

2006

Asbestos Litigation and Indemnification

Paul Grammens
University of Northern Iowa

Let us know how access to this document benefits you

Copyright ©2006 Paul Grammens

Follow this and additional works at: <https://scholarworks.uni.edu/hpt>

Recommended Citation

Grammens, Paul, "Asbestos Litigation and Indemnification" (2006). *Honors Program Theses*. 625.
<https://scholarworks.uni.edu/hpt/625>

This Open Access Honors Program Thesis is brought to you for free and open access by the Student Work at UNI ScholarWorks. It has been accepted for inclusion in Honors Program Theses by an authorized administrator of UNI ScholarWorks. For more information, please contact scholarworks@uni.edu.

Offensive Materials Statement: Materials located in UNI ScholarWorks come from a broad range of sources and time periods. Some of these materials may contain offensive stereotypes, ideas, visuals, or language.

ASBESTOS LITIGATION AND INDEMNIFICATION

A Thesis or Project
Submitted
in Partial Fulfillment
of the Requirements for the Designation
University Honors with Distinction

Paul Grammens
University of Northern Iowa
December 2006

This Study by: Paul Grammens

Entitled: Asbestos Litigation and Indemnification

has been approved as meeting the thesis or project requirement for the Designation

University Honors with Distinction

12.14.06

Date

Dr. Syed Kirmani, Honors Thesis/Project Advisor

12/17/06

Date

Jessica Mood, Director, University Honors Program

Asbestos started out as an amazing product. It was not only easy to manufacture and easy to work with but also fire resistant and a great insulator, asbestos became one of the most common manufacturing products in the United States, especially after World War I. What the public did not know about asbestos at the time is that long-term exposure could lead to sickness. Because of this unforeseen liability, industrial companies and insurance companies were not able to properly prepare for the losses due to asbestos.

About Insurance

Insurance companies are unique in the business world. They sell promises to return claimants to their original lifestyle if they suffer a loss. The ability of a group of people to pool their money and risks together gives a sense of security in return they would not otherwise have. Not only does this allow for the average American to make investments, such as purchase a home with the security of not being homeless if a disaster occurs, but insurance provides a large amount of capital for the insurance companies to invest into the American and world economies.

The only drawback to selling this promise is the insurance companies do not know the costs of the products are sold when they are first offered. This is where the role of actuarial science becomes vital to the continuation of the insurance industry. Using a variety of different types of data, actuaries can project the number of claims and the severity of those claims for a particular type of exposure. One of the duties of the actuary is to properly price premiums for different insurance policies. While the premiums need to be adequate to cover the amount of losses that will be incurred, the price also needs to be low enough to remain competitive with other insurance companies. The other

responsibility of the actuaries in an insurance company is to make sure that the company is holding enough money in reserves for expected losses on a variety of insurance policies. Usually, the premiums alone are not by themselves enough to cover all of the losses. To solve this problem, the premiums are invested by the insurance company to produce a proper return.

The importance of insurance becomes very clear when there is a lack of insurance adequacy. If insurance companies are not able to properly reserve for different types of risks that will result in a large number of severe claims, the reserves will quickly be exhausted. Johns Manville is an example of a corporation that did not have adequate insurance for the number of claimants it had. After being sued for negligence by many former employees, the company had to file for bankruptcy in August of 1982 (“Asbestos and the Law” 2006). Had the Johns Manville known the severity of the situation it would encounter, perhaps it would have been able to get more insurance to cover the losses. However, the people that suffered the most are those that truly became ill from exposure to asbestos. Without proper insurance coverage, there was only so much money that could be given out to those that had a claim against the company.

Personal Experience

I have personally been involved in the insurance industry for two summers as an intern for The Hartford Insurance Group. During the summer of 2005, I worked for a subsidiary called Specialty Risk Services (SRS), which is a third-party claims administrator. Over the summer, I worked with other actuaries in my department to develop a profitability analysis of the different companies with whom we did business. Since the company does not collect any premiums but only handles claims for any

companies that are self-insured, all of the revenue for the company comes through charges on a per claim basis. Using actuarial models, the ultimate number of claims was calculated to project ultimate revenue.

In the summer of 2006, I worked in the Complex Claims Group division of Heritage Holdings, which is a division of the company that works to remove some types of business from its books. This department handled claims that can be difficult to project and do not follow normal loss models. One of the main jobs of the actuaries in this department was to keep track of different types of claims from year to year, such as losses from lead, silica, and asbestos. Unexpected spikes in the number of claims can result either from unforeseen losses or from data problems. One of the most important roles of an actuary in the Complex Claims Groups is loss allocation analysis. Since most decisions on how to allocate asbestos losses are decided in the court system, the actuaries analyze a variety of different loss allocation scenarios and future claims projections to arrive at possible amounts of liability for the insurance company. This information is used by lawyers for the insurance company to negotiate settlements with the insured company.

