

update

Brokers post big earnings gains

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lion from \$273.5 million.

M&M also reported that first-half net income soared to \$83.9 million from \$700,000 in the first half of 1984, while revenues rose 18% to \$655 million from \$554.8 million. M&M's first-half 1984 earnings reflected a \$110 million pretax charge taken by M&M because of unauthorized investment activities.

Memphis, Tenn.-based Crump Cos. Inc., the ninth-largest broker, said its net income increased 77% in the second quarter to nearly \$2.3 million, compared with \$1.3 million in 1984. Revenues grew 31% in the second quarter to \$23.4 million from \$17.9 million.

For the first half, Crump's net income increased 60% to \$4.3 million from \$2.7 million, and revenues rose 33% to \$43.6 million from \$32.7 million.

Arthur J. Gallagher & Co. of Rolling Meadows, Ill., the nation's 10th-largest broker, said second-quarter net income grew 158% to \$989,000 from \$384,000. Second-quarter revenues totaled \$17.3 million, up 26% from \$13.6 million. For the first half, Gallagher said net income increased 64% to \$4.11 million from \$2.5 million, while revenues grew 25% to \$36.6 million from \$29.4 million.

Mentor's creditors to meet

HAMILTON, Bermuda—The first meeting of creditors of Mentor Insurance Ltd., which is in court-ordered liquidation in Bermuda, will be held Sept. 20 in Hamilton City Hall.

Almost 2,000 companies that ceded risks to Mentor, most of which are in the United States, will be sent notices of the meeting and requests for proof of debt.

Mentor, a wholly owned subsidiary of New Orleans-based Ocean Drilling & Exploration Co., was ordered into liquidation by the Bermuda court on June 21.

Florida seizes Old Dominion

JACKSONVILLE, Fla.—Florida Insurance Commissioner Bill Gunter has seized control of Old Dominion Insurance Co. of Jacksonville to preserve its assets in the wake of a civil suit by the U.S. Justice Department against the insurer and its owner, Larry D. Barnette. The department is seeking a buyer for the insurer.

The May 16 lawsuit was brought under the federal Racketeering Influenced and Corrupt Organization Act. It seeks more than \$47 million in actual and punitive damages from Mr. Barnette, and also charges the insurer was "unjustly enriched" by funds stolen from the U.S. government, a department spokeswoman said.

Mr. Barnette already has been convicted of several criminal charges related to the alleged theft of federal money.

The 4-year-old insurer wrote more than \$10 million in workers compensation, commercial liability and various other types of insurance throughout Florida in 1984, the spokeswoman said.

Policyholders' claims currently are not in danger, Mr. Gunter said, adding this is the first time the department has seized a solvent insurer. But, he said, if the insurer is found liable in the suit, it would become insolvent.

Jury rules in park fire case

TOMS RIVER, N.J.—A New Jersey Superior Court jury has found an amusement park and its parent corporation not guilty on criminal charges of aggravated manslaughter and manslaughter in an amusement park fire that killed eight teen-agers.

The July 21 verdict involved a May 11, 1984, fire in the "Haunted Castle" at Great Adventure, in Jackson Township, N.J.

The park and its parent, Six Flags Corp. of Chicago—a subsidiary of Chicago-based Bally Manufacturing Corp.—were indicted last fall by an Ocean County, N.J., grand jury on charges of aggravated manslaughter.

Two corporate officials also were indicted on manslaughter charges (*BI*, Sept. 24, 1984). They are participating in Ocean County's "pre-trial intervention" probation program, and charges will be dropped if probation is served satisfactorily.

Several civil cases are still pending (*BI*, June 18, 1984).

St. Paul Fire & Marine Insurance Co. is the primary liability insurer at risk for the fire (*BI*, May 21, 1984).

Striking workers lose benefits

PITTSBURGH—Some 8,200 United Steel Workers striking the bankrupt Wheeling-Pittsburgh Corp. are without medical, life and sickness and accident insurance.

USW attorney Carl Frankel says the company voided its union contract July 21, a few days after a federal bankruptcy judge authorized such action.

The same day, the employees went on strike, protesting the company's action. And, two days later, he said, the company said can-

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Insurers offering new plan to alter Superfund liability

By ROBERT A. FINLAYSON

WASHINGTON—Property/casualty insurers, after receiving a chilly Senate reception to a proposal to radically alter the Superfund Act's liability provisions, are offering a House panel a more modest plan to set up a special arbitration process for toxic waste dumpers.

Meanwhile, the House Energy and Commerce Committee was expected to complete work last week on a bill to extend the 5-year-old Superfund law, which is scheduled to expire this year.

Several other House committees are expected to review and amend the Energy Committee's bill. A separate bill to extend the Superfund is pending in the Senate.

Testifying before the House Public Works and Transportation Committee, William O. Bailey, president of Aetna Life & Casualty Co., said the American Insurance Assn.'s proposal to replace Superfund's strong liability provisions with a no-fault scheme "has not received a positive response in the Senate" (*BI*, April 8).

"We have been working quite hard on a more modest amendment of the Superfund law which would address (the Environmental Protection Agency's) settlement policy without changing the current liability regime."

The new proposal, offered by Mr. Bailey on behalf of the AIA, would amend the Superfund law to allow

those responsible for abandoned hazardous-waste dumps to participate in a "dispute resolution process" to determine their individual share of the cost of cleaning up a dump site.

Responsible parties that participate in this resolution process would do so without litigation and without admitting liability.

A three-member arbitration panel—with one member chosen by EPA, one by the dumpers and the third chosen by the first two members—would oversee the resolution process for each dump site. Participants would be bound by the panel's determinations.

The AIA proposal also calls for the federal government to assume responsibility for cleaning up that portion of an abandoned dump that cannot be linked to any responsible party. Money to finance such "orphan shares" would come from the Superfund, the proposal says.

Under the AIA's proposal, those responsible parties that choose not to join the resolution process would be subject to the current Superfund liability standards, which the courts have interpreted as providing joint and several liability.

Under this liability standard, one dumper can be required to pay for the cost of cleaning up an entire dump, regardless of the dumper's contribution of waste to the site.

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Kastiel named associate editor

Diane Lynn Kastiel has been promoted to associate editor, *Business Insurance* Editor Kathryn J. McIntyre announces.

Ms. Kastiel, 26, joined the staff of *Business Insurance* as editorial assistant in May 1983, and she was promoted to the position of staff reporter in August 1984.

Before joining *BI*, she was an inside sales representative at Motorola Semiconductor Sales in Schaumburg, Ill.

She earned a bachelor of science degree in journalism, with a minor in business, from the University of Illinois at Urbana-Champaign in 1982.

Ms. Kastiel will continue to be based in the Chicago office, where she will report on employee benefit issues and risk management.

She also writes the Benefit Beat and Comings & Goings: Buyers columns for *Business Insurance*.

Ms. Kastiel can be reached at 312-649-5393.



Ms. Kastiel

Pennsylvania suspends operations of Paxton

By DOUGLAS MCLEOD

HARRISBURG, Pa.—Paxton National Insurance Co. is expected to fight a Pennsylvania Insurance Department order suspending the company's operations.

The July 17 order cites the company for a "pattern of operations that creates a hazardous condition," according to an insurance department official.

Under the suspension order, Paxton is barred from writing any new or renewal business, paying claims or transferring assets of the company without the insurance department's approval.

The department official refused to comment on specifics of the order.

However, Leslie W. F. Cornelius, Paxton's president, said that the department may contest a \$3.55 million credit Paxton took in 1984 for loss portfolio reinsurance with National Union Fire Insurance Co. of Pittsburgh, Pa., a unit of American International Group Inc.

Mr. Cornelius said that if the department disallows credit for the National Union reinsurance, Paxton will be technically insolvent unless it receives a capital infusion.

A hearing on the suspension order is scheduled for Aug. 1.

Meanwhile, the Oregon Insurance Division proposes to revoke Paxton's authority to write business in the state.

Paxton wrote several surety bonds in Oregon—including one for the Oregon State Board of Higher Education—after the insurance division refused to grant it authority to write surety risks, according to James Kleen, a supervisor with the Oregon Insurance Division.

Paxton has requested a hearing on Oregon's proposed revocation of its certificate of authority, but no date has been set for the hearing, Mr. Kleen said.

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GE is last to settle in supper club fire

By JERRY GEISEL

ASHLAND, Ky.—After eight years, the litigation stemming from a Kentucky nightclub fire that killed 165 people and injured about 80 others is coming to the end.

General Electric Co., the last of the defendants sued following the 1977 Memorial Day fire at the Beverly Hill Supper Club in Southgate, Ky., earlier this month agreed to a \$10 million settlement shortly before a U.S. District court jury was to begin deliberations, says Cincinnati attorney Stanley M. Chesley, chairman of the counsel committee representing the plaintiffs.

The plaintiffs charged that GE should have warned that its electrical receptacles could cause a dangerous buildup of heat when used with aluminum wiring.

But GE attorney Charles Brown said the settlement is not an admission of liability. GE settled because "there is a time to put litigation to bed," he said, adding the suit could have dragged on for years.

He said during the last 20 years there have not been any complaints of fire when the receptacles were connected to aluminum wiring.

The bulk of the \$10 million GE settlement will be covered by underwriters at Lloyd's of London and by Electric Mutual Liability Co. of Lynn, Mass., sources said.

The settlement, which still must be approved by U.S. District Court Judge Henry Wilhoit in Ashland, Ky.,

brings the amount of money that defendants have or will pay to the plaintiffs to more than \$40 million, said Mr. Chesley. At one time, more than \$3 billion was sought.

Defendants included 4-R Corp., owner of the club; a

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clarification

Aetna Life & Casualty Insurance Co. issued the following statement to clarify its position on the new Insurance Services Office claims-made form and proposal to include defense costs within policy limits (*BI*, July 22):

"We fully intend to adopt, upon state approval, the entire ISO program including claims-made, occurrence and the inclusion of defense in the policy limit.

"While we expect that claims-made with defense within the limit eventually will become the industry standard, there will be a transition period in which we will offer both claims-made and occurrence forms—including defense costs in policy limits where approved. The policy form used will be selected based on underwriting guidelines recognizing risk characteristics."

Court eases accountant liability standards

By STEPHEN TARNOFF

ALBANY, N.Y.—A recent decision by the state's highest court makes it more difficult for third parties, such as investors and lenders who rely on accounting firm audits in business decisions, to sue accountants for negligence.

The decision by the New York Court of Appeals in *Credit Alliance Corp. vs. Arthur Andersen & Co.*, is being hailed by the accounting industry as a reversal of a trend that has expanded accountants' liability in negligence actions.

According to attorneys for the accounting profession, traditional tort rules on accountants' liability have been eroded in some states in recent years, allowing more negligence suits against accountants by third parties and larger damage awards. This in turn has resulted in higher professional liability

insurance rates for accountants.

The July 2 decision reaffirms a long-standing rule that if a third party does not have or does not approach a direct contractual relationship with the accounting firm, it can't recover from the accountant for negligence.

However, the ruling does not affect suits that charge accountants with fraud.

The Court of Appeals decision could reduce the number of negligence claims filed in New York, attorneys say. And because New York is a leading commercial state whose courts are often cited as precedent, the decision could significantly influence courts in other states.

The suit against Andersen was brought by Credit Alliance, which along with a sister company—Leasing Service Corp.—are leaders in the financing of capital equipment purchases through installment sales or leasing agreements.

The companies, relying on Andersen financial statements concerning L.B. Smith of Virginia Inc. in the late 1970s, provided more than \$15 million in financing to Smith, a capital intensive company that regularly required financing, according to court papers.

Those financial statements contained an auditors' report prepared by Andersen stating it had examined Smith's statements in accordance with generally accepted auditing standards and found them to reflect fairly the financial position of Smith in conformity with generally accepted accounting principles.

However, in 1980 Smith filed for bankruptcy. By that time, it had already defaulted on several million dollars of obligations to Credit Alliance and Leasing Service, according to the court's opinion.

Credit Alliance contended that Andersen's

statements overstated Smith's assets, net worth and general financial health and that Andersen failed to conduct investigations in accordance with proper auditing standards. In 1981, Credit Alliance sued Andersen alleging negligence and fraud.

The suit also alleged that Andersen knew, or should have known, that the financial statements certified by it were being used by Smith to induce companies to make credit available to it. Furthermore, the suit charges, Andersen knew or should have known that the statements were being shown to the plaintiffs for that purpose.

The trial court, and then a state appellate court, held that Credit Alliance and Leasing Service, could sue for negligence even though there was no direct contractual relationship or privity between them and Andersen.

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Photo: Carol Cain

Work comp reform will be a hard trek, say experts at the National Symposium on Workers' Compensation in Orono, Maine. Coverage continues on page 7.

Experts look into future of workers comp system

By CAROL CAIN

ORONO, Maine—The workers compensation system cannot stand alone anymore.

Experts from both within and outside the workers compensation community say it is imperative to take off the blinders and see how workers compensation is interrelated with other injury compensation systems and population trends and leisure activities that can affect the system.

This theme of interrelatedness was reiterated by speakers and participants during the ninth annual National Symposium on Workers' Compensation held July 14-19 at the University of Maine at Orono.

"There was a time, until perhaps a decade or so ago, when participants and practitioners in one segment of our non-system of injury compensation mechanisms rarely, if ever, thought about the other elements in the mosaic, or even came into contact with them," said Les Cheek, vp of federal affairs for Crum & Forster Insurance Cos. in Washington.

"Workers compensation lawyers didn't attend conferences on toxic tort law; risk management and loss prevention were associated with industrial hygiene; economists specializing in hospital cost containment had never heard of the collateral source rule of tort law or medical expense thresholds in automobile no-fault laws," Mr. Cheek said.

"Most scholarship in workers compensation, the law of torts, health maintenance and income protection policy tended to be inward-looking, even parochial, as though change in one area of the picture would have no effect on the remainder," Mr. Cheek added.

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California plan addresses work comp rating inequity

By CAROL CAIN

SAN FRANCISCO—The California Workers' Compensation Insurance Rating Bureau has hammered out a plan to solve the rating inequity among employers in the construction industry.

The bureau put the finishing touches on its new rating system last week and will file it Wednesday for approval with the California Insurance Department, along with a proposal to increase workers compensation rates an average 7.5% next year.

If approved, the pilot rating system initially will apply only to six of the state's many construction classifications and will take effect Jan. 1.

The new plan calls for splitting each of the six construction classifications—plumbing, painting, electrical wiring, sheet metal and two carpentry classifications—into two rate categories, one for high-wage employees and the other for lower-paid employees.

Workers compensation premiums in 49 states are computed from a formula based on total payroll. The higher the total payroll, the higher the premium. Only in Washington are workers compensation premiums based on a different system, known as "man-hours."

This system, which has been used in Washington since its workers compensation law was enacted in 1911, uses the number of hours employees work, rather than total payroll, to determine premium.

In recent years, representatives of the construction industry nationwide have asked insurance rating bureaus, regulators and state legislators to change the rating system for their industry to one based on man-hours, rather than total payroll.

