affecting the surpluses of insurance companies. An insurer's surplus is roughly equivalent to the net worth of a conventional business. It is the money available to pay claims if premiums are inadequate.

In the Spring of 1984, the reinsurers that had survived the rate cutting frenzy let it be known that, as their treaties (contracts with insurance companies) came up for renewal, sanity would have to return to the markets. By the Spring of 1985, most of the treaties that had not been cancelled had been renewed with strict requirements that the primary insurers increase their premiums -- particularly in the liability lines. The commercial underwriters had no choice but to comply. Appendix B, which follows, describes how the unregulated reinsurance market exercises ultimate control over commercial insurance underwriters.

APPENDIX B

The Capacity Crunch and the Reinsurers

The "capacity crunch" is industry jargon referring to the insurance companies' inability to write as many policies, measured by the amount of "premium" or money taken in each year from policyholders, as they did a few years ago. There are three reasons why the companies do not have the capacity to handle new policyholders or even some of their old policyholders.

The first is that the companies' surplus (money available to pay claims that exceed the total of premiums taken in) has diminished as interest rates have fallen and claim frequency increased.

Second, there are recognized industry guidelines limiting the amount of premium property and casualty insurers can write. The amount of premium, which translates into number of policies written, has a fixed relationship to the amount of surplus. Insurance companies can generally write up to three times as much premium as they have surplus. Historically, most insurers have written more policies -- more premium -- than three times their surplus, but have maintained their good ratings by passing the excess premium (policies or "risks") on to a reinsurance company. When the reinsurance carriers pulled out of the market, that practice was severely restricted or ended.

The third reason for the capacity crunch is that higher premiums on individual policies meant fewer policies could be supported by a relatively fixed or shrinking capacity. Some companies were forced to cancel policies to stay within their capacity level.

To illustrate, assume an insurer had $100 million of surplus and thus could write $300 million of premium based on its own resources. Such a company might have written as much as $400 million by passing excess premium (and risk) on to a reinsurer. The cash flow underwriting binge has not only depleted the $100 million surplus and thus the amount the company could write on its own resources, it has also caused the reinsurer to withdraw from the market. Thus, the insurance company is limited in its writings by its own resources. If, in this example, its surplus had been reduced from $100 million to $90 million, the company is now limited to $270 million of premium, instead of the $400 million it was writing when its surplus was $100 million and it had reinsurance treaties extending its writings to as much as $400 million. Capacity has been reduced by $130 million -- from $400 million to $270 million.

A company with its capacity limited is like a merchant who can sell more goods than he has on the shelf. The supply is constricted but the demand continues to grow. An insurance company in this situation will contrive to raise premiums, be very selective in its underwriting, cancel contracts with its producing agents, and generally conduct itself like any supplier in a seller's market.

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF COMMERCE & ECONOMIC DEVELOPMENT

OFFICE OF THE COMMISSIONER

POUCH D
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PHONE: 465-2500

December 17, 1985

Honorable Bill Sheffield
Governor
Juneau, AK 99811

Dear Governor Sheffield:

As chairman of your Task Force on Insurance Availability and Pricing, it is my pleasure to submit the report of the task force. I believe we have fulfilled our clearly delineated responsibility. The report summarizes the testimony and documentation presented to the task force without making specific recommendations.

The issue of insurance availability and pricing is expansive. The task force accumulated a huge amount of documentation on the subject. The documents appended to the report are only a fraction of the available data. We included in the report only the minimal documentation necessary to adequately explain the issues.

The task force believes that insurance issues will continue to be at the forefront for at least another year. We also believe that an ongoing review of insurance issues would be beneficial.

Throughout the work of the task force, the issue of tort reform was suggested as one of several probable causes of the insurance crisis.

It is apparent that tort reform will be a major issue in the next Legislature and will receive prominent attention. You may, therefore, wish to consider appointing a task force or advisory group to further study this specific issue.

The task force is pleased to report to you that State agencies universally expressed their desire to work with licensees, vendors and contractors to resolve insurance problems stemming from State mandated insurance requirements. We believe this reflects positively on your Administration.

