

# THE RHA REVIEW

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## FAIRY TALES CAN COME TRUE

by Robert N. Hughes, CPCU, ARM

Headline: "Startup In Bermuda Targets Asbestos Risks," *Business Insurance*, January 14, 2008

"For the first time since the 1980s, corporate America will be able to purchase insurance to protect against legacy asbestos risk which, according to the US Chamber of Commerce, has cost companies an estimated \$70 billion and forced more than 70 companies into bankruptcy. Based in Bermuda, St. George Re Limited (St. George Re) announced today that it has commenced operations to write insurance designed specifically to remove uncertainty and provide resolution to historical corporate asbestos risk." – *Business Wire*, January 9, 2008

One of the vexing problems presented by claims arising out of long-term exposure events (pollution, asbestos, etc.) is the question of allocation ... who pays what. Take, for instance, a pollution event in which it is determined that property damage began in 1960 and has continued until this day. Further assume that the policyholder purchased liability insurance every year, albeit in lower amounts in the earlier years. If every year is fully insured (i.e., no policyholder retention) and if all of the insurance carriers are solvent, then some courts have deter-

mined that each carrier must share on a pro-rata basis calculated on the basis of their time-on-risk, its policy limits or a combination. Other courts have dictated the "all sums" or "joint and several" application, which allows the policyholder to pick specific "triggered" years and claim coverage from

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the bottom to the top, moving to other years if the total amount available in the first year is insufficient to indemnify the insured.

The process is complicated, however, when there are periods during the span of the "event" during which the policyholder has no coverage at all or no coverage in certain layers. The latter circumstance usually results when the insurers for a particular coverage layer have become insolvent. The former circumstance can be due either to a conscious decision on the part of the

insured to retain risk or to the fact that there was no insurance coverage available for a particular exposure, such as pollution or asbestos.

In the case of policyholder retentions, some courts have determined that the insured must participate with the insurers in the allocation process as if it had been the insurer for each year of retention. Other courts, however, have determined that the insured is responsible only for a single retention.

There have been disparate court decisions regarding insolvent insurers and regarding the lack of availability of insurance. The dominant theory prevailing today, however, seems to be the one dictated by the Owens-Illinois decision, in which the courts determined that, if the insured lacks coverage because there was no insurance available, then the insured shall not be required to participate in the allocation,

(FAIRY TALES, continued inside)

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**(FAIRY TALES, cont'd from opposite)**

purchased” section of the ruling, and presuming that allocation would be based upon limits and time-on-risk, the total coverage available during the span of the event would be deemed to be \$250,000,000: \$150,000,000 pre-1970 and \$100,000,000 post-1970. Assuming that the insured did not purchase EIL coverage or did purchase it and found it to be worthless, that insured would be responsible, under the insurer’s interpretation, for 10/25ths of all of the damages, or \$40,000,000.

Now that you have suffered through this excruciating tutorial, I finally come to point. St. George Re of Bermuda (with assistance from Berkshire Hathaway) has announced that it will be writing “asbestos liability coverage,” for (according to Jason Paterniti,

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***“Therefore, it is, again, generally agreed that after 1986 insureds have been unable to purchase CGL coverage for any pollution event, whether ‘sudden’ or not.”***

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co-owner of the company) “companies that did not purchase sufficient coverage in earlier decades when it was available and are now finding themselves either underinsured or with coverage that doesn’t respond to asbestos, either because of exclusions or merger activity.” Whoa, Nellie! That sounds a lot like Environmental

Impairment Liability to me. Which brings to mind the question, “Is this truly a boon to U.S. companies that are crying for some relief from the burgeoning asbestos claims against secondary and tertiary players, or is this a disaster waiting to happen for those companies dealing with decades of old asbestos liabilities that are currently litigating to try to collect coverage that they do have?” Perhaps an even better question is, “Is this another Warren Buffett end run?”

Consider this ... Company A has \$200,000,000 in asbestos liabilities emanating from exposures spanning the period from 1940 to 2000. Its CGL policies began to exclude asbestos liabilities in 1986. The coverage that it is able to reconstruct with solvent companies for the pre-1986 period is \$200,000,000. It approaches St. George Re for a quote to purchase coverage for asbestos liabilities and finds that the coverage is (a) too expensive, (b) unavailable for “underwriting reasons” or (c) not really true insurance but just swapping dollars, so it doesn’t buy it. Further presume, however, that the mere existence of the St. George program establishes an allocation defense by its old insurers under Owens-Illinois. In that case it would likely be deemed to have participated as co-insurers for 14 years of non-coverage. The number could be anything, but for purposes of this discussion, let’s presume it is deemed to be equal to St. George’s total capacity, i.e., \$250,000,000. So under that scenario, the insured would have to contribute 25/45ths of the \$200,000,000 in claims, or \$111,000,000. So instead of the prior

insurers being responsible for \$200,000,000 in coverage, they are now arguably responsible for only \$89,000,000.