Many contractors, particularly high-wage or unionized construction companies, say the payroll-based premium system is inequitable because their employees' high salaries result in unfairly higher workers compensation premiums. They say this is the case even though they often have better safety programs—and therefore better loss experience—than construction companies with lower-paid employees.

However, insurers' opposition to a change in the payroll-based system has been strong, and instead plans have been designed that adjust the rating structure to offset the proven inequity in construction classifications.

California's plan is the most recent of these.

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Soccer star's homecoming insured

By JOHN BARHAM

RIO DE JANEIRO, Brazil—The return of Zico, one of Brazil's best-loved soccer players, to his home turf is being covered by a Brazilian insurer.

Zico, whose real name is Artur Antunes Coimbra, had gone to Italy to play soccer, but he returned earlier this month to the friendly surroundings of Rio de Janeiro's Flamengo Soccer Club.

The triumphant welcome for Zico, as well as an exhibition soccer match at the Flamengo club and two exhibitions to be played later in Italy, were insured by Companhia Nacional Sul America de Seguros, Brazil's fourth-largest insurer.

In addition, the insurer is helping to sponsor the matches, along with the principal organizer, Estrutural, a Rio de Janeiro advertising agency.

Under the terms of the coverage, Sul America would pay Zico \$160,000 if, for any reason during the next six months, he is unable to play soccer.

The insurer also provided coverage for the welcoming ceremonies

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Photo: UPI/Bettmann Newsphotos

New law bolsters Oregon risk management

By MEG FLETCHER

SALEM, Ore.—Oregon has enacted what may be the broadest state risk management law in the nation, according to the state's risk manager.

"To the best of my knowledge, it is the broadest risk management act any state has adopted," said Risk Manager Gene Snyder. "Most states, in general, have developed programs on a piecemeal basis," he explained.

House Bill 2152, signed July 13 by Gov. Victor Atiyeh, gives the risk management division of the state Department of General Services blanket authority to "direct and manage all risk management and insurance programs of state government except for employee benefits insurance programs."

When the law, which was sponsored by the state's Executive Department, goes into effect Aug. 1, the risk management division will:

- Be able to better manage the cost of state employees' workers compensation coverage, which is purchased through the competitive state fund.
- Have the ability to self-insure more state risks.
- Be able to better manage its monies

'Most states, in general, have developed programs on a piecemeal basis,' Mr. Snyder says.



lations.

"We are excited about it. It is the first time this Legislature has put its stamp of approval on a risk management program," said Mr. Snyder, who was instrumental in the Legislature's efforts to draw up a risk management

law. And, although his 16-member staff was already performing 70% to 80% of the duties outlined in the new law, the new law gives them authority to handle 100% of these responsibilities, he added.

Mr. Snyder, who became Oregon's risk manager in February 1981, created a model state risk management program that received recognition in 1984 when he was named to *Business Insurance's* Risk Management Honor Roll (*BI*, April 2, 1984). At that time, judges were impressed by his ability to implement his plan efficiently and diplomatically in a political atmosphere.

The new law is designed to allow for better management of the state's risks, associated with \$3.5 billion in property, 11,000 state vehicles.

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GE settles in club blaze

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power company; the club's insurers; aluminum wire and wire device manufacturers; and manufacturers of furniture and other products in the club.

The first settlement was reached in February 1979, when 4-R agreed to pay \$3 million to settle class-action suits seeking \$.8 billion (BI, Dec. 8, 1980).

The company was known to have at least \$1.3 million of liability coverage written by American States Insurance Co. of Indianapolis and CNA Insurance Cos. of Chicago.

Aside from the GE settlement, the largest so far was the \$5.75 million paid by Union Light, Heat & Power Co., a division of Cincinnati Gas & Electric Co.

Union Light was accused of negligence in supplying power to the club, where there allegedly were electrical violations. The utility's liability coverage, primarily written by Lloyd's underwriters, covered nearly all of the settlement.

In addition, the Kentucky FAIR plan, a state-regulated assigned risk insurance pool that supplied \$600,000 of property coverage to the club, agreed to

pay \$3 million to the plaintiffs.

The FAIR plan, which has 900 insurer members, was accused of negligence for insuring a risk with alleged safety violations.

Also, Market Insurance Co., which wrote \$250,000 of property insurance for the club, agreed to pay \$925,000 to settle claims brought by victims and survivors, who charged Market should not have insured an allegedly unsafe structure.

Other settlements, according to Mr. Chesley, have included:

- More than \$8.5 million made by 27 aluminum wire and electrical equipment manufacturers, distributors or suppliers. Of these 27 companies, some 13 participated in a settlement of \$4.1 million and the other 14 were involved in a settlement of about \$4.5 million

- \$3 million to \$3.5 million paid by 18 companies that made or supplied plastic coating used on electric wiring.

- More than \$4 million paid by 10 to 15 companies that supplied various products and furnishings used in the club.

In addition, interest on the settlements amounts to between \$4 million and \$5 million, Mr. Chesley noted.

Maine to hold hearings on future of comp market

By CAROL CAIN

AUGUSTA, Maine—The state insurance superintendent is wondering how Maine employers will be able to buy workers compensation insurance if leading insurers curtail underwriting in the state.

Superintendent Theodore T. Briggs is planning to hold a fact-finding hearing late next month to answer that question and others.

Mr. Briggs wants to know why insurers are reducing the amount of work comp business they write in Maine, what impact that will have on the market and what licensing action, if any, can be taken against the insurers.

Several workers compensation insurers have said they will reduce the business they write in the state

because of a new workers compensation law (BI, July 1).

The new law, which became effective July 1, mandates a rate reduction this year of "at least" 8%, freezes rates for the next 18 months and caps annual rate increases at 10% in 1987 and 1988.

Mr. Briggs said three insurers have notified the Maine Bureau of Insurance that they are changing underwriting criteria and will stop writing new or renewal work comp business. They are Boston-based Liberty Mutual Insurance Co., the state's largest workers compensation insurer; United States Fidelity & Guaranty Co. in Baltimore; and Peerless Insurance Co., a member of the Nationale-Nederlanden U.S. Group in Keene, N.H.

One of these insurers, though, says it still plans to write in Maine.

"We're not saying we're not going to write any new business, but we are stringently underwriting every piece of business, new or renewal," said Minor Carter, vp of government and industry affairs for USF&G.

A hearing on how to implement the new law's rating provisions will be held either in late August or early September, Mr. Briggs said, even though the effective date for the new rates is Aug. 1.

Although the fact-finding and rate hearings will cover separate issues, they are related, he said, citing insurers that are pulling out as servicing agents for the assigned risk pool.

Liberty Mutual, USF&G and Travelers Insurance Cos. say they'll no longer act as assigned risk pool servicing agents for new business on Aug. 1 and for renewal business on Oct. 1, leaving only three servicing agents remaining, Mr. Briggs said.

"I think Mr. Briggs is doing what any regulator would do—protect the market. But none of the insurers said they wouldn't write workers compensation in Maine in the future," said Joseph P. Hegarty Jr., senior vp in Boston for the Alliance of American Insurers.

Zico covered

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and for the exhibition match, played July 12. In the match, Zico's team notched a 3-1 victory over a team comprised of Zico's friends, including Maradona, the crack Argentine forward who currently plays for an Italian team, and Socrates, a Brazilian who also currently plays in Italy.

During the match, Maradona was covered for \$4 million against injury or any other occurrence that would prevent him from playing, and Socrates and each of the other players was insured for \$1.2 million each. The policy would have paid the claim to the players' clubs.

No injuries occurred during the match.

The companies sponsoring Zico's return to Flamengo also are sponsoring two exhibition games to be played later this year in Italy. The proceeds from the exhibitions will be used to pay Zico's transfer fee from Italy to Flamengo, which is reported to be about \$2 million.

A Sul America policy will pay the sponsors of the Italian matches \$1.6 million if the matches are canceled because key players are injured or otherwise fail to perform.

Sul America collected \$12,000 in premium for all the coverage it wrote on the matches featuring Zico. According to the insurer, the package was fully reinsured in Brazil.

This is the first time that an insurance and sponsorship package of this type has been put together in Brazil.

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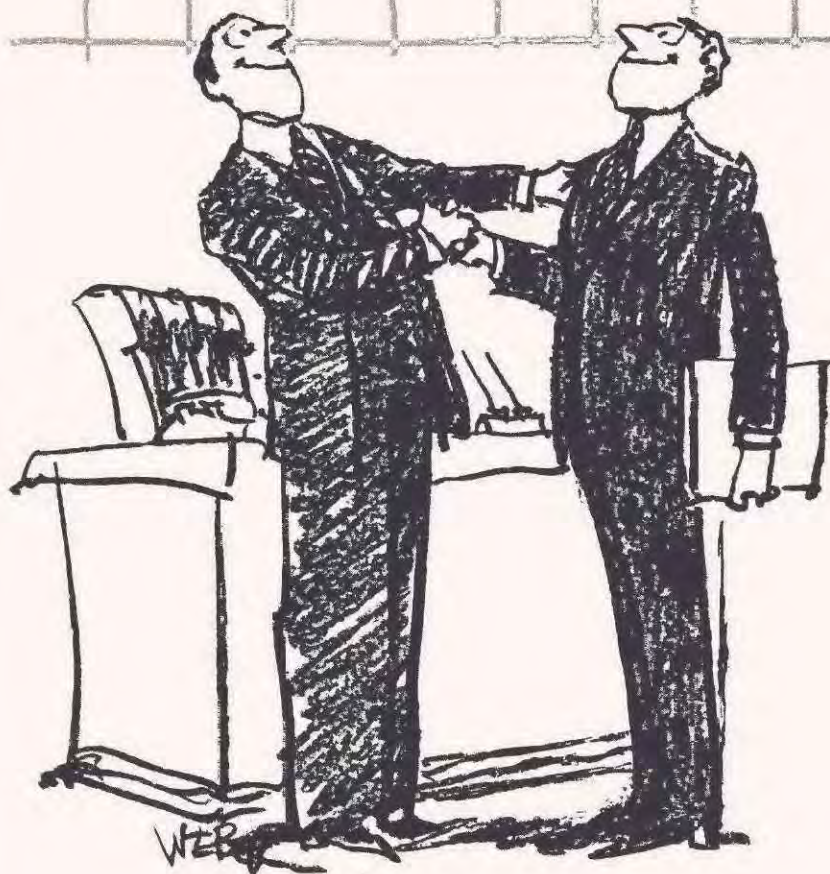
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Oregon law

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vehicles and 41,000 state employees.

Generally, the new law should allow for "more efficient and effective risk management," said Gerry Thompson, Gov. Atiyeh's executive assistant.

First, the risk management division will also have greater authority in handling workers compensation risks insured through the State Accident Insurance Fund. The quasi-governmental entity is among 13 competitive state funds in the United States that compete with private insurers to provide workers compensation insurance in their respective states.

State taxpayers now pay about \$8.8 million up front annually to cover the state's workers compensation risks for about 41,000 employees through the fund, according to figures for fiscal year 1983-84. In return, SAIF is paying out for incurred claims an estimated \$7.5 million "subject to further development," according to state SAIF estimates quoted by Mr. Snyder.

Previously, individual state agencies paid premiums monthly to SAIF through payroll deduction. Employees were categorized into five classes that gave very limited consideration to loss experience, Mr. Snyder said. The state's Executive Department merely monitored SAIF's loss reports.

The risk management division now plans to pay monthly workers compensation premiums to SAIF through the Insurance Fund. Meanwhile, individual state agencies will be billed on the basis of their loss experience.

The risk management division plans to better manage workers compensation costs by reviewing computer printouts of each paid claim. The division also will create incentives for loss control by charging back workers compensation costs to individual agencies; will shorten the time it takes for loss experience to be reflected in premiums; and will review SAIF's claim reserves to ensure they are not excessive.

Mr. Snyder said the sensitive relationship between the risk management division and SAIF caused legislators in 1983 to scuttle a similar risk management bill because of their concern that the risk management division might be too aggressive in its cash-management efforts (BI, April 2, 1984).

Although Mr. Snyder worked out an agreement in advance with SAIF officials this year, it was "nip and tuck" getting the bill through the Legislature because questions persisted about the division's relationship to SAIF, he said.

With the new law, the risk management division's power to self-insure has been broadened. Previously, the risk management division had authority to self-insure some perils, but only if they were specifically authorized by state law. Authority to self-insure a new peril required legislative approval.

The previous law also required any self-insured state property to be located on state-owned property. If the state leased part of a building on private property for an office, state-owned office equipment could only be protected by purchasing a separate insurance policy or by arranging for the building owner's insurance to cover the state-owned equipment, he said.

The new law gives the division authority to provide all-risk property coverage to state agencies, regardless of whether the property is on state-owned land. Therefore, the state will self-insure risks that previously couldn't be self-insured, including business interruption coverage for university sporting events, extra expense and dishonesty bonds, Mr. Snyder said.

Mr. Snyder estimates that the state expects to save at least

\$300,000 by eliminating the need for an estimated 10 to 15 separate policies for coverages the state can now self-insure.

The only loss that the division still may not self-insure is "mysterious disappearance," to cover claims for property that disappears without explanation.

The new law continues the risk management division's practice of apportioning premiums among individual state agencies on the basis of their respective loss experience, he added.

The new law also gives the division greater ability to manage its money as a result of its mandate to merge the state's Restoration and Liability funds into a single Insurance Fund.

Through the Restoration Fund, the state now self-funds the first \$3 million in property losses from limited and specified perils for state property on state-owned land. Above that, it purchases \$200 million in excess property insurance to

protect state universities and other state-owned facilities, some of which sit on earthquake faults.

Through the Liability Fund, the state self-insures the first \$3 million in losses from lawsuits brought against state employees under the Oregon Tort Claims Act. In addition, the state has purchased \$25 million in excess insurance coverage above the \$3 million self-insured retention.

Insurance costs should be trimmed in the future when the division purchases a single, manuscript excess insurance policy above a self-insured retention for property and casualty losses that could be doubled to \$6 million from the current \$3 million for property losses and \$3 million for casualty losses, Mr. Snyder said. However, in light of the current tight market, he noted that it probably will be easier to renew the state's current excess policies than to combine them at this time. The excess liability coverage expires Aug. 1, while

the excess property coverage expires Sept. 15.

Having a single fund also will enable the risk management division to better manage its cash flow and thereby increase its investment returns, according to Mr. Snyder.

The new law says that the Insurance Fund should operate on "an actuarially sound" basis, which reinforces its independence and should forestall any "raids" by legislators on the accumulated insurance funds, Mr. Snyder said.

The new law also creates a "safety net" by allowing the Insurance Fund to borrow money from the state treasury, although it must have the approval of the Legislative Assembly's Joint Ways and Means Committee or Emergency Board if the loan exceeds \$50,000. However, Mr. Snyder said that borrowing probably won't be necessary.