Thank you for giving us this opportunity to assist.

Sincerely,

Loren H. Lounsbury
Commissioner

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TASK FORCE ON INSURANCE AVAILABILITY AND PRICING

REPORT TO GOVERNOR BILL SHEFFIELD

STATE OF ALASKA
OFFICE OF THE GOVERNOR
DECEMBER, 1985

9/26/85

GOVERNOR'S TASK FORCE ON INSURANCE AVAILABILITY AND PRICING

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INSURANCE TASK FORCE REPORT

EXHIBITS

I. Written Testimony

II. New Jersey Liability Survey

III. State Regulation and the NAIC

IV. NAIC Accounting Procedures

V. Typical Annual Statement

VI. Reports of Insurance Services Office

VII. Surplus Lines Insurance

VIII. Civil Justices Response

IX. Position of the Citizens Coalition for Tort Reform

X. Opposition to Tort Reform

XI. Typical Insurance Rate Filing

XII. Alaska News Articles

XIII. National News Articles

XIV. Report of the Governor's Medical Malpractice Insurance Commission

XV. Bodily Injury Reparations Advisory Committee

SCOPE

The Task Force has been charged with determining the scope and seriousness of problems of insurance availability and pricing.

Prior to appointment of the Task Force, it was recognized that a crisis existed in insurance. No one had compiled sufficient information on the various groups affected or the extent of the problem to delineate clearly what the real crisis is. Although many solutions were being proposed (from all sides), the basis for rational examination of the entire problem had not been collected.

The intent of this Task Force Report is to delineate clearly the problem, examine the reasons for the problem, define the persons or groups affected by the problem, capsulize pertinent testimony, and to present the documents and evidence collected by the Task Force.

It is not within the scope of the Task Force to make recommendations or to endorse recommendations made by others.

SUMMARY

The Task Force has found that the problems associated with insurance availability and cost are not unique to Alaska. They impact directly or indirectly every citizen in the entire country.

Many underlying causes contribute to the numerous separate problems which have been referred to as the insurance crisis. We have verified to our satisfaction that the majority of major insurers definitely have lost substantial amounts of policyholder surplus during the past year. This impairs their ability to offer as much insurance to consumers, because of diminished financial capacity. Many insurers have been put into liquidation or rehabilitation by State regulators due to severely impaired financial condition.

Insurers acted foolishly in overcompeting for business in prior years in order to reap investment income. When investment yield fell at the same time that insurers were experiencing higher than anticipated claims awards, premiums were forced to adjust dramatically upward and underwriting criteria tightened.

The Insurance Report for 1985 prepared by the Division of Insurance compiles premium and loss figures for admitted insurers for calendar year 1984. It indicates that the experience of insurers in Alaska was uneven. Some insurers had profitable years while others were not so fortunate.

However, overall insurers had better pure loss ratios (claims vs. premiums) in Alaska than the national average. Although comparisons of premium and losses do not account for the expenses of operation, these are similar comparisons to other types of comparisons included in the appendix for national experience. Despite a better than average performance, the small volume of business and high cost of operation still makes Alaska a less than attractive place to insure risks. A significant factor to consider when reviewing the report is that the accumulation of coverages for premium and loss comparisons, tends to hide bad losses by a particular subcoverage by combining them with profitable subcoverages to show an average loss or gain. Thus, day care experience is comingled with many other lines making it impossible to examine it separately.

It appears that insurers are selecting out subgroups of coverages to improve profitability, to mesh with reinsurance coverage, or to concentrate their efforts in areas they feel more competent to underwrite.

The Task Force finds that in Alaska most coverages are available at some price either from the regulated or unregulated insurance market, for those insureds that have good claims experience and are high quality risks. However, excess policy limits are sometimes unavailable, and insurers who have been largely unprofitable have limited capacity to issue insurance policies even at adequate rates.

FINDINGS

A. THE TASK FORCE CONCLUDES THAT EVERY ALASKAN IS DIRECTLY OR INDIRECTLY AFFECTED BY THE HIGHER COST OF INSURANCE WHICH IS BEING DEMANDED IN TODAY'S MARKETPLACE.