Asbestos

Asbestos was considered a wonder product when it was first heavily utilized after the First World War. Not only was it a fire-resistant but it was also a great insulator. Asbestos was used extensively not only in commercial building but also residential homes. Shingles, boiler insulators, vinyl tile, and insulation for wiring were some of the ways asbestos was used (Virta, 4). Firefighter suits were even made out of the material since it was fire resistant. Overall, the product was used in over three thousand

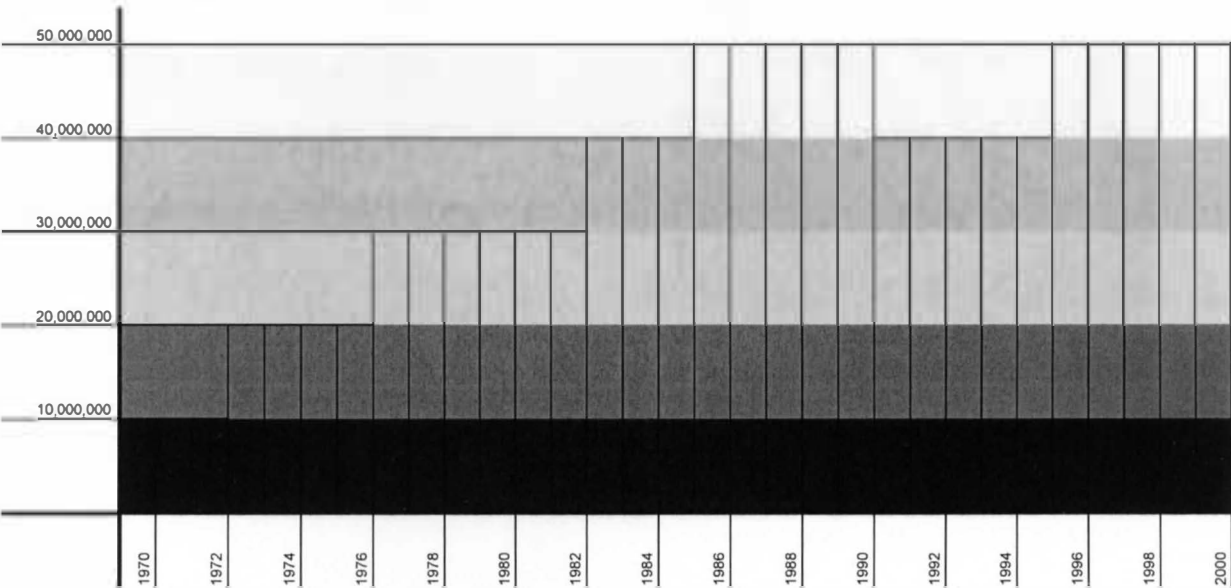
applications, which is one of the main reasons why it became such a large problem (Virta, 4).

It wasn't until the 1960's that the proof of health problems caused from long-term exposure to asbestos became known to the public. The asbestos particles, once inhaled into the lungs, were linked to asbestosis, mesothelioma, and lung cancer. Many of these health problems take several decades to surface. Asbestosis takes on average ten to twenty years for symptoms to show up, twenty to thirty years for lung cancer and thirty to fifty years for mesothelioma (Biggs 2003 3). The majority of the health problems came from those who had worked with asbestos for several decades. Compounding the problem was the fact that this was an unforeseen loss exposure by most of the insurance companies and the manufacturers of asbestos. Having not seen this problem coming, most of these manufacturers had not purchased enough insurance coverage. Likewise, the insurance companies had not recognizing the high risk these companies posed and did not developing adequate reserves.