The risk management division's role in providing for defense and indemnification of elected state of-

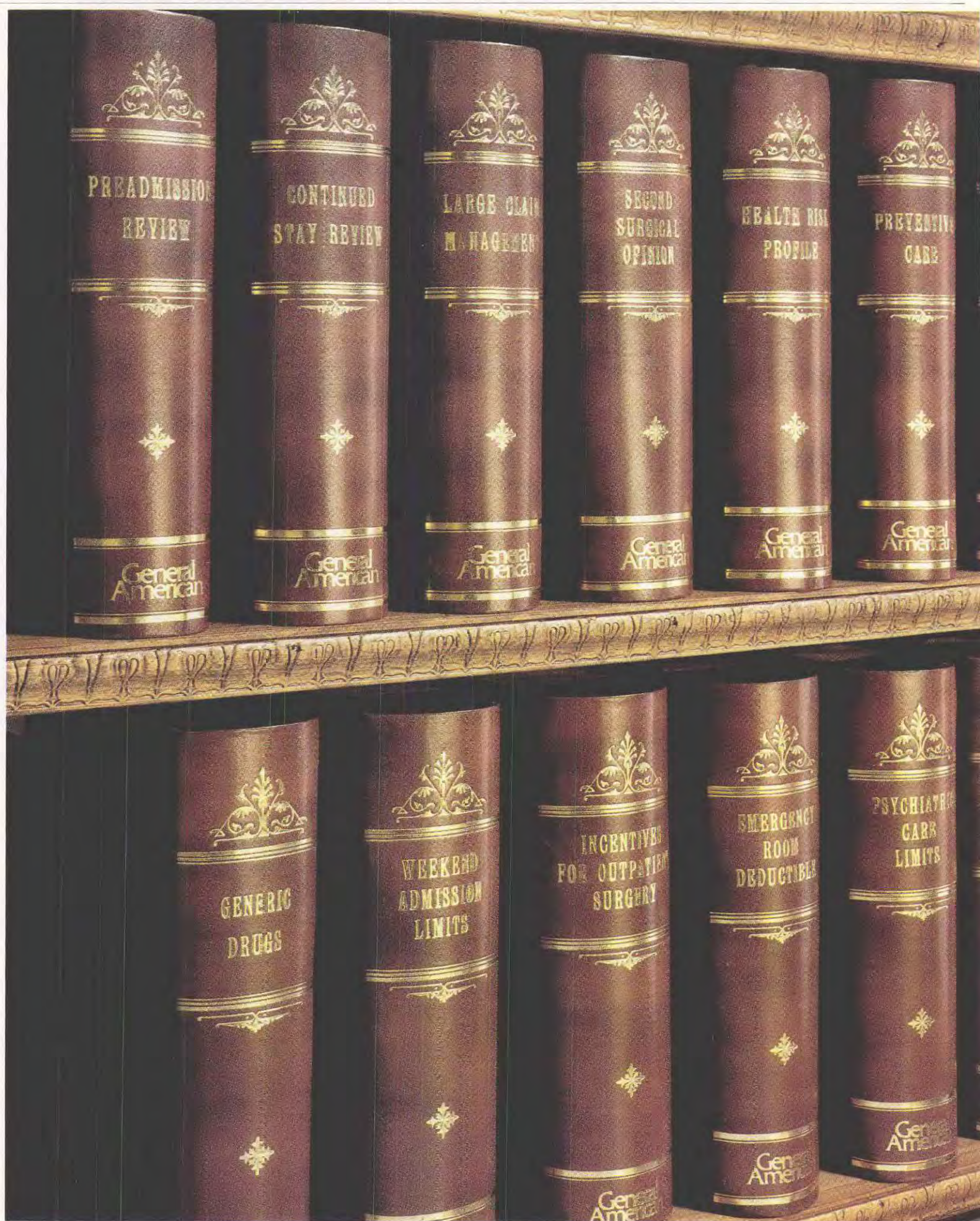
ficials in civil rights cases has been broadened under the new law.

Previously, some of those cases had been handled by the individual state agencies whose officials' programs were being legally challenged. Now all cases will be processed through the risk management department.

But because some legislators were concerned about protecting the rights of elected state officials, the bill was amended to give elected officials the authority to review and approve settlement agreements involving their departments before the settlements are finalized.

The division was also given greater authority to investigate, document and settle employee tort claims previously handled by individual state agencies.

In addition to passing the new law, legislators have also ordered the risk management division to help the state's Justice Department better manage legal defense costs, he said. ■



Trends in comp

Continued from page 3

"There are developments in society as a whole that have some implication on workers compensation," said John Burton, a professor of labor relations at Cornell University in Ithaca, N.Y.

Professor Burton cited the level of economic activity, the unemployment rate, the shift away from manufacturing to safer jobs, changes in the sex and age of the workforce and the influx of immigrants, both legal and illegal, into the workplace.

"And the shift to older workers will bring an increase in workers compensation claims," Professor Burton predicts, explaining that



Prof. Burton

degenerative back and heart problems are expected to increase as the workforce ages.

The declining power of labor unions also will affect the work comp system, Professor Burton explained.

"In many states and on the national scene, the trade union movement has been a major player in workers compensation reform," he said, noting the unions usually won increases in benefits for their members.

"To the extent that the union movement is losing its strength...one force will disappear, and will make it harder to change workers compensation laws," Professor Burton said.

"Unions are simply in the wrong industries, in the wrong place. They are not where business is moving, which is the South and Southwest," said John Seel, associate vp with The Naisbitt Group, a Washington-based research firm that monitors developments relat-

ing to the future of business and society.

The chairman of The Naisbitt Group is futurist John Naisbitt, author of the popular book "Megatrends."

"Workers compensation is not immune to the changes in this environment that are affecting every industry in this country...and abroad," Mr. Seel said.

Mr. Seel advises leaders not to wait to act until after a change occurs, but instead to monitor small incidents that will lead up to a change.

"The key is to anticipate change. Change taking place outside of workers compensation may affect workers compensation," Mr. Seel warned.

The Naisbitt Group is monitoring five states it has identified as bellwether states: California, Colorado, Connecticut, Florida and Washington.

In the future, throughout the world, "economics will be based on

ideas, rather than capital; on human capital, rather than financial capital," according to Mr. Seel.

He quickly shot down two prevailing myths: that the older smokestack industries will disappear and that all future jobs will be in high-tech industries.

"The smokestack industry will not disappear, but it will change drastically," he said.

By the year 2030, only 3% of the workforce will be involved in the manufacturing of goods, Mr. Seel said. Currently, about one-fifth of the workforce is involved in manufacturing.

But also in the future, he predicts that only 5%-6% of the jobs will be in the high-tech industries.

The rest will be in areas not even yet created, Mr. Seel said, adding that the world is at the threshold of new locomotive technologies.

He compared this time to the era when the automobile was invented. That invention led to the building of highways and the opening of

fast-food restaurants that created new jobs, he said.

Similarly, the new technology will create other jobs in areas outside high-tech.

Robotics, particularly in telecommunications and biotechnology, is the driving technology of the future, Mr. Seel said.

Overall, the future lies not in the production of goods, but in the application of goods, Mr. Seel said.

To prepare for the future, several business, labor and government groups are conducting special studies on the workers compensation system.

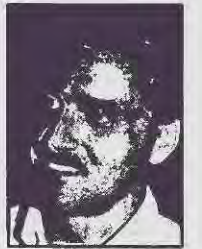
For example, the U.S. Chamber of Commerce's ad hoc National Business Council on Injury Com-

ensation spent the past year studying compensation for injuries stemming from industry that affect not only workers but other people outside the workplace.

In its report, released in April, the Chamber noted that it is a long-standing tradition of the American society to seek to ensure that injured individuals are cared for and are compensated appropriately.

"There are numerous remedies presently available to the American public to provide compensation for injury. These existing compensation systems include common law tort liability and its statutory derivatives, statutory no-fault administrative systems, hybrid statutory and common law remedies, contractual insurance coverages and a wide variety of taxpayer and in-

Continued on page 10



Mr. Seel

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business
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Trends in comp

Continued from page 7
dustry financed public programs," according to the report of the Chamber.

The ad hoc council concluded that each of these systems works "reasonably well" most of the time. But still, improvements are needed, the report said.

In determining compensation for injury, questions of causation need to be addressed, the Chamber's report said.

"The U.S. Chamber supports efforts to better clarify and refine the nexus between science and law in determining compensation and encourages its members to work with the public, the scientific community and government to achieve this goal," according to the report.

Among the recommendations in the Chamber's report are:

- Distinctions must be made between the desire to compensate and punish harmful conduct that is

wrong and to compensate for the consequences of harmful conduct that is not wrong.

Affixing blame and assessing damages to punish and deter harmful conduct where fault is not at issue are inconsistent and inherently unfair.

- The tort liability system is no longer the only means of assuring compliance with societal norms. Other societal institutions also play a significant and increasing part in

**Congress sees work
comp 'as too
complicated to deal
with,' says Mr.
Elisburg.**

setting and enforcing standards of behavior.

Therefore, compensation systems should not be viewed or used as the primary means to be used to punish, blame or prevent socially unacceptable conduct.

- Where compensation costs are imposed on industry, there must be recognition that these extra costs may have adverse social consequences. These social consequences must be considered and balanced against the need and purpose of any new proposals or modified compensation systems. Efforts must be made to minimize aggregate costs and eliminate excessive transaction costs.

The U.S. Chamber's report and other similar studies "are all based on the premise that we can't start all over again, but have to live with the current workers compensation system," said Donald Elisburg, a labor attorney with the Washington law firm of Connerton, Bernstein and Katz.

He looked into the future and noted that the workers comp system is on two tracks: short-term and long-term.

Short-term solutions are the "changes that need to happen in existing systems, primarily in the states," he said.

These are the types of changes that will take place within the next 15 years, but the mega-changes, those that will affect the next 30 years, "most certainly will take place at the national, rather than state level," according to Mr. Elisburg.

But, the major roadblock to a long-term, national change is the U.S. Congress, Mr. Elisburg continued.

"Congress sees much of the workers compensation program as too complicated to deal with. And the other side of that is that Congress does not see occupational disease and occupational disease compensation as a 'workman's comp' program," Mr. Elisburg explained.

Congress does not link occupational diseases, like poisoning from exposure to toxic substances, with traditional workplace injuries, like "smashing your arm on the forklift truck," he said.

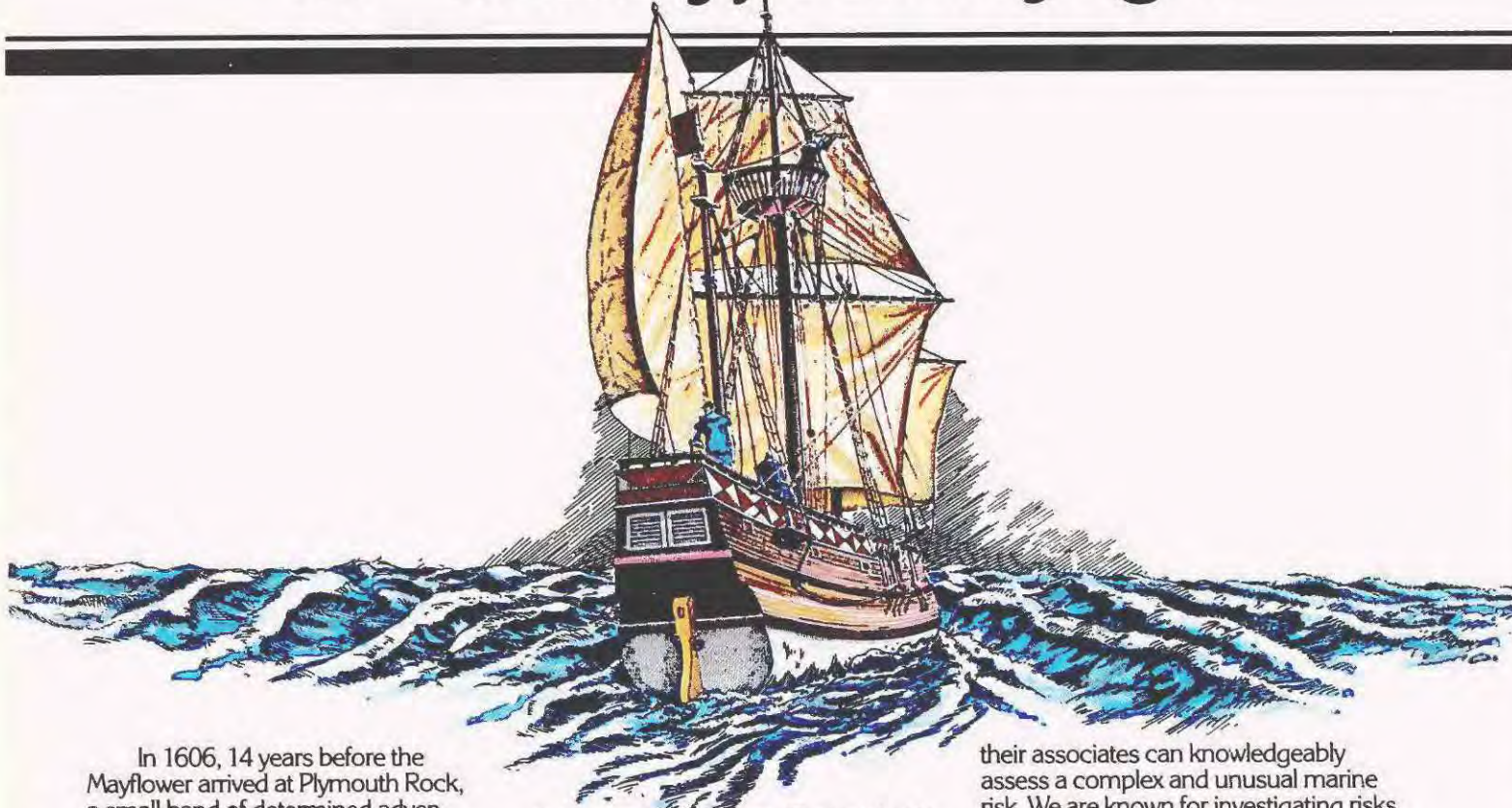
Rather than deal with 100-page pieces of workers compensation legislation, loaded with actuarial and rating information, Congress will turn around and say "fix it," Mr. Elisburg said.

"And they'll fix it with money, not complicated schemes in which people don't get their money," he said.

He also believes that leaders and planners need to take a more global approach to workers compensation reform by studying the systems used in European countries, where the concept of workers compensation began.

None of those systems is perfect, Mr. Elisburg said. However, he said they should be looked at when trying to redesign the current U.S. system.

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re•spon•si•bil•i•ty (ri spon' se bil'i te), n. 1. the state or fact of being responsible. 2. an instance of being responsible. 3. a particular burden of obligation upon one who is responsible. 4. something for which one is responsible; dependability, esp. in meeting debts or payments. 5. on one's own initiative or authority.