B. THE TASK FORCE FOUND THAT THE BEST RISKS OF MOST CLASSES OF BUSINESS WERE INSURABLE AT LEAST FOR PRIMARY LIMITS IN VIRTUALLY ALL CASES IF THE INSURED WAS WILLING TO PAY THE HIGH COST. MUCH, BUT NOT ALL, OF THIS INSURANCE WAS OFFERED IN THE UNREGULATED SURPLUS LINES MARKET.

C. WE FURTHER FOUND THAT HIGHER POLICY LIMITS WERE NOT READILY AVAILABLE IN MANY CASES.

D. THE TASK FORCE FINDS THAT TORT REFORM WAS RAISED AS A SIGNIFICANT ISSUE BY MANY WITNESSES. TORT REFORM IS A BROAD CONCEPT WHICH HAS MANY SPECIFIC PARTS EACH OF WHICH REQUIRE EXHAUSTIVE STUDY AND IS FAR BEYOND THE SCOPE OF THE TASK FORCE TO COMMENT KNOWLEDGEABLY ABOUT. THE TASK FORCE ACKNOWLEDGES TWO PREVIOUS REPORTS, THE REPORT OF THE GOVERNOR'S MEDICAL MALPRACTICE INSURANCE COMMISSION (1975) AND THE BODILY INJURY REPARATIONS ADVISORY COMMITTEE (1979) BOTH OF WHICH ARE INCLUDED IN THE APPENDIX. THESE REPORTS BOTH CONTAIN COMMENTS ON TORT REFORMS.

E. THE TASK FORCE FINDS THAT THE INSURANCE CRISIS IS NATIONAL OR INTERNATIONAL IN SCOPE. THE PROBLEMS EXPERIENCED IN ALASKA ARE NO DIFFERENT THAN EXPERIENCED IN OTHER STATES.

THE TASK FORCE FINDS THAT MANY THINGS ARE CURRENTLY BEING DONE TO EASE THE INSURANCE CRISIS. THE FOLLOWING ARE AREAS WHERE THE STATE IS ACTIVELY WORKING TO RESOLVE THE PROBLEMS.

1. THE DIVISION OF RISK MANAGEMENT HAS BEEN WORKING WITH STATE AGENCIES ON REVISION OF STATE CONTRACT INSURANCE REQUIREMENTS.

2. THE DIVISION OF INSURANCE HAS ESTABLISHED A MARKET ACCESS PROGRAM TO ASSIST INDIVIDUALS IN LOCATING INSURANCE COVERAGE.

3. THE DIVISION OF INSURANCE HAS ESTABLISHED THE CADIS (COORDINATION OF ALASKA DAY CARE INSURANCE SEARCH) PROGRAM TO IDENTIFY POTENTIAL MARKETS AND SHARE INFORMATION WITH BOTH INSURANCE PRODUCERS AND DAY CARE OPERATORS.

THE TASK FORCE RECOMMENDS THAT THE DOCUMENTS COLLECTED DURING THE TASK FORCE RESEARCH BE READ BY ANYONE WHO INTENDS TO PROPOSE A SOLUTION TO THE COMPLEX PROBLEM WE ADDRESS AS THE INSURANCE CRISIS.

HOW INSURANCE IS REGULATED

INSURANCE IS A HIGHLY REGULATED INDUSTRY IN WHICH THE INDIVIDUAL STATES, NOT THE FEDERAL GOVERNMENT, HAVE COMPLETE JURISDICTION. IN ORDER TO REGULATE INSURANCE MORE UNIFORMLY AMONG THE STATES AND TO AVOID SERIOUS DUPLICATION OF EFFORTS, THE STATE REGULATORS CREATED THE NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS.