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***“The importance of these issues to insureds, therefore, is that, under the Owens-Illinois ruling, it would not be called upon to be contributors to allocations for those years after 1970 for ‘non-sudden’ pollution events and after 1986 for any pollution event, since coverage was arguably unobtainable.”***

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Now, one final presumption ... presume that the prior insurers were all reinsured by one of Mr. Buffett’s companies. Hmmmm, what is that strange smell? Did the establishment of the “availability of coverage” just erase more than \$100,000,000 in covered claims? Of course, this presumption is, for now at least, just a fairy tale.

But as Jiminy Cricket sang:

*“Fairy tales can come true, it can happen to you ...”* 

*Robert N. Hughes is founder, chairman of the board, and chief executive officer of Robert Hughes Associates, Inc.*



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(FAIRY TALES, cont'd from cover)

but if insurance was available but not purchased, then the insured must participate as if it were an insurer.

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***“In the case of policyholder retentions, some courts have determined that the insured must participate with the insurers in the allocation process as if it had been the insurer for each year of retention.”***

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The limited pollution exclusion (aka “Sudden and Accidental Pollution Exclusion”) was promulgated and published as an endorsement to CGL coverage in 1970. It was inserted as a permanent part of the standard CGL wording in 1973. While there have been Herculean arguments regarding the meaning of the term *sudden* it is generally agreed that insureds, for the most part, ceased to be able to purchase coverage in about 1973 for pollution events that were not deemed to be “sudden and accidental.”

In the 1980s, various iterations of a so-called “absolute” pollution exclusion appeared. It is generally agreed that by 1986, the exclusion was about as nearly “absolute” as could be reasonably attained. Therefore, it is again generally agreed that after 1986 insureds have been unable to purchase CGL coverage for any pollution event, whether “sudden” or not.

The importance of these issues to

insureds, therefore, is that, under the Owens-Illinois ruling, they would not be called upon to be contributors to allocations for those years after 1970 for “non-sudden” pollution events and after 1986 for any pollution event, since coverage was arguably unobtainable. Insurers, on the other hand, have maintained that it is not correct that pollution coverage was unobtainable because, since about 1977, there has been a form of coverage available known as “Environmental Impairment Liability.” They argue that insureds that did not purchase such “EIL” coverage must become full contributors to allocations because coverage was “available” and they elected not to purchase it.

Space does not allow a full tutorial on EIL coverage. Suffice it to say,

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***“The dominant theory prevailing today, however, seems to be [...] that, if the insured lacks coverage because there was no insurance available, then the insured shall not be required to participate in the allocation, but if insurance was available but not purchased, then the insured must participate as if it were an insurer.”***

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however, that the coverage was extremely limited. In the end, most insureds that did purchase the cover-

age and that have sought coverage have had their claims denied. That notwithstanding, however, insurers that have liabilities for long-term pollution exposure cases under their pre-1986

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policies generally contend that the availability of EIL coverage triggers the Owens-Illinois test and that the insured becomes a co-insurer for the post-1970 years.

For example, presume you have a disposal site that opened in 1950 and was closed in 2000. Suppose also that a Potentially Responsible Party (PRP) purchased \$5,000,000 in CGL coverage for each year and that, after 1970, its policies provided no coverage for claims arising out of the site. Further presume that the total damages for which the PRP is deemed responsible are \$100,000,000. Under the Owens-Illinois decision the insurers would provide \$150,000,000 in coverage, and the insured would not be responsible for any allocation. If, however, EIL were deemed to satisfy the “insurance available but not

(FAIRY TALES, continued opposite)

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**FROM NEAR AND FAR**



Jackson, TN – Union University suffered a direct hit from a tornado that was part of a severe storm system that swept across much of the Southeast on February 5. More than 70 buildings were damaged or destroyed. According to an article published in *Business Insurance*, insured losses could exceed \$35 million.



Chicago, IL – According to a study published by Navigant Consulting, Inc., 278 lawsuits have been filed in federal courts that are related to the subprime mortgage crisis. That is already half of the total number of cases filed in the savings and loans litigation (559) during the early 1990s.



Washington, DC – In December, the president signed into law the Terrorism Risk Insurance Program Reauthorization Act, which extends TRIA until the end of December 2014.



Charleston, SC – In January, South Carolina’s supreme court handed down a ruling that says that the citizenship of injured workers should not affect their rights to benefits for job-related injuries.

**THE RHA REVIEW**

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