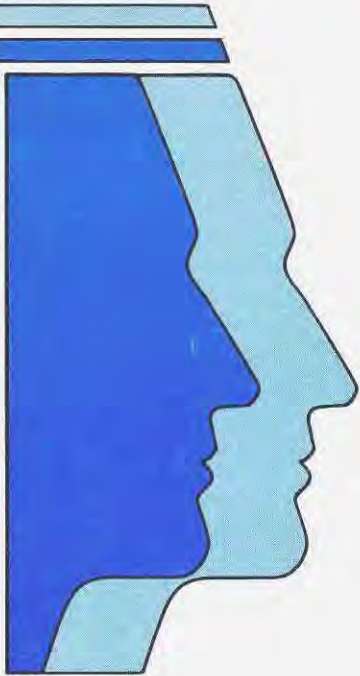
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AGENDA

GENERAL SESSIONS focus on the foundation of effective communication.

Listening To Employees

Suzanne Kenney, Manager, Employee Listening Services, HEWITT ASSOCIATES

After interviewing more than 29,000 employees and examining written survey responses from 85,000 others, Ms. Kenney will present fascinating data on how employees feel about their benefits. What are employees saying, what questions are they asking, and what choices are they making about benefits?

Working With Consultants: The Consultant Side

George Heiring, Managing Partner, HEWITT ASSOCIATES

In the first of a two part series, Mr. Heiring offers a practical approach, injected with gentle humor, to the ever-changing relationship between consultant and client. He addresses such issues as what should the client expect, what is unreasonable for the client to expect, and how clients can get the most results from their consultant.

Working With Consultants: The Company Side

Steve Wasserman, Director, Benefit Communication & Training, DART & KRAFT, INC.

In part two, Mr. Wasserman addresses the client side of the consultant-client relationship. He will make practical suggestions on when, where, why and how you should use consultants. Further, Mr. Wasserman will recommend what groundwork should be done prior to and while working with a consultant — groundwork that will save you time and money.

You Be The Judge

Herbert Zeltner, HERBERT ZELTNER CONSULTANT INC.

A dynamic speaker who sparks controversy and leads you in an energetic session, Mr. Zeltner returns once again to the *BI Conference*. He will introduce selected audio-visual programs submitted to the EBC Competition and will offer you a glimpse of what other industry professionals are doing.

CASE STUDIES encourage group interaction.

Your Retirees: An Untapped Health Care Cost Containment Weapon

Jeffrey M. Ostroff, President, JEFFREY M. OSTROFF ASSOCIATES

Vivian Anderson, Corporate Personnel, ALLSTATE INSURANCE COMPANY

Providing medical benefits to retirees can be very costly; and expenditures will continue to rise as the retiree population grows. Mr. Ostroff will present a brief overview of the post-retirement health benefits issue. In addition, Ms. Anderson will walk you through a communications program Allstate used to effectively deal with this problem. Attendees will be given strategies which offer companies the opportunity to contain health care costs for both retirees and active workers.

Benefits Overhaul

Steve Wasserman, Director, Benefit Communication & Training, DART & KRAFT, INC.

While producing communication materials for benefit changes may have to be done in a tight time frame, good plan and communications design takes months. The communicator

must keep all lines of communication open during the design and production process, and have suppliers ready to go when the job begins. In an informative presentation, Mr. Wasserman discusses effective communications planning, what communication approach was taken in a benefits package redesign, and how production was achieved in a short time frame.

Computers Can Talk Benefits

Pam Keeler, Director, Advanced Benefit Communications, METROPOLITAN LIFE INSURANCE COMPANY

In an effort to increase employee understanding and perception of their benefits program, Met Life took a new look at the employee communications field. After a careful study of benefit communications needs, Metropolitan designed an innovative program. Now, Met employees can directly access their benefit and savings plan information through interactive computer terminals stationed throughout Met Life headquarters. Ms. Keeler will explain the intricacies of this unique communications vehicle and what it takes to make it succeed.

PRINT WORKSHOPS address specific communications needs.

The Power of Personalizing Print

Deborah K. Huffman, Senior Vice President, FRANK B. HALL CONSULTING COMPANY

Ms. Huffman will address the pros and cons of personalizing print communications. How technology is distancing the workforce from management, the pressure that "personalizing" can place on your data base, and current applications for personalized benefits communications, are just some of the issues she will discuss. Additionally, Ms. Huffman will compare the strengths and weaknesses of traditional vs. laser print materials, and will provide good and bad examples of personalized communications using both techniques.

Standard Print Communications & Print Enhancement

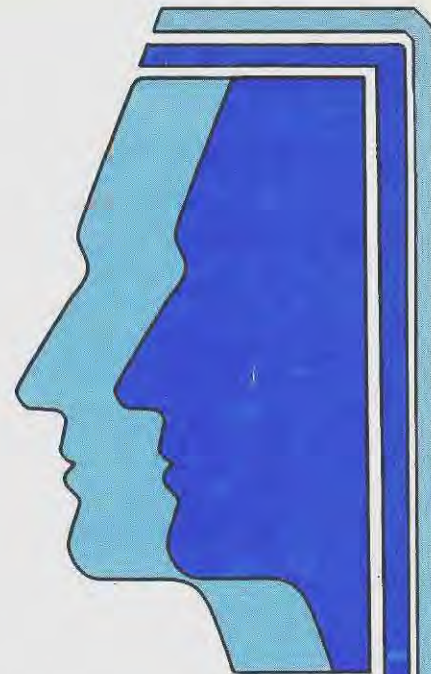
Martin Lapidus, Consultant, TOWERS, PERRIN, FORSTER & CROSBY

To effectively communicate benefits to employees you must have a precise understanding of the issue at hand. You must also anticipate what reaction management expects from employees. Mr. Lapidus suggests that it is the nature of the benefits program (positive change, negative change, update, etc.) that helps determine the elements of effective communication. Further, he offers a practical approach to what management's goals should be in communicating benefits to employees.

TASK FORCE is a challenging professional forum.

Designed to encourage idea-sharing among attendees, the task force is perhaps the most intriguing component of the Business Insurance Conference. At the time of registration we invite you to submit questions, problems, or issues on benefits communications (see registration form). During this session the group will be divided into small task force units. Within this unique "give and take" framework you will discuss and evaluate the proposed communications problems with your professional counterparts. Each task force will then have the opportunity to state the problem and present their findings to all attendees. The task force is a stimulating forum where your input is an integral part of the *BI Conference* learning experience.

August 5 and 6 The Grand Hyatt Hotel, New York City



This year our Conference format covers four major areas. While meeting as a large group, the general sessions focus on the foundation of effective communication. Small case study meetings encourage group interaction, and rotating schedules afford you the opportunity to attend all three sessions. Print workshops will center on two techniques — standard and laser printing — and you can select the one which best suits your needs. The task force, a new component of the *BI Conference*, is a challenging forum where you actively partake in evaluating the “real life” problems confronting communicators. We encourage you to submit your problems, questions or postulates of benefits communications on the attached registration form.

Highlighting the 1985 *BI conference* is the 13th annual EBC Competition Awards Presentation. Print programs submitted to this year's Competition will be available for review in the EBC Gallery. Another feature, the Benefits Literature Gallery, is where you can collect some of the latest information available from consultants, insurance companies and service organizations.

COMMUNICATING EMPLOYEE BENEFITS

EBC COMPETITION

EBC AWARDS LUNCHEON

Alfred Malecki, Publisher, *BUSINESS INSURANCE*

At a luncheon honoring the winners of the 13th annual EBC Competition, awards will be presented to those companies who have excelled in communicating their employee benefits programs. One of the winning audio visual programs will be shown.

A limited number of additional seats are available for the EBC Awards Presentation luncheon. Tickets are \$50.00 each, available on a first come-first serve basis; advance reservation is required. Please contact the Registrar.

REGISTRATION

The Business Insurance Conference opens Sunday evening, August 4, with advance registration and cocktail reception. Sessions begin Monday, August 5, at 8:45 am and adjourn Tuesday, August 6, at 4:15 pm.

The cost is \$575. A 10% discount is offered to additional registrants from the same company. The fee includes sessions, workbook and educational materials, breakfast, coffee breaks, luncheons and cocktail reception.

Payment required with registration.

All cancellations must be received in writing. A full refund will be made on cancellations received prior to July 5. A \$100 service charge will apply to cancellations received after July 5. No refund will be made on cancellations received less than 5 business days prior to the conference.

However, if your plans change at any time, you may substitute the name of another person from your company without penalty.

All registrations will be confirmed in writing.

To register, simply complete the form and send it along with your payment to:
Business Insurance, Communication Services Department
220 E. 42nd St., Suite 930, New York City, NY 10017
For additional information call: Ann Vazquez, Registrar, at 212/210-0137

HOTEL ACCOMMODATIONS

We have set aside a block of rooms at a special rate at the Grand Hyatt Hotel in New York City. Rates available to Conference Registrants only: \$100 single; \$125 double.

You must mention the *Business Insurance Benefits Conference* when making your reservations. Hotel cards will be included with your Conference Registration Confirmation. Or call the Grand Hyatt Hotel at 212/883-1234; or toll free at (800)228-9000. These rates will be honored only until July 22.

REGISTRATION FORM

BI 729

Please register me for the 1985 BI Conference
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August 5 and 6
The Grand Hyatt Hotel in New York City

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Workers comp reform
no easy task: Experts

By CAROL CAIN

ORONO, Maine—Workers compensation reform is not a one-year effort, but a “a year, after year, after year drudge,” one battle-worn reformer says.

“We have to question whether we have the stamina to stick with workers compensation reform,” says John Lewis, a non-practicing attorney in Coconut Grove, Fla., who has been involved in workers compensation reform in several states during the past decade.

Reform is not simply adopting a new law, Mr. Lewis explains. “You pass a law and then next year you have to watch what was changed, what has to be fixed,” he says.

How states attempt to reform their workers compensation laws was addressed by Mr. Lewis and other speakers and participants at the ninth annual National Symposium on Workers’ Compensation, held July 14-19 at the University of Maine at Orono.

Many of the participants concluded that employers and employees need to take a more active role to make workers compensation reform more effective.

Reform is a “terribly arduous process,” but one that’s needed, especially in Massachusetts, noted William J. McCarthy, general counsel to the Associated Industries of Massachusetts, based in Boston. The Massachusetts Legislature, which is in session all year, currently has three major reform bills pending in its Joint Committee on Commerce & Labor.

“My impression is that workers compensation is a terribly complicated issue, known only to a few of the initiators—claimants and lawyers—and a handful of claims adjusters and administrators,” Mr. McCarthy said.

The first step to any reform effort is to educate the legislature about issues like workers compensation benefits, rating and rehabilitation, Mr. McCarthy said.

“It took me one year of study to understand how the issues were related. These issues are not understood by policymakers,” he said.

“I don’t think legislatures have the capability to write a good comp law,” Mr. Lewis said, adding that only two groups should draft work comp laws: employers and employees.

Attorneys and insurers are the “experts” who need to be contacted and questioned when drafting reform measures, but they shouldn’t get involved in the negotiations, Mr. Lewis said.

“Employers and employees have to play a much more active role,” agreed James N. Ellenberger, assistant director of occupational safety, health and social security for the AFL-CIO in Washington, who was a participant at the symposium.

Mr. Ellenberger said employers and employees have to “grab” control of the workers compensation system, which has been “used and abused” by attorneys and insurers.

“We have to take the lead role and get away from this reliance on counsel,” Mr. Ellenberger said.

AIM’s Mr. McCarthy agreed.

“Perhaps the single most basic defect in the current system in Massachusetts... is that state government has failed in the delivery of workers compensation services, and employers and employees, for whom the system was designed to operate, have lost control of it,” Mr.

McCarthy said.

“Any reform program in Massachusetts simply must address that issue: The need for both employers and employees to regain their lost control. The establishment of a powerful advisory council with real teeth comprised principally of employee and employer representatives with enormous power to oversee the future operation of the system will accomplish that end,” he said.

Others also advocated a permanent advisory council made up of employers and employees to constantly monitor a state’s workers compensation system.

Creation of such an advisory council was the concluding recommendation of Theodore J. St. Antoine in his report late last year on the Michigan workers compensation system. Mr. St. Antoine, a law professor at the University of Michigan in Ann Arbor, was appointed in 1983 by Michigan’s governor to study the system.

The state of Wisconsin has had an advisory council for 60 years, “and only once in the past 50 years did it fail to come up with an agreed (piece of legislation),” Mr. St. Antoine said.

A more active role by employers and employees also was advocated by a Massachusetts researcher.

“Workers compensation in Massachusetts is kind of like an ocean liner with two paying customers—employers and employees. One wants to go to Georgia and the other wants to go to Florida. Meanwhile, the pilot and copilot—insurers and attorneys—are taking them to Japan,” said Walter Horn, the research supervisor for Massachusetts’ Joint Committee on Commerce and Labor.

“And the state Legislature is like Gopher (the purser) on Love Boat,” doing what the other parties want it to do, Mr. Horn commented.

However, some insurers attending the symposium believe that any reform effort hinges strongly on input from insurers.

“If funding of benefits, the costs, were not something we were vitally involved in, then we could support (leaving reform to employers and employees),” said John Richman, senior vp with Zenith Insurance Co. in San Francisco.

“But in terms of how the system operates, the expertise really rests with the insurers.”

“We also have the statistics and data to determine if and where problems exist,” said Roger Thompson, director of industry affairs for Travelers Insurance Cos.

Another insurer representative, John Purkis, a vp with Liberty Mutual Insurance Co. in Boston, said employers and employees can be in charge “as long as we’re talking about benefits.” But when it comes to rating, it’s the insurers that have the knowledge, he said.

The trick to having an employer-employee group work effectively, however, is getting them to trust each other, several speakers noted.

“You have to come to a joint labor-management committee with clean hands to deal open and honestly,” said Martin Foley, legislative director for the Massachusetts AFL-CIO.

Mr. Lewis said the success of reform would depend on the ability of labor and management interests to “talk quietly for a year” before publicly issuing any recommendations.



Mr. Lewis



Mr. McCarthy



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Groups search for answer to work comp rate inequities

ORONO, Maine—A new system of computing workers compensation rates for construction job classifications unveiled late last year is coming under scrutiny.

The new system—known as the Loss Ratio Adjustment Program (LRAP)—was the subject of a discussion on workers compensation rating at the National Symposium on Workers' Compensation at the University of Maine at Orono.

Speakers from Florida and California, in particular, critiqued the new program developed by the National Council on Compensation Insurance and offered alternative rating systems that initially would apply exclusively to construction classifications.

Employers in the construction industry have criticized most workers compensation rating systems, which use a formula based on payroll, saying that such a system is inequitable to contractors that pay high wages. In many cases, contractors have suggested that premium be based on the number of hours worked, rather than payroll.

LRAP, which went into use in Oregon, Illinois and Maryland on July 1, allows for the use of an additional credit or debit factor on top of experience modification credits or debits when an employer's workers compensation premium is calculated (BI, May 13). The credit/debit factor is based on an employer's three-year loss ratio.

The NCCI is a New York-based national workers compensation rating and research organization. In some states, like California, an independent rating organization keeps statistics and develops manual rates for approval.

Last week, the California Workers' Compensation Insurance Rating Bureau approved a system for six construction classifications in which each classification would be split into two rate categories, one for high-wage and one for lower-paid employees.

This pilot system is expected to be submitted to California's insurance commissioner around Aug. 1 and, if approved, would go into effect Jan. 1 (see story, page 3).