THROUGH THE NAIC, ACCOUNTING AND FINANCIAL REPORTING BY INSURERS HAS BEEN STANDARDIZED AMONG THE STATES. EVERY ADMITTED INSURER DOING BUSINESS IN ALASKA MUST FILE THE STANDARD NAIC FINANCIAL REPORTING STATEMENT WITH THE DIRECTOR OF INSURANCE. THE ANNUAL STATEMENT IS COMPREHENSIVE AND IS SPECIFICALLY DESIGNED TO REFLECT THE INFORMATION REQUIRED TO DETERMINE THE FINANCIAL HEALTH OF THE INSURER. THE DIRECTOR HAS THE AUTHORITY TO CONDUCT EXAMINATIONS OF INSURERS IN ORDER TO VERIFY THE TRUTHFULNESS OF THE FINANCIAL STATEMENTS. EACH COMPANY IS PERIODICALLY EXAMINED TO DETERMINE ITS SOLVENCY, BY NAIC EXAMINER TEAMS, MADE UP OF EXAMINERS FROM VARIOUS STATE INSURANCE DEPARTMENTS. ALASKA CONDUCTS SOME OF ITS EXAMINATIONS THROUGH NAIC EXAMINATION TEAMS.

THE NAIC ENTERS INFORMATION FROM INSURER FINANCIAL STATEMENTS INTO ITS COMPUTER WHICH IS DESIGNED TO COMPUTE SIGNIFICANT RATIOS AND COMPARISONS. COMPANIES WHOSE RATIOS ARE FOUND OUTSIDE THE NORMAL PARAMETERS ARE TARGETED FOR IMMEDIATE EXAMINATION. IN 1985, OVER 200 INSURERS FAILED SEVEN OR MORE OF THE ELEVEN RATIO TESTS.

THE NEED FOR IMMEDIATE EXAMINATION OF THESE COMPANIES HAS SEVERELY TAXED THE ABILITIES OF THE STATES' EXAMINER TEAMS TO CONDUCT TIMELY EXAMINATIONS OF THE MOST SERIOUSLY TROUBLED COMPANIES.

* ALASKA ALSO DEPENDS HEAVILY ON SURPLUS LINES INSURERS WHO OPERATE IN A TOTALLY UNREGULATED SYSTEM. ALASKA STATUTES REQUIRE INSURANCE PRODUCERS TO ATTEMPT TO PLACE INSURANCE IN ADMITTED OR REGULATED INSURERS FIRST. IF COVERAGE IS UNAVAILABLE IN THE ADMITTED MARKETS, THEY MAY PLACE COVERAGE THROUGH A SURPLUS LINES BROKER IN THE UNREGULATED MARKET. ALASKA RELIES HEAVILY ON THE SURPLUS LINES MARKET FOR MARINE, AVIATION, PROFESSIONAL LIABILITY, EXCESS LIMITS AND OTHER NONSTANDARD CLASSIFICATIONS. NO RATE OR POLICY FORM RESTRAINTS APPLY TO SURPLUS LINES INSURERS.

ALL ADMITTED INSURERS DOING BUSINESS IN ALASKA ARE REQUIRED TO SUBMIT INSURANCE RATES AND POLICY FORMS TO THE DIRECTOR OF INSURANCE FOR APPROVAL PRIOR TO USE. ONLY A FEW EXCEPTIONS TO THESE FILING REQUIREMENTS EXIST. STAFF LIMITATIONS PRECLUDE THE DIVISION FROM CLOSELY SCRUTINIZING EVERY RATE AND FORM FILING PRESENTED; HOWEVER, THE DIVISION DOES A CURSORY REVIEW OF EACH FILING TO SELECT A LIMITED NUMBER FOR DETAILED EXAMINATION. RATES ARE REVIEWED TO DETERMINE THAT THEY ARE ADEQUATE BUT NOT EXCESSIVE BASED ON PROBABILITIES OF FUTURE EXPECTED LOSSES ACCORDING TO THE BEST ACTUARIAL INFORMATION AND ASSUMPTIONS AVAILABLE.

PUBLIC TESTIMONY

The Task Force heard testimony from a broad spectrum of Alaska's entrepreneurs. Represented in this group were day care facilities, architects, engineers, aircraft operators, commercial vehicle operators, bar owners, fuel oil distributers, commercial fishermen, school districts, municipalities, security services, nonprofits, Native corporations, school bus contractors, and State agencies. It is safe to speculate that, with the possible exception of private passenger automobile insurance and homeowners insurance, all property and liability insurance has been affected to some degree by the current insurance market situation.