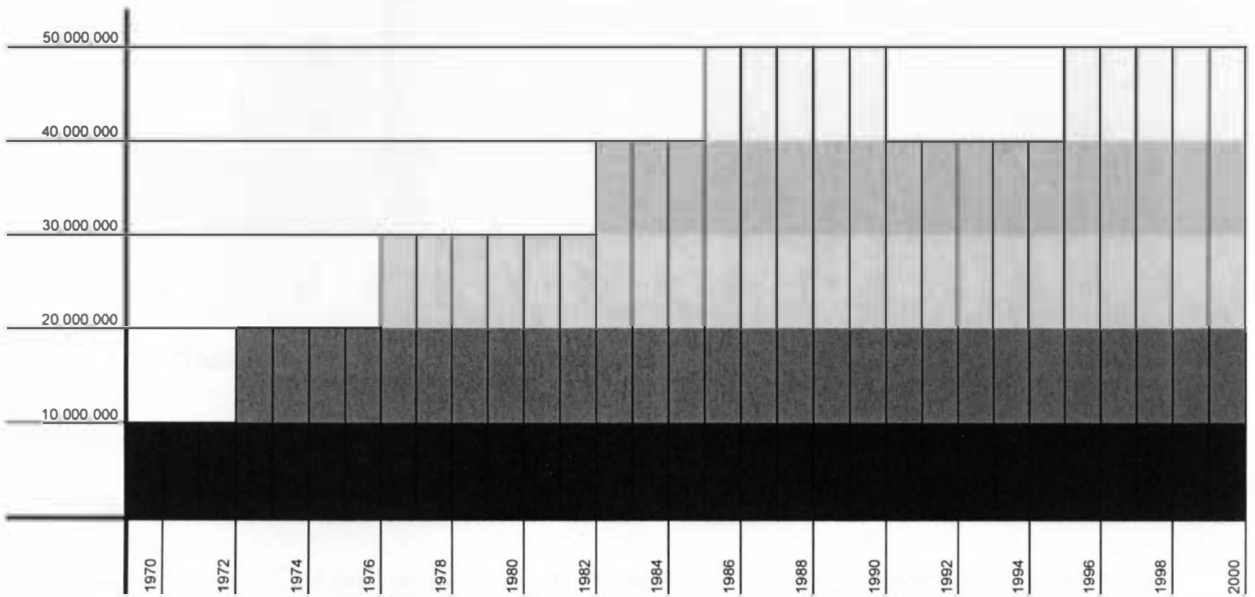
Another complication with asbestos is the difficulty of removing the material from buildings. Any building with large amounts of asbestos that needs to be demolished has to either have the asbestos removed first or have the entire destruction of the building be contained so as not to contaminate the air. A temporary solution is to encapsulate the asbestos in these buildings so that the asbestos fibers could not be released into the air. However, this asbestos can still pose a threat. The fire in Gilchrist Hall on the University of Northern Iowa campus in the fall of 2005 became complicated because of the presence of encapsulated asbestos. While tests showed that no asbestos has been released into the air, the presence of this asbestos will complicate the cleaning process.

The theoretical problem that arises with allocating losses for asbestos exposure comes from the long-term exposure to asbestos by the people who have become ill. For example, with a car accident, all the facts are very concrete. When the accident happened, how much the damage to the vehicle was, and which insurance company has a liability. However, with asbestos exposure over many decades in most cases, it is not entirely clear who is legally responsible for paying claims. Insurance companies do not have the ability to pay every claim, and it is their job to decide whether the claim is legitimate.

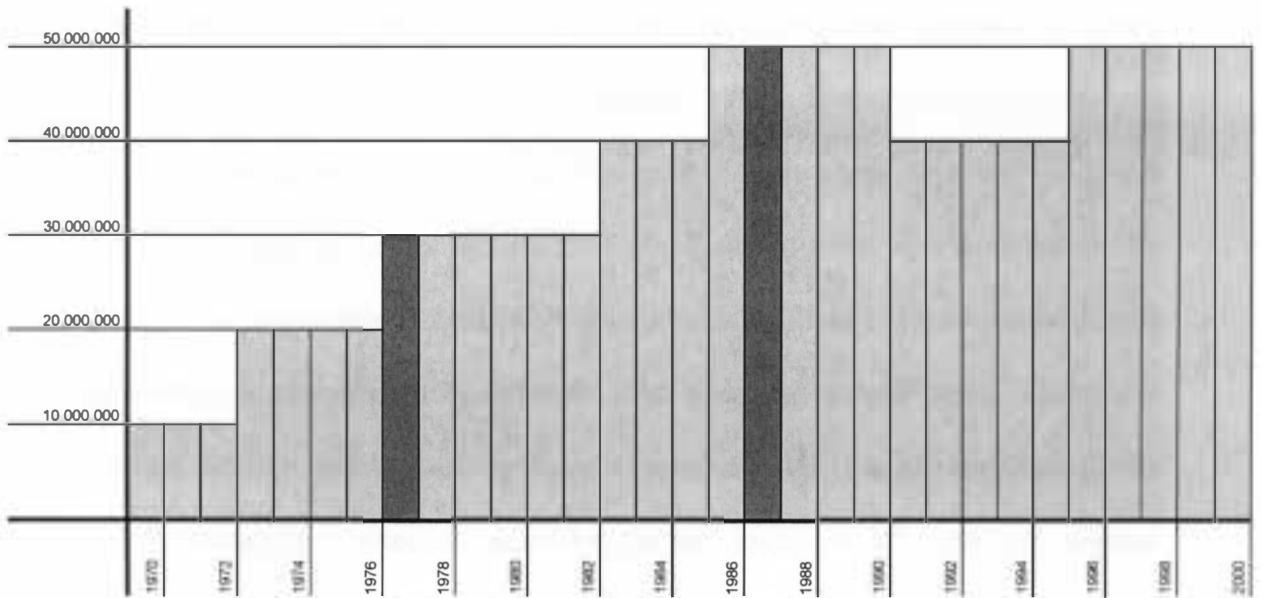
Most of the time the decisions on which company needs to be paid and how much should be paid has resided in the courts. A variety of allocation methods have arisen from court settlements. The simplest method is a pro-rata allocation model. In this situation, the losses are allocated equally for each year of coverage. If the insurance policies for that year are exhausted, then the insured company is responsible for paying the remaining amount. The graph below is a simplified insurance coverage chart with coverage from 1970 until 2000 and variety of different policy limits.