Both the NCCI and the California bureau are addressing the inequitable aspects of workers compensation rating in the construction industry. "The only difference with NCCI is the solution," said Leo Souza, the California bureau's president.

In addition, the Florida Labor/Management Council in Plantation, Fla., has proposed a rating system in which part of the premium would be based on hours worked and part on payroll.

"The construction industry has long held workers' hours to be an equitable basis for premium because worker hours is the most valid measure of hazard and at the same time it provides for an equitable distribution of premium between high- and low-wage payers within the same classification," said Robert D. Edwards, chairman of the Florida Labor/Management Council, an employer-employee construction industry association.

"Wages is a poor measure of hazard. There is absolutely no basis for equating wages to risk," he said.

But the group is not a proponent of using man-hours as an "exclusive" basis for rating. "We favor manual premiums based on payroll for wage-related benefits and on worker hours for medical-related benefits," Mr. Edwards said.

Although the NCCI believes that payroll is a good basis for premium calculations, Mr. Edwards cited reasons why it isn't. For example, an employee bonus would result in

a higher premium, even though there would be no additional exposure.

Mr. Edwards said that while the NCCI maintains payroll-based rating is a sound system, "LRAP demonstrates the abysmal failure of total payroll to produce equitable premiums for the insureds."

"There isn't a particular base of premium out there that's perfect," said Michael Camilleri, vp of na-

tional affairs for the NCCI. However, payroll-based rating is the best system in most cases and LRAP further sensitizes the payroll basis to loss experience, Mr. Camilleri said.

In designing LRAP, the NCCI studied systems similar to the ones being proposed in California and Florida, but decided that a further credit or debit based on loss history was the most equitable, he said. ■

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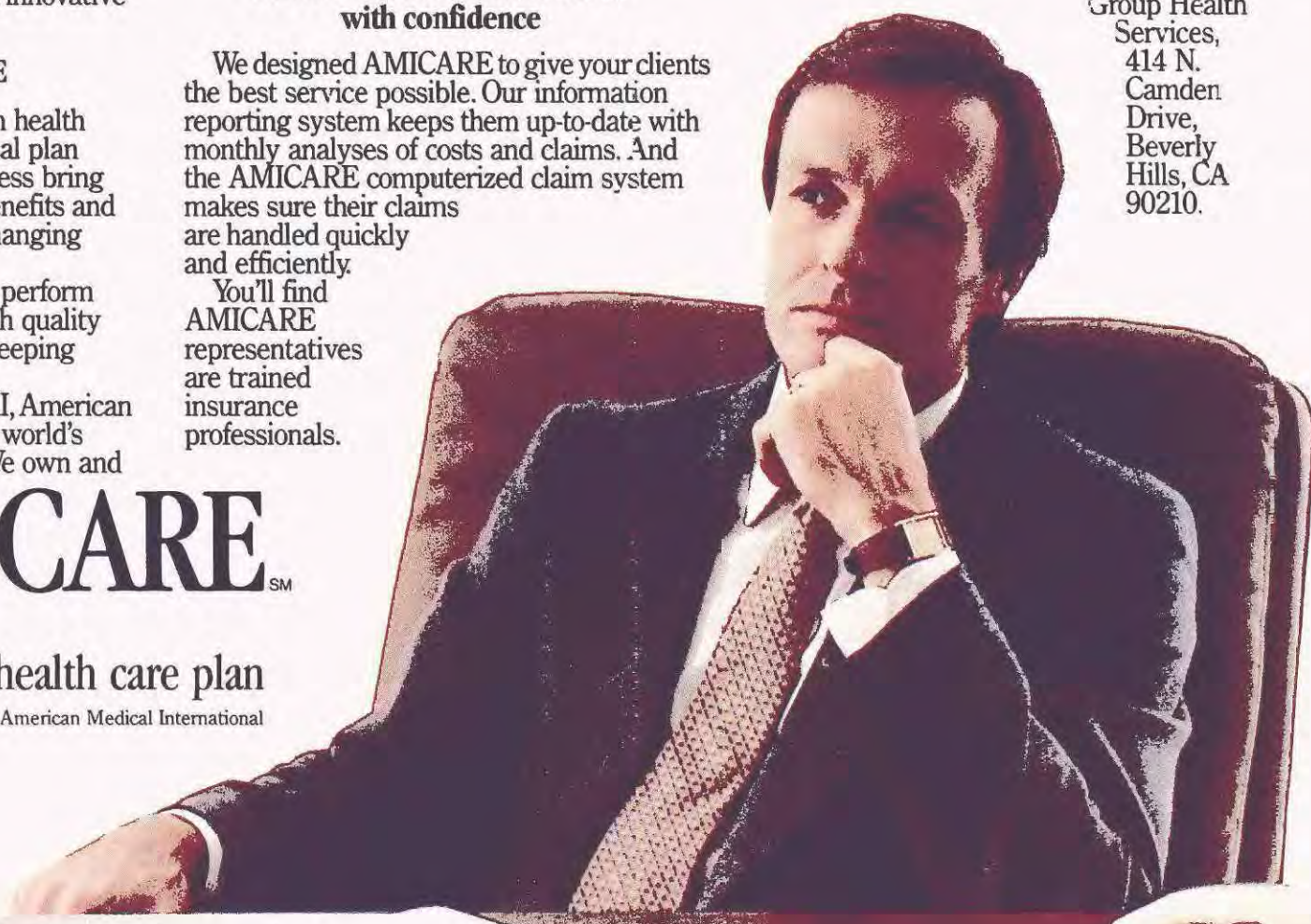
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INDUSTRY UNDER ATTACK

Court interpretation of policies leads the list of new problems for insurers

By Robert V. Hatcher Jr.

ONE BILLION seconds ago it was 1952. . . .

One billion minutes ago, Christ was alive. . . .

One billion hours ago, nothing on this earth walked on two legs. . . .

Forty billion dollars in underwriting losses and five-plus years ago, the property/casualty business was richer. It just shows what can be done with billions in a short time frame when there's real talent at work. . . .

Can it be only a year ago that I drew so much comment by suggesting in print that the solvency of the insurance market deserved more attention than the price of the product? Now that the market has finally turned, the price of the product seems almost an afterthought: It is the very *existence* of the product that is at stake for many of our clients.

Many are willing to live with larger self-retentions in the first loss area. But, none are comfortable with gaps in coverage on all those layered millions of both property and casualty insurance.

How could the insurance market turn upside down and inside out in such a short time? The answer to that is not at all irrational, once we concede that insurance capacity is more psychological than it is financial. Effectively, insurance capacity is how much insurance underwriters *want* to write.

The amount of capacity, then, changes with underwriters' expectations. In the good part of the cycle, profits influence underwriters to sell more and others to enter the business. Since all companies are selling the same product, the only way one company can take sales away from another is to add coverage and cut

prices.

Price-cutting squeezes profit margins until, at the worst part of the cycle, underwriters are losing money on each premium dollar collected. Because buyers still want to buy, supply then becomes less than demand. And, inevitably, prices go up.

That's the underwriting cycle. And, more than we sometimes realize, it is the result of *rational* behavior in a relentlessly competitive business: Underwriters' expectations move capacity; capacity moves prices; prices move profits; profits change expectations again; and it goes on.

What is not so rational or so easily understood—but which now fuels the hardening market—is the theory of entitlement that generates verdicts in product liability cases that are becoming *rewards* instead of *awards*. Social inflation is really on a roll.

Mesmerized by a no-risk theory of entitlement and universal coverage, government and the courts are using insurance to carry out social and political objectives: According to Jury Verdict Research Inc., 45% of all million-dollar verdicts are either product liability or medical malpractice.

Product liability leads, with 404 million-dollar verdicts since 1973; medical malpractice comes in second, with 296 for the same period. Between 1977 and 1983, there was an increase of nearly 600% for product liability.

And, try not to be a defendant in New York—they're No. 1 in the million-dollar club, with 16% of the total for the past decade.

What also is not so easily understood is the spectacle of American lawyers clawing at one another to be first in line to represent the victims of the Bhopal

disaster in American courts. This is a sickening aftermath of the tragedy that brought the world to tears.

What also is not so easily understood is the inability of those who write insurance policies to write them in such a way that the meaning cannot be changed or distorted by a court of law.

For example, the word "aggregate" no longer means aggregate, but seems to take on the connotation of "unlimited." So, an underwriter who had the good sense to include a \$30 million aggregate on pollution coverage in the state of New Jersey may end up paying 10 times that amount.

This kind of judicial inflation also permits a Lloyd's of London underwriter to say, "I would like to provide coverage for *sudden and accidental* pollution, but I can't do that until you can show me some way of saying it in English so some American court will not assume that it means *all* pollution." So much for judicial inflation and the hard market.

It seems pretty clear that our underwriting cycles also lead to cycles of insurance regulation. The availability of insurance has great economic and social value. The accepted loss ratios in much of property and liability insurance indicate that people so value the ability to transfer certain risks that they will contribute one-third to one-half of their premium dollar to the operating expenses of the risk-distribution system.

It is no wonder that a public that is willing to pay that much to spread certain risks will react forcibly against what it thinks is an unfair curtailment of its ability to spread those risks.

Generally, government can be expected to act to strengthen or replace the private insurance mechanism when the shortage of insurance is serious

enough and the social cost of not acting—of leaving the individual to take his or her chances alone—is too high.

As an industry, we have to be concerned by this tendency. It is well-known that whatever insurance mechanism goes into the public sector rarely comes out again.

I believe the insurance industry's emphasis on tort reform, which would have the effect of limiting liability recoveries, may be misplaced. Perhaps the first reform our industry should be looking for is contractual reform. We could accomplish it by changing that portion of the insurance law that permits commercial insurance contracts to be construed strictly against the drafter.

This rule of construction is an anachronism in the commercial insurance marketplace. Commercial insureds have legal resources to get what they deserve from an insurance contract, unlike individuals with limited resources who attempt to recover under a personal lines policy. The solution is to have commercial insurance contracts be interpreted in such a way as to carry out the reasonable intent of both parties.

Perhaps we need legislation to level the legal playing field for commercial insurance. If that field remains tilted, as it is now, our clients could suffer by not being able to buy the broad protection they have enjoyed in the past.

Another element contributing to judicial inflation and the hard market has been the inability of insurance industry lawyers to mount a proper defense, regardless of the level of the playing field.

One of the striking features of the asbestos litigation is the fact that the lawyers for the asbestos producers have

Continued on next page

Book is technical, but well worth the effort

"Risk Theory: The Stochastic Basis of Insurance," Third edition
By R.E. Beard, T. Pentikainen and E. Pesonen
Published by Chapman & Hall, 733 Third Ave., New York, N.Y. 10017
\$24 softcover; \$49.95 hardcover

By John R. Stroik

THE THIRD EDITION of this classic work will not be as widely read as it should. But, the loss in this case will be borne by those who do not make the effort.

The book is arranged somewhat like a textbook, and that makes it particularly useful. Definitions of the more arcane terms from the world of insurance are clearly and precisely laid out. These are often followed by a more informal, almost background, discussion of the issue.

The notation has been updated from earlier editions to modern mathematical form, and this is a tremendous aid in both ease and precision of argument.

In addition, many of the more difficult parts of the computational arguments are relegated to separate, starred sections, to the appendix or to

referenced material.

This allows the book to be read at several layers of technical involvement, and it helps keep the principal thrust of each section unobscured.

The topics are presented in a logical progression. The book begins with a very general description of the problems and the fundamental mathematical relations.

Next comes a discussion of the claim-count process, both in a general way and with some specific models and formulas.

Then the severity distribution and its many forms receive treatment.

Finally, the basic loss distribution is introduced and examined, along with several methods of approximation. There is a rather nice characterization of how the components of randomness shift as the expected number of claims gets larger.

Once the loss process is defined, its behavior is studied, first over a short period of time. Reserve funding, retentions and reinsurance are introduced.

books & ideas

Then the loss process is considered over a long period of time. Losses become only one factor in the health of a company, while other cyclical and secular variables begin to play a role.

The book concludes with discussions of life insurance, asymptotic behavior and general business models.

Much new material has been added from earlier editions.

There is a more extensive discussion of how inflation influences the models (ironically, just as inflation has lost some of its steam). There is also some discussion of the role that modern computers play in the theory.

Unfortunately, this discussion is limited to computational aspects and not to the abilities of current data bases to rearrange and summarize data.

This leads to the one shortcoming of the book, although it is admittedly self-imposed by the authors. Because the book originally was written at a time when "risk" was something that only insurers managed, things are by and large looked at from the point of

view of an insurance company. The form and defects of the "raw data" are always taken to be outside the scope of the book.

The introduction of risk into a portfolio, and its cost, are taken to be a function of the markets.

But, the world has changed. Large corporations today retain substantial risk. There are captive insurance companies, associations, retrospective policies.

It would have been useful to have added a section that treats risk as a residual quantity in an operating firm (the "sell side") in addition to the standard treatment of it as a commodity (the "buy side").

But, this is a book that every risk manager should not only have, but read.

John R. Stroik is a quantitative consultant in the Sausalito, Calif., office of Risk Sciences Group Inc.



CGL policy doesn't cover breach of contract: Court

The Supreme Court of Wyoming upheld that the coverage of a comprehensive general liability contract encompassed only liability for tortious conduct and did not extend to liability that arises from breach of contract.

Action Ads entered into an employment contract with Kenneth Judes, a salesman, that required Action Ads to provide a medical insurance program for Mr.

These abstracts were prepared by Cases Unlimited Inc. A copy of an entire decision may be obtained by sending a check for \$5 made out to Cases Unlimited to Business Insurance, 740 N. Rush St., Chicago, Ill. 60611. List the number for each opinion.

legal briefs

Judes. Action Ads failed to furnish any insurance coverage.

Mr. Judes was seriously injured in a gas explosion in his mobile home. Mr. Judes sued Action Ads for breach of an obligation to obtain insurance under the employment contract.

Action Ads was insured under a CGL policy issued by Great American Insurance Co. covering bodily injury or property damage that Action Ads was legally obligated to pay.

Great American refused to defend Action Ads in the

suit brought by Mr. Judes. Action Ads then sued Great American for breach of the insurance contract. The trial court ruled in favor of Great American.

The appellate court said that courts universally have interpreted liability coverage provisions identical to that in American Ads' policy as referring to liability sounding in tort, not in contract.

According to the court, Action Ads' potential liability in this case stemmed not from its own negligent behavior, but from a contractual obligation. Therefore, the court said that Great American had no duty under the CGL policy to defend Action Ads. *Action Ads Inc. vs. Great American Insurance Co.*, Supreme Court of Wyoming, Aug. 8, 1984 (BI/05/Jy.—\$5).

Court interpretation of policies tops list of new woes

Continued from previous page
been better prepared than the lawyers for the insurance companies. We have seen instances where lawyers for asbestos producers have done extensive research into the Insurance Services Office hearings preceding each new ISO commercial general liability form. It should be no surprise that judges will decide in favor of the insured, when their lawyers are so well-prepared.

The new ISO CGL forms are being spawned in a welter of testimony. Unfortunately, the drift of the new forms is to keep premium and losses out of the insurance industry.