Anyone who needs to purchase property and liability insurance will be affected by higher insurance cost this year. Additionally, the Task Force learned that some businesses faced higher rate increases than others. Liability insurance rates increased more than property rates and some types of liability coverages increased more than others.

THE TASK FORCE CONCLUDES THAT EVERY ALASKAN IS DIRECTLY OR INDIRECTLY AFFECTED BY THE HIGHER COST OF INSURANCE WHICH IS BEING DEMANDED IN TODAY'S MARKETPLACE.

Several witnesses testified that they were unable to obtain any insurance coverage whatsoever. Further examination by Task Force staff reveals that several different reasons for the "I can't get insurance" statements.

Some have been offered insurance at a price which is deemed to be so high as to preclude purchase. Others have been told by one or more agents that it isn't available. Task Force staff has successfully found markets for the majority of these people after canvassing the marketplace. Coverage was not always inexpensive but was available in most cases if enough time and effort were expended. In the few cases where insurance was not found, the particular risk was not insurable even though others in its same class of risk were insurable. Examples were individual claims history, condition of a particular fishing boat and inability or unwillingness to institute loss control measures. In only a very few cases was no coverage found for a class of risk. Pollution coverage and sexual abuse coverage for day care operations were not offered at any price.

Division of Insurance staff were successful in finding limited markets at some price for wooden fishing vessels, fuel distributors, day care operators, fireworks display operators, liquor liability and others when the particular policyholder did not have poor loss history or an unseaworthy vessel.

A related problem was nonavailability of required excess limits coverages. Although liquor liability is available for primary limits of $300,000 per occurrence, higher limits were not always found. The same is true in other classes of insurance such as fuel delivery, day care, and professional liability. If entrepreneurs require high policy limits, they may not always be able to procure them.

One reason given for lack of higher limits was the inability to generate enough premium in the excess layers where losses are less frequent but more severe. Another reason was primary insurers lacked the internal capacity to retain the exposure and were unable to find reinsurers to share the risk.

THE TASK FORCE FOUND THAT THE BEST RISKS OF MOST CLASSES OF BUSINESS WERE INSURABLE AT LEAST FOR PRIMARY LIMITS IN VIRTUALLY ALL CASES IF THE INSURED WAS WILLING TO PAY THE HIGH COST. MUCH, BUT NOT ALL, OF THIS INSURANCE WAS OFFERED IN THE UNREGULATED SURPLUS LINES MARKET.

WE FURTHER FOUND THAT HIGHER POLICY LIMITS WERE NOT READILY AVAILABLE IN MANY CASES.

Many persons testified about what they felt was the underlying cause of the insurance crisis and their own personal crisis if insurance coverage was unavailable. Summary of the testimony of the vast majority of the witnesses leaves the Task Force with the impression that the witnesses were frustrated with the liability imposed upon them by the courts or by their insurers settling cases in which they did not feel they were liable.

Although witnesses expressed willingness to accept responsibility for what they interpret as their own negligence, almost everyone expressed resentment of the actual or potential negligence and related high awards assessed against them by the legal system. In short, they believe the theories of negligence and compensation imposed by the civil justice

system are out of synch with their own. The proposals of the Citizens Coalition for Tort Reform included in the appendix summarize the various specific suggestions made by the pro tort reform witnesses.

Two witnesses gave testimony in opposition to tort reform. The disparity in numbers of persons for and against tort reform relates to the nebulous make up of persons who would benefit from the no tort reform option. These are in most cases persons who have not yet been injured but who will in the future seek recovery through the civil justice system. Since they are presently unidentified, they did not testify. Clearly aligned with this group of future benefactors of the present system are the attorneys who have represented injured parties in the past and who presumably will be asked to obtain recovery for persons injured in the future. In essence, they testified on behalf of their future clients.