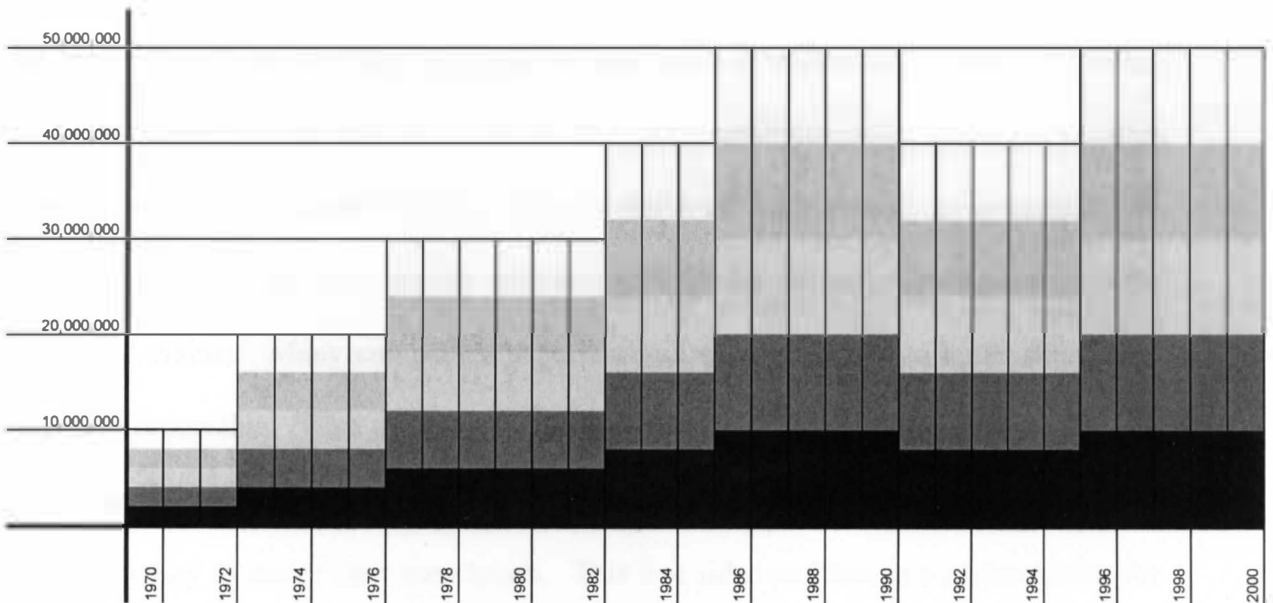
A second method is referred to as the collapsing model. In this case the insured does not pay any money for claims until all of the insurance policies are exhausted. As different insurance policies with lower limits are exhausted, the remaining policies will receive a larger portion of the claims.



The third method is referred to as the all-sums method. This allocation method allows the insured to pick a year with the highest coverage limits and allocate all of the losses to the insurance policies in that year. The responsibility then falls to those insurance companies to see funds from the other insurance companies that would have had to pay losses if a different allocation model had been used.



The final allocation method is called the Carter-Wallace allocation method. Resulting from a court case, the coverage for a particular year is calculated as a percentage of the coverage for all years. That percentage of the losses is then allocated to that coverage year. This will result in all of the years of insurance coverage exhausting at the same time.