Our industry, rather than attacking the

root cause of the problem, which is judicial misinterpretation of contracts, has decided to try new language to exclude risks. The consequences may be as follows:

- The risks that supposedly were excluded will be brought back in by judges working under a system of law that permits them to interpret contracts freely.
- Because fewer risks will be insured, fewer premium dollars will flow into our industry, and there will be less money available to pay for the awards that will be handed down by judges anyway.
- The elusive concept of what is an occurrence will be replaced by the more pernicious concept of what is a claim. A claim can be triggered whenever a nervous client thinks of an adverse happening in his business. Also, claims-made forms may produce "John Doe" claims, in which all known or unknown claims similar to any one real claim are reported.
- The occurrence tails have now been chopped off by claims-made forms, at

least in theory. The menace of incurred-but-not-reported losses supposedly will not lash the underwriters. Instead, the tail of excluded claims—limitations on prior acts—may haunt the National Assn. of Insurance Brokers members present in this room, and our clients.

Now that capacity has been bled from the insurance industry by low prices, there is a question of where new capacity should come from. There are only three sources: profits, new private capital or new public capital.

In times of crisis, the last alternative always looks attractive because it seems so painless. We have seen it happen already with Superfund legislation, and there is talk of having a government earthquake pool to provide limits that are unavailable from private sources.

Similarly, since the government already participates in hail insurance, there are those who ask why we don't extend that to windstorm losses, including hurricanes. Perhaps government satellite insurance will be next.

What is amazing is that these proposals are getting a hearing in Washington, even though the government is more conservative now than at any time during the past 50 years.

We also must be careful, it seems to me, in encouraging bank capital to bolster insurance capacity. The problem with bank capital is that it comes with a governmental string attached to it. The Federal Reserve and the Federal Insurance Deposit Corp. seldom are reluctant to define the public interest.

We recently witnessed Maryland's governor intervening in the banking industry at the first hint of trouble. What will stop another governor from forbidding a bank-owned insurer to pay claims that might undermine the assets of the bank itself?

The NAIB can help us guard against the entry into our business of public or private capital that would change the nature of the business. The return of profits, as it always has, will attract private capital that is free and unencumbered.



Robert V. Hatcher Jr. is chairman and chief executive officer of Johnson & Higgins. This article is taken from his keynote address to the annual convention of the National Assn. of Insurance Brokers.

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Cal-Farm bonds

Continued from page 1

No financial guarantee or surety bond claims have been paid by Sacramento-based Cal-Farm since it was placed in conservatorship under the California Insurance Department's control by a March 29 California Superior Court order. Conservatorship in California is analogous to rehabilitation in other states.

At that time, the Insurance Department said that \$62.6 million in loss reserves to cover demands made for payment on surety and financial guarantee bonds had driven Cal-Farm into insolvency. The department said Cal-Farm's assets of \$119.5 million were \$32 million short of meeting its liabilities of \$151 million.

Subsidiaries sold

Since then, Cal-Farm's conventional property/casualty business and its life insurance company were sold last month to Zenith National Insurance Co. for \$56.5 million, providing those policyholders with continuity of coverage and leaving Cal-Farm with assets of \$116 million. The department is paying claims against conventional property/casualty policies written by Cal-Farm, which was founded in 1948.

Cal-Farm's 1983 direct premiums written of \$80.5 million were generated primarily by auto liability, auto physical damage, farm owners and homeowners insurance.

Financial guarantee and surety bonds totaling \$261 million in face value were written by Cal-Farm over an 18-month period beginning in May 1983, the department says. Most of those bonds were written on behalf of Cal-Farm by Eagle Bonds and Barclays Mortgage Corp. of Irvine, Calif., the depart-

ment says.

Cal-Farm received about \$5.2 million in premiums for those bonds, according to the Insurance Department.

Some losses on these bonds were reported in 1983 but they snowballed in 1984, according to the Insurance Department.

Whether Cal-Farm can meet its obligations depends upon the ultimate demands for payment under the financial guarantee and surety bonds and the value of collateral posted to obtain the bonds, which the department is still assessing.

"We've got something to work with, but whether we're going to pay everybody off at this time is still up in the air," says Joe A. Morton, chief of the department's conservatorship and liquidation division.

Recoveries in the litigation the Insurance Department is pressing against the owners of Eagle Bonds also would help pay claims.

The department is seeking \$45 million in one suit charging Eagle Bonds, its owners and an employee with conspiracy to defraud Cal-Farm, citing the federal Racketeer Influenced and Corrupt Organizations Act. The suit alleges \$15 million in damages, but demands \$45 million under RICO's provision for triple damages.

The suit, originally filed by Cal-Farm in U.S. District Court for the Central District of California in January, was dismissed in May for failure to show a cause of action under RICO.

"Because this court holds to a strict interpretation of RICO, defendants motion to dismiss is granted," Judge James M. Ideman said.

However, The California Insurance Department is appealing the dismissal to the Ninth Circuit Court of Appeals, and the department's attorneys—Gibson, Dunn &

Crutcher in Los Angeles—are optimistic they will win, based on a U.S. Supreme Court decision last month.

In a July 1 ruling, the Supreme Court refused to restrict civil lawsuits under the anti-racketeering act (BI, July 8).

Department files action

Following dismissal of the RICO suit in May, the Insurance Department filed another action against the owners of Eagle Bonds in June in Superior Court of the State of California, County of Los Angeles.

However, the state court action names Eagle Bonds' owners in their capacity as owners of the construction company that borrowed the money and purchased financial guarantee bonds underwritten by Eagle Bonds.

The state action, which also names the construction company—California-Pacific Construction Co.—demands reimbursement of payments made on financial guarantee bonds issued naming Cal-Pac as principal. The suit charges the defendants with fraud for failure to collateralize the Cal-Farm financial guarantee bonds as was represented in the financial guarantee bonds.

The state action seeks \$6.7 million in damages, plus interest, and \$42 million in exemplary damages and attorneys fees.

The state court action does not name Eagle Bonds. The managing general agency agreement between Eagle Bonds and Cal-Farm calls for arbitration of disputes.

(The RICO claim, however, is not arbitrable, according to the plaintiffs.)

If Cal-Farm cannot meet its obligations, the department will liquidate the insurer and claimants will receive a pro-rata share of the assets available to pay losses.

To the extent claims against conventional property/casualty insurance policies are not paid, the state guaranty fund will step in and pay losses, the Insurance Department says.

But, those with claims against bonds will receive only their pro-rata share of assets available to pay losses, not the entire amount of the claim, because California's guaranty fund does not cover surety losses.

Those seeking payment under the financial guarantee bonds because borrowers have defaulted on

mortgage loans include banks, savings and loans, retirement funds and individual investors, who are primarily located in California, the department says.

Demands are also pending against performance bonds and license bonds.

Currently, no one involved in the investigations of Cal-Farm and the litigation against its MGA is ready to discuss in much detail how a successful property/casualty insurer was brought down by millions of dollars in financial guarantee and surety bond losses.

The lawsuits charge that the owners of the managing general agency that wrote the financial guarantee bonds defrauded the insurer, driving it into insolvency.

The defendants counter that Cal-Farm was incompetent and misdirected Eagle's underwriting activity.

Fraud by Eagle Bonds and mismanagement by Cal-Farm and the lenders all contributed to the insolvency, the Insurance Department suggests.

Documents filed with the federal RICO action contain charges and countercharges about Cal-Farm's entry into the financial guarantee and surety bond business.

The suit names Eagle Bonds and its owners: brothers Errol P. Coughlan, president, and John M. Coughlan Jr., secretary and treasurer, and their father John (Jack) M. Coughlan, an employee of Eagle Bonds.

The RICO complaint

According to the RICO complaint:

Cal-Farm entered into a managing general agency agreement in May 1983 with Eagle Bonds to underwrite construction surety bonds guaranteeing performance and/or completion of real estate construction projects by contractors.

Eagle Bonds was given authority to solicit and review bond applications and "to issue bonds bearing Cal-Farm's name as surety, in its sole discretion, and without obtaining Cal-Farm's prior approval or review by Cal-Farm," the suit says.

The MGA agreement required Eagle Bonds to cover the first \$500,000 of deficit in any one underwriting year, thereby giving Eagle Bonds a stake in the results of its underwriting.

"Cal-Farm was led to believe that defendants would issue surety

bonds only after proper investigation of the person or entity which applied for the bond and by employing sound underwriting principles," the suit continues.

An addendum to the MGA agreement between Cal-Farm and Eagle Bonds specifically excluded certain bonds, including "Guarantees of Installment Paper or Note Guarantee Bonds, except when fully collateralized."

Such bonds, which Cal-Farm says Eagle Bonds called "financial guarantee bonds," are guarantees by which a surety agrees to pay a lender if a borrower defaults on a loan.

Cal-Farm's suit charges that after the MGA agreement was signed on May 11, Eagle Bonds began to solicit applications for financial guarantee bonds from so-called loan-brokers who bring lenders and borrowers together.

Borrowers generally would sign promissory notes pledging to repay the loan, backed by collateral. Then, Eagle Bonds would write a financial guarantee bond to further induce the lender to provide the loan.

Eagle Bonds received 1% or more of the loan amount from the loan proceeds, Cal-Farm charges.

In addition, Cal-Farm charges, the Coughlan brothers obtained loans for Cal-Pac, their construction company, by securing financial guarantee bonds written by Eagle Bonds.

Cal-Pac wanted the loans to invest in such business ventures as real estate developments, oil fields, travel agencies and record companies, the lawsuit charges.

"In order to accomplish their desire," Cal-Farm charges, the defendants "developed a scheme to conduct the business of an enterprise, Cal-Pac, through a pattern of racketeering in violation of" the RICO statute.

Cal-Pac, the insurer charges, requested that Eagle Bonds and its agents, the loan brokers, solicit money from lenders on Cal-Pac's behalf. Defendants Errol and John Coughlan Jr., on behalf of Cal-Pac, executed promissory notes to each lender promising to repay the loan.

"As the primary inducement to each lender to make a loan, defendant Eagle Bonds issued a financial guarantee bond naming Cal-Farm as surety in favor of the lender in the event that Cal-Pac defaulted on its note," the lawsuit charges.

Some of the promissory notes issued by Cal-Pac required repayment of the loans within 180 days.

"At the time they executed the notes on behalf of Cal-Pac, defendants Errol P. Coughlan and John M. Coughlan Jr. knew that Cal-Pac did not have assets available to pay the lenders, that Cal-Pac's investments would not yield immediate profit, and that money from investments or other sources would not be available to Cal-Pac, if ever, until years after the loans were due," the lawsuit charges.

The defendants, including Eagle Bonds, did not require Cal-Pac to provide collateral to lenders to secure the promissory notes or to Cal-Farm before the financial guarantee bonds were issued on the loans, the lawsuit says.

This omission was in violation of Eagle Bonds' MGA agreement and its fiduciary obligations to Cal-Farm, the suit charges.

The lawsuit specifically names seven loans taken out by Cal-Pac, for each of which Cal-Pac issued a promissory note backed by a financial guarantee bond issued by Eagle Bonds on behalf of Cal-Farm.

Cal-Pac loans

These loans included:

- A \$500,000 loan from Mercer Savings & Loan Assn. in Trenton, N.J., on Feb. 3, 1984, to be repaid within 269 days.

- A \$500,000 loan from the City of Baton Rouge-Parish of East

Continued on page 24



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Cal-Farm bonds

Continued from page 22

Baton Rouge, La., Employees Retirement System, for \$500,000 on March 28, 1984, to be repaid within 180 days.

- A \$200,000 loan from Tremont Savings & Loan in Tremont, Ill., on April 2, 1984, to be repaid within 180 days.

- A \$525,000 loan from the Baton Rouge Employee State Retirement Fund on March 28, 1984, to be repaid within 180 days.

- A \$200,000 loan from Fulton Bank in Fulton, Ky., on Nov. 15, 1983, to be repaid within 269 days.

- A \$200,000 loan from Interstate Federal Savings & Loan in McGregor, Iowa, on Nov. 21, 1983, to be repaid within 269 days.

- A \$100,000 loan from Cosmopolitan State Bank in Stillwater, Minn., on March 7, 1984, to be repaid within 269 days.

Cal-Pac defaulted on each of these loans and Cal-Farm paid the claims made by the lenders, totaling \$2.2 million.

In addition to these seven loans, Cal-Pac entered into about 50 other loan transactions as borrower between May 1983 and October 1984—with the total value of the loans exceeding \$15 million—all of which were covered by Cal-Farm financial guarantee bonds, the Cal-Farm lawsuit charges.

The lawsuit alleges that Cal-Pac will default on many or all of these loans, thereby exposing Cal-Farm to liability for claims under the financial guarantee bonds without any collateral to mitigate the losses.

When Cal-Farm learned that Cal-Pac had borrowed money from lenders "without intending to pay the loans in accordance with their terms," the lawsuit continues, Cal-Farm demanded that the defendants cause Cal-Pac to assign or place in trust for Cal-Farm all of Cal-Pac's interests and rights in the various investments that were financed from loan proceeds procured by use of the financial guarantee bonds.

In October 1984 and again in November 1984, Errol P. Coughlan and John M. Coughlan Jr., in the presence of their attorneys, told Cal-Farm officials that they would assign all of Cal-Pac's rights and interests in various investments to pay claims on the financial guarantee bonds, the lawsuit says. Later, the two defendants refused to do so, according to the suit.

Further, the lawsuit says, Errol P. Coughlan, John M. Coughlan Jr. and Eagle Bonds have refused to provide a complete accounting of all financial guarantee bonds issued on loans to Cal-Pac. And, they have failed to provide "a detailed explanation of how Cal-Pac and defendants used loan proceeds which were secured by a financial guarantee bond," so Cal-Farm does not know where the money was invested.

The lawsuit says that defendants' activities constitute "a pattern of racketeering activities" in violation of RICO.

As originally filed, the lawsuit also claimed damages for breach of the MGA contract, breach of fiduciary duty and failure to account for all premiums and losses owed Cal-Farm under the MGA agreement, contending that these claims were inseparably intertwined with the RICO claim.

Some claims dropped

In a subsequent filing, however, Cal-Farm's attorneys said these claims would be dropped because a recent Supreme Court ruling made it clear that these claims, since they were subject to arbitration, must be arbitrated. As a result, only the dismissal of the RICO claim for damages is on appeal.

Cal-Farm canceled its underwriting agreement with Eagle Bonds on Sept. 29, 1983, effective March 31, 1984, under the 180-day

cancellation notice required by the MGA contract. The cancellation, however, was not precipitated by losses on bonds written by Eagle Bonds, the Insurance Department says, and Cal-Farm accepted bonds written by Eagle Bonds even after the MGA agreement was terminated March 31, 1984.

Mr. Morton of the Insurance Department estimates that for three or four additional months, Cal-Farm authorized Eagle Bonds to write bonds that had been negotiated prior to the termination of the agreement.

Cal-Farm's suit also states that Eagle Bonds issued bonds on loans taken out by Cal-Pac as late as October 1984.