Paul Cossman's letter to the Task Force summarizes the testimony in opposition to tort reform and is included in the appendix.

THE TASK FORCE FINDS THAT TORT REFORM WAS RAISED AS A SIGNIFICANT ISSUE BY MANY WITNESSES. TORT REFORM IS A BROAD CONCEPT WHICH HAS MANY SPECIFIC PARTS EACH OF WHICH REQUIRE EXHAUSTIVE STUDY. IT IS FAR BEYOND THE SCOPE OF THE TASK FORCE TO COMMENT ON TORT REFORM AT THIS TIME. THE TASK FORCE ACKNOWLEDGES TWO PREVIOUS REPORTS, THE REPORT OF THE GOVERNOR'S MEDICAL MALPRACTICE INSURANCE COMMISSION (1975) AND THE BODILY INJURY REPARATIONS ADVISORY COMMITTEE (1979) BOTH OF WHICH ARE INCLUDED IN THE APPENDIX. THESE REPORTS BOTH CONTAIN COMMENTS ON TORT REFORMS.

DOT INSURANCE REQUIREMENTS

During one of the Task Force meetings, Department of Transportation requirements for contractor bonding and insurance were discussed. Although the department has the ability to waive bonding requirements, they seldom, if ever, do so. Apparently, the decision has been made that contractors who are unable to obtain bonding do not necessarily have the financial capability of financing the job and successfully performing the contract performance. If DOT waives the bond requirement, the State could end up with no recourse in the case of contractor default. DOT did express some interest in bidding certain contracts for architects and engineers with and without professional liability insurance in order to better define the insurance cost of the job. Cost benefit comparisons could be made for the specific job to determine the merit of insurance. They also are considering waiving professional liability insurance on contracts where in-house expertise is available to monitor and approve the contract work for quality.

Although DOT could eliminate insurance and bonding problems for contractors dealing with the State by simply not requiring insurance, they must also consider the increased liability and exposure to the State which is assumed by the process.

LOSS CONTROL

Although the Task Force heard from numerous individuals and groups on the availability and price of insurance and some commented on the high cost of resolving loss through the legal system, little testimony centered on elimination of or reduction in loss frequency. Any resolution of the crisis involving transfer of risk to insurers would be incomplete without fully exploring cost containment through loss prevention.

Loss control is an individual, industry and government function. One concern expressed to the Task Force in written testimony was that any resolution of the crisis must include continued and possibly increased State effort in policing labor standards, law enforcement and license qualifications. Insureds also have an obligation to control their own loss expense through prevention.

Documents submitted to the Task Force and testimony support the national and international scope of the insurance crisis. A report prepared by the State of New Jersey summarizes the problems reported by the majority of states. Other documents support the contention that European insurance markets have withdrawn or are about to withdraw from the U.S. market due to severe losses. Only a small portion of their book of business is concentrated in the U.S. but the majority of their losses have been sustained here.

THE TASK FORCE FINDS THAT THE INSURANCE CRISIS IS NATIONAL OR INTERNATIONAL IN SCOPE. THE PROBLEMS EXPERIENCED IN ALASKA ARE NO DIFFERENT THAN EXPERIENCED IN OTHER STATES.

The general consensus of the information sources surveyed by the Task Force was that nationally insurers began competing aggressively for premium dollars for investment purposes in 1979. High interest rates could provide profit to the extent that some underwriting loss could be offset. New insurers were formed to take advantage of high profits generated by small underwriting losses and high investment yield. As competition increased the law of supply and demand caused rates to drop further. As the competitive spiral decreased premium rates, inflation slowed and interest rates fell. Insurers found that they could not increase premiums in order to make up for lost interest income. To do so meant almost instant loss of new business to lower priced competitors.

At the same time that rates were at a seriously inadequate level, insurers began to experience increased losses.

Had rates remained at the 1979 level they would not have generated profits in many lines of insurance. Increased social pressure and liberal interpretation of policy language by the courts caused coverage for claims which insurers had intended to exclude. It caused average awards to increase and promoted the rare but often quoted multi-million dollar awards for seemingly minor or questionable negligence.