A different type of complication has arisen from class action law suits. So many people have joined in these suits that it is becoming difficult to reserve enough money to cover all of these claims. Many of the claimants in these cases have non-malignant cancer and are vying for money that should be going to those who have become ill from asbestos and are unable to continue with everyday activities. Whether these people with non-malignant cancer are truly sick from asbestos is also under dispute. While there is correlation between asbestos exposure and cancer, causation has not been necessarily proven. For example, if someone smoked cigarettes during all the years they worked with asbestos, their cancer may have been caused by the asbestos exposure. In one study, doctors working for a law firm collected x-rays of patients and “interpreted 96% of those films as being consistent with asbestosis” (Parloff “Tort Lawyers” 2004 3) while a panel of doctors only agreed that 4.5% actually had lung scarring.

Currently the government is debating Fairness in Asbestos Injury Resolution Act of 2005. This act would establish a trust fund to pay claims resulting from exposure to asbestos. There are problems with this act that make it impractical. One of the main problems is the medical definitions in the act would unfairly exclude many people who deserve money for indemnification. Also, if this trust fund were to be exhausted, the government could go back to the insurance companies to get more money for any additional claims. Many companies have reserved enough money to cover the claims they are responsible. With this trust fund, these companies would have to come up with more funds than necessary to cover those insurance companies that have not reserved enough money to cover their own losses. This free rider problem is a major reason for this being a poor solution to the problem of asbestos indemnification.

Solutions

The responsibilities of reserving enough money for asbestos losses should fall on the individual insurance companies. With the unique exposures each insurance company has, an insurer can better project the number claims for which it is responsible and reserve adequately. There are indications that the gap is beginning to close between losses and reserves. In 2004, A.M. Best reports that environmental and asbestos losses only rose 4% and the reserves grew by the same amount (Altonji 2006 4). On the other hand, there are also projections of a 50% increase in projected ultimate losses due to asbestos, past and future (Angelina 2004 1). If the latter is true, the trust fund set up by the government would fall drastically short of what would be necessary to meet all the claims.

Asbestos still poses a risk when it is present in buildings even when it has been encapsulated. The fire in Gilchrist is an example of how the University of Northern Iowa should consider itself lucky. Had the fire broken out when people were in the building and the encapsulated asbestos had burned, the liability on the university would have been extreme. Institutions that have encapsulated asbestos are taking a major risk. This risk should be examined, and the money may need to be spent today to remove the asbestos. This cost could far outweigh the cost of the liability from exposing people to asbestos during a fire.

A better way of diagnosing sickness from asbestos from the medical community would greatly improve the way claims are handled in the court and in class action lawsuits. With 77% of the payouts from the Manville trust going to people with non-malignant cancer and with estimates that 66% to 90% of those claimants with non-

malignant cancer are unimpaired, better diagnosis methods would get the money reserved for indemnification to those who truly need the money for medical costs (Parloff "Diagnosing for Dollars" 2005 3).

An imperfect system of indemnification has arisen from the unforeseen risk of asbestos. With the common use of asbestos and difficulty in allocating losses from a theoretical standpoint, asbestos has become the single largest problem for the insurance industry. As time passes, the ultimate number will become more certain. With innovations in actuarial science, the insurance industry will be able to accurately predict the amount of money needed to solve the problem of indemnification for asbestos and those that deserve indemnification will receive it.

Works Cited

Altonji, Gerard. "Asbestos and Environmental Losses Edge Toward Peak in 2004 As Funding Gap Narrows." *A.M. Best* March 2006:1-15.

Angelina, Michael and Jennifer Biggs. "Analyzing Reserves: Devil Is In The Details." *National Underwriter* 28 June 2004: 18-20.

"Asbestos and the Law." December 2006:

http://en.wikipedia.org/wiki/Asbestos_and_the_law

Biggs, Jennifer. "Committee on Property/Casualty Insurance National Conference of Insurance Legislators, Hearing on "Proposed Resolution Regarding the Need for Effective Asbestos Reform": Statement of Jennifer L. Biggs, FCAS, MAAA, Chairperson, Mass Torts Subcommittee, American Academy of Actuaries." *American Academy of Actuaries* 10 July 2003.

Parloff, Roger. "Diagnosing for Dollars." *Fortune* 13 June 2005: 97-105.

Parloff, Roger. "Tort Lawyers: There They Go Again!" *Fortune* 6 September 2004: 186-204.

Virta, Robert. "Worldwide Asbestos Supply and Consumption Trends from 1900 to 2000." November 2006 <http://pubs.usgs.gov/of/2003/of03-083/of03-083.pdf>