And, Cal-Farm paid \$12 million to \$13 million in bond losses before it stopped paying on bonds. "That was about the time we got into the picture," said Mr. Morton of the Insurance Department.

The insurance department became involved in Cal-Farm's operations early in February 1985.

"They were probably paying bond claims before they knew what was happening. They weren't wise to how much trouble they were in," Mr. Morton said.

While pressing its RICO claim, Cal-Farm also complained to the court that the defendants prevented one former employee of Eagle Bonds, Neil Holverson, from being deposed twice. According to the papers, Mr. Holverson was arrested on two separate occasions by the Los Angeles County police when Cal-Farm attorneys attempted to take his deposition.

On the first occasion, the police were accompanied by Errol P. Coughlan and on the second occasion by Mr. Coughlan's wife, Marissa Coughlan, according to the lawsuit.

"Clearly, the actions of defendants with respect to the arrests of Mr. Holverson at his deposition strongly suggest an intention by the defendants to intimidate Mr. Holverson," the suit says. "Fearing that his testimony will be harmful to their defense, the defendants tried to block his testimony altogether or to intimidate him and to affect his testimony and credibility," the suit continues.

In addition, Cal-Farm complained that the defendants Errol, John and Jack Coughlan each invoked the Fifth Amendment during depositions "and refused to answer virtually every question asked."

As a result, "Cal-Farm was prevented from obtaining information from the president of its agent, Eagle Bonds, on such issues as potential reinsurance for Cal-Farm's losses, potential defenses to claims on bonds issued by Eagle Bonds on behalf of Cal-Farm, the identity of all such bonds and potential liability of Cal-Farm, the alleged failure of Eagle Bonds to account for all premiums, bonds issued or collateral obtained, the amounts of money and collateral received by Eagle Bonds on behalf of Cal-Farm and hundreds of other questions relative to Cal-Farm's legitimate needs," Cal-Farm complained in its suit.

Defendants' response

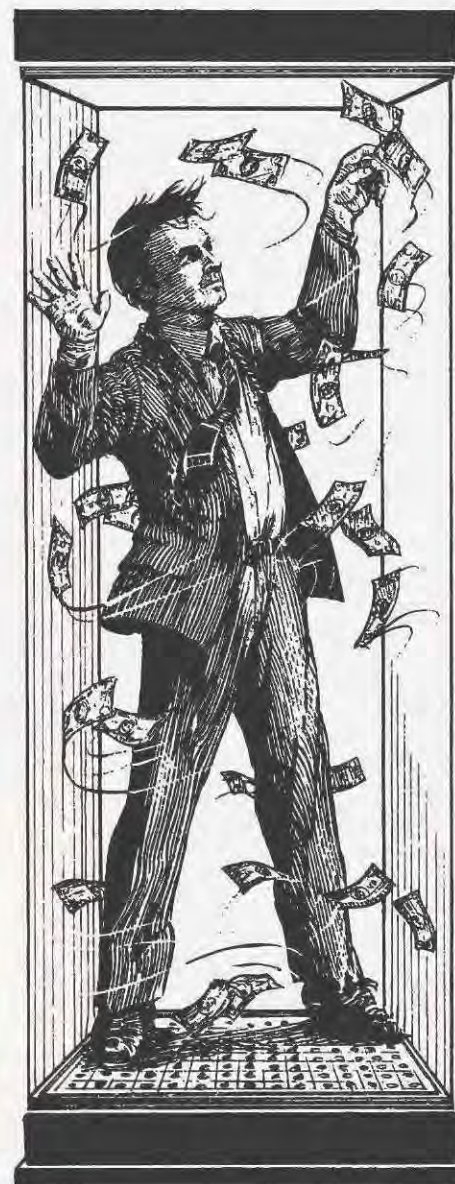
In response to Cal-Farm's allegations, the defendants' successful motion to dismiss argued that the complaint failed to plead any actionable RICO claims.

"The plethora of misstatement of fact in the complaint are grossly misleading, slanted for the obvious purpose of achieving federal jurisdiction" over "what would otherwise be a state claim for breach of contract," a memorandum filed on behalf of the defendants said.

"Most charitably viewed, the complaint describes complex commercial transactions, made in the ordinary course of business, with no unique or remarkable character."

Continued on facing page

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Continued from facing page

teristics. The complaint sets forth a pattern of commercial behavior wherein a dispute or disagreement has arisen, and not a pattern of racketeering," the defendants argued in another document filed with the court.

Responding to charges that the defendants had precluded Mr. Holverson from being deposed with two arrests, the defense countered that Mr. Holverson "has twice been released from lawful custody by the intercession of plaintiff's counsel."

Citing depositions, the defendants responded that Mr. Holverson was arrested the first time on charges of embezzlement of funds from Cal-Pac Leasing, also owned by the Coughlan brothers, and the second time on a warrant for his arrest levied by the State of California, Bureau of Consumer Affairs, arising out of his unauthorized practice of public accounting.

Responding to complaints that the defendants refused to answer questions during depositions, the defense said, "Plaintiff uses countless pages bemoaning various defendants' proper use of their Fifth Amendment rights against self-incrimination, use of the 14th Amendment rights relating to due process, equal protection and their use of certain doctrines relating to parallel proceedings; all compelled by the vicious connivance of plaintiff's counsel with myriad law enforcement and regulatory agencies, for the purpose of finding a suitable scapegoat to cover plaintiff's own incompetence and misdirection of Eagle's underwriting activity."

"Plaintiff has admitted to one defendant's counsel that this action was brought to mollify regulatory agencies," the defense also stated.

The defendant's attorney, Mr. Halperin, said later during an interview with *Business Insurance* that at the time of the depositions, "We knew there were various and sundry investigations going on. We did not know what they were or where they were going, so I advised my clients to take the Fifth Amendment."

Now, Mr. Halperin says, his clients are fully cooperating with "every authority looking into this matter."

Also during the interview, Mr. Halperin says the lawsuit attempts to prove that Eagle Bonds' owners never intended to repay the loans taken out by Cal-Pac for which the financial guarantee bonds were written.

He says that Cal-Farm knew that Cal-Pac planned to roll over the loans "and any statement by Cal-Farm to the contrary is false."

"One of the more appalling things, and this is where they tried to get a lot of mileage out of the RICO thing, is that Cal-Farm is claiming that at the time the Coughlans were issuing these bonds (to Cal-Pac) they knew the loans couldn't be paid by their terms," he says.

"Now what they're not saying, and this is a major omission on their part, is that the loan terms included the fact that you would normally roll these over eight or 10 times."

Errol Coughlan replies

Errol Coughlan also states in his declaration that "at all times Cal-Farm knew of the bonds being issued to our related entities. Eagle filed a monthly report indicating all outstanding bonds and the customers involved therein. At all times Cal-Farm was fully apprised of and consented to Eagle's issuance of bonds to our various projects."

Errol Coughlan's declaration continues:

"The majority of these funds were being invested in projects and the brokers were told that it may be necessary to renew, extend or

refinance the notes until the completion, sale or refinancing of the projects. The brokers advised me and Cal-Farm that they would, in fact, obtain renewals, extension or refinancings of the notes so long as the underlying bonds guaranteeing the obligations were to be similarly renewed or extended.

"Cal-Farm granted permission for these transactions and assured us of the requisite bond placements, extensions or renewals. Indeed, in a substantial number of transactions such replacements, extensions or renewals were granted by Cal-Farm. Abruptly, Cal-Farm reneged on its agreement and left us and various lenders in the lurch."

Citing defaults by Cal-Pac, lenders began to make demands against financial guarantee bonds in August 1984, according to court papers.

Errol Coughlan counters that the alleged pattern of racketeering "is no more than a common pattern of commercial behavior in the invest-

ment and development business. Not only were all the lenders and brokers aware of this, Cal-Farm was similarly aware in view of the many conversations I had with Cal-Farm as bonds were being issued pursuant to Cal-Farm's special powers of attorney."

Attached to Errol Coughlan's declaration is a letter to Jack Coughlan on Cal-Farm stationery signed by an assistant vp, Richard L. Vavra, which states:

"You have informed us of your participation, either corporate or individual, in projects wherein you have issued a Cal-Farm bond.

"This letter will confirm our knowledge and consent of this action."

Further, Errol Coughlan disputes the charge that the financial guarantee bonds were to be collateralized.

"At no time during our relationship with Cal-Farm were we ever directed that bonds be collateralized; to the contrary, the underwriting managers agreement makes no ref-

erence to collateralizing bonds only."

He further contends that Addendum A to the underwriting managers agreement is "only a commission schedule," which "mentions collateral in reference to commissions only."

Errol Coughlan also disputed Cal-Farm's recollection of the October 1984 meeting at which he allegedly agreed to assign all of Cal-Pac's rights and interests in various investments to pay claims on the financial guarantee bonds.

"We never offered to transfer or convey our properties to Cal-Farm or its designees. We were willing to surrender substantial valuable equities if it were a complete settlement of all claims, but Cal-Farm refused to accept this settlement."

"If Cal-Farm had accepted the offer made at that time, we would not be presently here in this court," he said.

Barclays Mortgage Corp.
The Coughlans' attorney, Mr.

Halperin, also maintains that Eagle Bonds was not responsible for most of the financial guarantee bonds that have caused losses for Cal-Farm.

Barclays Mortgage Corp. of Irvine, Calif., was responsible for the bonds that forced Cal-Farm into conservatorship, Mr. Halperin said during an interview.

Barclays Mortgage Corp., a loan broker for commercial development projects, had an agreement with Eagle Bonds, according to documents filed with the federal court. Also a party to the agreement was J.F. Parrish.

The agreement, dated May 16, 1983, said, in part:

"Barclays and Parrish desire to use the facilities of Eagle to place Financial Guaranty Bonds/Mortgage Guaranty Bonds.

"Barclays will be the sole representative of Eagle to underwrite, process and deliver all financial guaranty bonds (excluding tradi-

Continued on next page

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Cal-Farm bonds

Continued from preceding page
(tional surety bonds).

"Barclays will underwrite such bonds in accordance with the guidelines and at premiums approved by Eagle."

The agreement also said, "Eagle will provide Barclays errors and omissions coverage and a fidelity bond, at Barclays' expense."

Mr. Halperin says that under this sub-agent arrangement with Eagle, Barclays was to channel business to Eagle Bonds.

Barclays, which assisted real estate developers in obtaining loans for new development projects, was to bring these projects to Eagle Bonds, which would provide a financial guarantee bond in order to make the loans more attractive to lenders.

But Mr. Halperin maintains that "very shortly after they began writing bonds through Eagle under the authority of Eagle's MGA, they began dealing directly with the folks at Cal-Farm."

"You take a look at where the defaults are occurring. Those defaults are occurring on the package of business that was done by Barclays and virtually never reported to Eagle," Mr. Halperin contends.

Peter Recchia, corporate counsel for Barclays, denies that Barclays dealt directly with Cal-Farm. And, Dick F. Sacino, senior vp with Cal-Farm, says the insurer was not even aware of the sub-agent agreement between Eagle Bonds and Barclays until after problems began to develop with the financial guarantee bonds underwritten by Eagle.

Meanwhile, the Insurance Department's Mr. Morton says it isn't clear from the bond records whether Barclays was acting as an MGA for Cal-Farm. He says that is now under investigation by the department.

Mr. Halperin admits that Cal-Pac defaulted on "six or seven loans," because "some savings and loans have a limit on the time they can issue loans where they don't take collateral."

Mr. Halperin also admits that there have been more defaults by Cal-Pac since Cal-Farm went into conservatorship because without new financial guarantee bonds, the loans cannot be rolled over. But, he says, other bonds have expired without claims being filed and that about \$25 million in bonds are outstanding now securing promissory notes issued by Cal-Pac.

Attorney general's probe

Mr. Halperin also asserts that the California attorney general's investigation into the Cal-Farm finan-

cial guarantee bond losses has "bypassed" his clients.

The investigation is more than a year old, he says. "Now if they are reaching the conclusion that Eagle and the Coughlans are evil, there would have been indictments a long time ago," he says.

Gary W. Schons, deputy attorney general with the special prosecutions office in San Diego, would not comment on the investigation except to confirm that it exists.

The allegations in the litigation aside, Mr. Recchia at Barclays blames the lenders to some extent for Cal-Farm's insolvency.

"I think we had a little bit of lack of due diligence on the part of the lenders," Mr. Recchia says.

Lenders first were supposed to determine if the project was viable, so if the project failed they could recover some assets and then turn to Cal-Farm "as an additional guarantor," he explains.

Instead, because a financial guarantee bond was involved, "their lips were smacking because they had two people on the hook: the borrower and Cal-Farm."

"Instead of looking up the project and saying 'Now, is this a viable project and do we really as a lender want to get involved in it regardless of where there is a third-party guarantee?' the banks merely lent the money because of the financial guarantee bond."

"They saw there was a financial guarantee bond and they figured it was liquid gold—they couldn't lose," Mr. Recchia suggests.

"And as soon as the borrower couldn't pay, they immediately looked to Cal-Farm. That wasn't the way it was supposed to be. They were supposed to go after the collateral and try to resolve the whole thing with the borrower and if they couldn't resolve it, then they were supposed to turn as a final resort to Cal-Farm."

While noting that the issue of fraud must be decided in court, Mr. Morton of the Insurance Department agrees that the loans were not properly underwritten.

"I can say in general terms, I don't think anyone did a good job. I don't think the bonds were properly underwritten. I don't think the loans were properly underwritten either."

"The financing arrangement was just about as bad as anything else. I've been told by lenders that they lent money on property they wouldn't ordinarily lend money on because there was a bond," Mr. Morton explained.

Reinsurance examined

Another source of recovery for the bond losses—reinsurance—also is under examination.

The MGA agreement between Eagle Bonds and Cal-Farm required Eagle Bonds to assist Cal-Farm in obtaining \$5 million in annual aggregate excess-of-loss reinsurance, excess of 15% of earned premium plus \$1 million.

In a January 1983 letter to Cal-Farm from Eagle Bonds, which was filed in federal court, Jack Coughlan said Eagle Bond's reinsurer was Waite-Hill Assurance Ltd., a wholly owned subsidiary of Figgie International Inc.

Waite-Hill also is mentioned as Cal-Farm's reinsurer for the bond business in depositions filed with the court.

Mr. Morton of the Insurance De-

partment said the department is trying to collect on reinsurance but there are "some problems in the reinsurance contract."

Waite-Hill Assurance Ltd. President Bruce Fowler, contacted by telephone about Cal-Farm, would only say, "I can't comment at this time on advice of our counsel."

Waite-Hill, a Bermuda-licensed company, is a subsidiary of Waite-Hill Holdings Inc., a Delaware company with in excess of \$20 million in surplus. Waite-Hill Holdings is owned by Figgie.

Eagle Bonds also had \$1 million in errors and omissions insurance underwritten by Allianz Insurance Co., according to the deposition of

Errol Coughlan.

Mr. Morton of the Insurance Department said it was inappropriate for him to say at this time whether the department had filed a claim or was planning to file a claim against the E&O insurance.

"I don't think it's appropriate at this time to respond, except to say we will try every avenue of recovery," Mr. Morton said.

When asked if the department would deny claim payments on bonds that were not collateralized on the basis that Eagle Bonds did not have the authority to issue bonds without collateral, Mr. Morton only said that attorneys are analyzing all claims.

Paxton's problems

Continued from page 2

Paxton is owned through two intermediate holding companies by Russell E. March, who also is a part-owner of Orient-Pacific Insurance Agency Inc. of Laguna Hills, Calif.

Paxton recently offered to reinsure business written by Orient-Pacific on behalf of Ranger Insurance Co., replacing Union Indemnity Insurance Co., said Mr. Cornelius.

He said he could not recall if the Insurance Department had cited Paxton's reinsurance offer in its suspension order.

Orient-Pacific sought a new reinsurer after Union Indemnity canceled its reinsurance agreement Jan. 1. Union Indemnity, a unit of Frank B. Hall & Co. Inc., is now in liquidation in New York.

The Paxton proposal, however, was withdrawn and Paxton's Delaware subsidiary, Remco Insurance Co., was proposed to replace Union.

The Delaware Insurance Department objected and ordered Remco to show cause why its certificate of authority should not be revoked, arguing that Remco's \$2.4 million surplus could not support the Ranger business. Remco countered that it had arranged retrocessions that would have reduced its exposure. A decision on the matter has not yet been reached by an Insurance Department hearing officer.

Meanwhile, Orient-Pacific is arbitrating with Ranger a contract dispute involving the reinsurance (BI, July 1, May 27.)

Pacific Imperial Management Inc., a Delaware holding company owned by Mr. March, bought Paxton and Remco in 1984.

At the time of the sale, losses had impaired Paxton's capital and surplus, and the company was operating under the supervision of the Pennsylvania Insurance Department, the department official said.

The supervisory order, which expired May 31 and was extended for 90 days, required the Insurance Department's approval for all transactions "outside the ordinary course of business," including all

reinsurance transactions, the official said.

In addition, an Insurance Department order at the time of Paxton's sale required the department's approval of any loss portfolio reinsurer the company hoped to use.

Mr. March—who contributed \$2.75 million to Paxton's surplus—had told the department before buying Paxton that he intended to arrange additional loss portfolio reinsurance for the company, which already had a portfolio reinsurance agreement with Pinnacle Reinsurance Co. Ltd. of Bermuda.

Paxton signed a portfolio reinsurance agreement with National Union on Jan. 15. Under the agreement, which was effective Dec. 31, 1984 National Union agreed to reinsure \$11.2 million in Paxton losses over a 10-year period for a consideration of \$7.65 million, according to Paxton's 1984 annual statement.

The National Union agreement increased Paxton's policyholder surplus by \$3.55 million to \$4.58 million at the end of 1984.

However, Mr. Cornelius said that he expects the Pennsylvania department to argue at the upcoming hearing that the National Union agreement "is not an acceptable treaty."

Paxton did not have the Pennsylvania department's written approval for the reinsurance, Mr. Cornelius conceded.

"We have nothing in writing from them approving it," he said. "It was an oral undertaking."

The Pennsylvania department official said the conditions of the treaty were not in accord with the New York Insurance Department's Regulation 108, which governs the terms and accounting of portfolio transfers and which the Pennsylvania department has used in approving such treaties.

"I would not deny that we have told Paxton that we would not allow the reserve credit," the official said.

Mr. Cornelius said that disallowance of the National Union treaty would bring Paxton below the stat-

utory surplus it is required to maintain.

"We would technically become insolvent if (the Insurance Department's) view in this persists," he said, noting that Mr. March would then have to decide whether to contribute more capital to Paxton.

The Pennsylvania department earlier had disallowed the \$545,000 credit to surplus, less accrued interest, Paxton took in its 1984 annual statement for portfolio reinsurance with Pinnacle.

Under that treaty, executed in January 1984, Pinnacle agreed to pay \$1.545 million in Paxton losses in 1987 and 1988 for a consideration of \$1 million.

Meanwhile, Paxton will have to explain to the Oregon Insurance Division why its agents wrote surety bonds in the state after the division turned down Paxton's application for surety powers.

Richard E. Moore, former president of Paxton, wrote to the Insurance Division in March and April asking that Paxton's certificate of authority be amended to cover several lines including surety, according to Mr. Cornelius.

The division wrote back on May 20 denying the company surety powers, he said.

However, agents of Paxton—including Val Jones & Associates Inc. of Indianapolis and Northwest Bonding Agency of Beaverton, Ore.—starting in late May issued about 30 bonds, including one to the state Board of Higher Education.

The latter bond, which the Board of Higher Education submitted to the Insurance Division for approval of the insurer, triggered the division's review of Paxton's bond-writing activities, Mr. Cornelius said.

Mr. Cornelius called the situation a "mistake" and said that Paxton officials weren't aware of the Oregon division's denial of surety power until after Mr. Moore left the company in June.

"Unfortunately, the existence of this correspondence was not revealed until we cleaned out Dick Moore's desk," Mr. Cornelius said.

Officials of the Oregon Insurance Division, telephoned by Val Jones, told the Paxton MGA that Paxton's certificate of authority included surety powers, Mr. Cornelius said. The MGA then arranged for the filing of rates and forms based on that assurance, he added.

Paxton agents have since canceled the bonds, returned premiums and replaced the coverage with other insurers, according to Mr. Cornelius.

Eastern storms cost \$70 million

NEW YORK—Wind, hail and tornadoes caused an estimated \$70 million in insured property damage June 24 in parts of Massachusetts, Pennsylvania and Virginia, according to C.E. Hermanson, vp of the Property Claim Services division of American Insurance Services Group Inc.

The storm was assigned Catastrophe Number 25 by the Insurance Services Office.

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Group health overhaul proposed

Continued from page 1

spouses must be given the option of enrolling in the employer plan.

• Requiring state and local government employees hired after Dec. 31, 1985, and their employers to pay the Medicare portion of the Social Security payroll tax. The Medicare portion of the FICA tax is now 1.35% of the first \$39,600 of an employee's wages. Next year, the Medicare portion of the FICA tax is scheduled to rise to 1.45%, but the taxable wage base has not been determined yet.

Currently, hundreds of state and local governments do not participate in the Social Security program, and thus they and their employees do not pay FICA taxes.

The Ways and Means Committee, though, did reject a radical proposal to impose new taxes on middle- and upper-income retirees who are covered by Medicare.

Under that proposal, individual retirees would have had to pay a tax equal to 1.4% of their adjusted income between \$20,000 and \$60,000 in order to receive benefits under Part B Medicare, which covers physician bills. Those filing joint returns would have paid this 1.4% tax on income between \$40,000 and \$120,000.

This tax would have been in addition to the \$15.50 monthly premiums retirees—regardless of their income levels—now pay for Medicare Part B coverage. Many employers now pay this Part B premium for their retired workers.

However, benefit experts are concerned about the proposals that the committee did pass, and about the speed with which the committee acted.

These benefit changes are included in a lengthy budget package primarily intended to reduce Medicare costs. The full House could vote on this package this week, although congressional staffers say it is more likely the House will wait to take up the package until after the August recess. These proposals haven't yet been considered by Senate committees.

The proposal to require employers to extend group health care coverage to dependents for five years is moving so fast that many were caught by surprise. "This is a real sleeper issue," notes Mary Nell Lehnhard, vp-government relations in Blue Cross & Blue Shield Assn.'s Washington office.

The extension of coverage was approved unanimously July 15 by the Ways and Means Health Subcommittee, and the full committee gave its unanimous approval on July 24.

One reason that the extension-of-coverage proposal slipped through is that the benefit community has been concentrating much of its lobbying on the Reagan administration's tax reform package.

Some experts, in fact, worry that too much attention may be placed on the tax reform plan, while other benefit proposals are racing through Congress almost unnoticed.

"Stay on top of these benefit bills," advises Edward J. Davey, vp-technical analysis at Johnson & Higgins in New York. "A lot can happen very quickly."

The health care coverage extension proposal originally was made by Rep. Fortney (Pete) Stark, D-Calif. He introduced legislation, H.R. 21, in January requiring employers to extend health care coverage for five years to spouses and dependents after there was a change in an employee's marital status (BI, Jan. 14).

Several letters from constituents raised the concern of Rep. Stark, a member of the Ways and Means Committee, about spouses' ability to afford health care coverage, an aide said.

Even if a spouse had to pay the full premium, coverage through an employer health care plan would be much less costly than an individual policy. Group policies are much less costly on a per-capita basis than individual policies because of greater economies of scale.

Experts agree spouses face serious problems when they lose their health insurance when they are divorced or widowed. "This is a societal problem," said Alice Rosenblatt, vp-group insurance operations at New England Mutual Life Insurance Co. in Boston.

Employers often do extend health care coverage to survivors when an employee dies, but this coverage usually is only for between six months and one year, consultants say. And extension of coverage to divorced spouses—for any period of time—is extremely rare. Employers generally do not extend coverage for lengthy periods because of the significant problems involved in administering such a program.

"It would be a tremendous headache," said John Hickey, a partner at benefit consultant Kwasha Lipton in Fort Lee, N.J.

Employers would have to keep track of spouses if they moved, to keep them abreast of any benefit changes or premium costs.

"The tracking problem would be formidable," said Deborah Chollet, a research associate at the Employee Benefit Research Institute, a benefits think-tank in Washington.

In addition, major employers would have to keep track of thousands of premium checks that would roll in from spouses. And if a spouse forgot to make a payment, an employer would have to send out dunning notices.

This may be the first time a congressional committee has said employers will lose their right to deduct health care costs as a business expense unless they offer a certain benefit. If this plan passes, Congress might—by removing the tax-deductible status of health care costs—try to require employers to offer other benefits that Congress deems "socially desirable," Mr. Hickey said.

As this trend continues, Congress—and not employers and unions—would determine the shape of group health insurance programs, experts say.

Congress isn't the only legislative branch that wants to require employers to continue group health insurance to spouses when there is a change in marital status.

Earlier this year, the Illinois General Assembly passed legislation, S.B. 300, that also says a former spouse who loses a husband or wife through death or divorce can continue to receive health care coverage from the former mate's employers. The bill has been sent to Gov. James Thompson.

But, the Illinois bill only requires extension of coverage for up to two years after death, divorce or separation. The Illinois bill also applies only to insured plans.

The Ways and Means proposal covers self-funded and insured plans. Several other states also require some extension of coverage to spouses and dependents.

Accountant liability

Continued from page 3

The appellate court ruled that the plaintiffs were members of a special class whose reliance upon the financial statements should have been specifically foreseen by Andersen.

Andersen then appealed to New York's highest court, which is called the Court of Appeals.

In its decision, the court reversed the appellate court and reaffirmed traditional rules that the plaintiffs had to have a direct contractual relationship with Andersen or a relationship approaching privity to sue Andersen for negligence.

"Because the allegations in plaintiffs' complaint and affidavit fail to set forth either a relationship of contractual privity with Andersen or a relationship sufficiently intimate to be equated with privity, the first cause of action, should be dismissed," the court said.

In doing so, the court reaffirmed two cases including the 1931 landmark case of *Ultramares Corp. vs. Touche & Co.*, and also *Glanzer v. Shepard*, decided nine years before *Ultramares*.

The court said that in certain circumstances, where there is no privity, accountants may be held liable in negligence to third parties that rely on inaccurate financial reports. However, in these cases:

- The accountant must have been aware that the financial reports were to be used for a particular purpose or purposes;

- The accountant must have known that a third party or parties intended to rely on the financial reports;

- There must be some conduct on the part of the accountants linking them to that party or parties, which indicates the accountants' understanding of that party or parties' reliance on the information.

In *Credit Alliance*, the court noted that the plaintiffs failed to demonstrate the existence of a relationship between the parties approaching privity, based on the above criteria.

Even though *Credit Alliance* alleged Andersen knew, or should have known the lenders were

being shown the reports by Smith to induce their reliance, the court found there was no showing:

- Of a particular purpose for the reports' preparation or the prerequisite conduct on the part of the accountants.

- That Andersen was employed to prepare the reports with the particular purpose in mind of inducing the lenders to extend credit to Smith.

- That Andersen had any direct dealings with the lenders, had specifically agreed with Smith to prepare the report for the lenders' use or according to their requirements, or specifically agreed with Smith to provide the lenders with a copy or actually did so.

"Indeed, there is simply no allegation of any word or action on the part of Andersen directed to plaintiffs, or anything contained in Andersen's retainer agreement with Smith which provided the necessary link between them," the court said.

The court also dismissed the fraud count because the plaintiffs did not sufficiently allege facts constituting the alleged fraud.

Jerome Congress, an outside attorney for *Credit Alliance*, said the company is considering whether to file a motion for rehearing before the Court of Appeals. He declined further comment.

While there will continue to be as many suits against accountants based on fraud, the decision will "put a large dent in suits by plaintiffs seeking to recover for negligence," said Robert L. King, an attorney for Andersen with the New York firm of Debevoise & Plimpton.

The decision is exceedingly important, he said.

"It adds another weapon to the arsenal of accounting firms defending these suits," Mr. King added.

Harold R. Cunningham, managing partner-legal affairs for Andersen, said the reaffirmation of *Ultramares* "is very important" in light of rulings contrary to the *Ultramares* decision in other states.

He predicts the decision will cause plaintiffs' lawyers to replace negligence claims with fraud claims in state courts or bring more

of the cases in federal court.

The decision is a "breath of fresh air that blows a few clouds away on the horizon of accountants' liability," said Kenneth J. Bialkin, whose firm, Willkie Farr & Gallagher, is outside counsel to the American Institute of Certified Public Accountants.

It is a "reversal of an extremely disturbing trend," said Mr. Bialkin, whose firm filed a friend-of-the-court brief on behalf of the AICPA in the Andersen case.

"The accounting profession feels the decision is a tremendous victory for them," concurs Dan Goldwasser, an attorney representing the New York State Society of Certified Public Accountants.

A copy of the decision already has been sent to an appellate court in California where the same issue is being considered, said Mr. Goldwasser. He is with the firm of Solinger, Grosz & Goldwasser, which also filed a friend of the court brief on behalf of the state accountant society.

However, he pointed out that large lenders, such as banks, will likely take steps to make sure they deal directly with the accountants of those to whom they make loans in order to establish the requisite legal relationship necessary to sue the accountants for negligence.

The decision also could cause plaintiffs to bring suits in jurisdictions that are more liberal than New York.

"There's no question that is a danger," Mr. Goldwasser said.

One reason behind the Court of Appeals decision may be the unstable insurance climate for accountants, he added.

In some cases, accountants are seeing premium increases of 500% to 1,000% in New York, he said.

Also some insurers have pulled out of the professional liability market for accountants in part because their reinsurers are unhappy with the losses in this area.

"Hopefully, that increase (in premium) coupled with the reversal in expansive court decisions might convince reinsurers to come back into the market and those in the market to stay there," Mr. Goldwasser added.

Superfund plan

Continued from page 2

"Thus, in addition to providing new affirmative incentives to quick settlement, the proposed system would leave intact EPA's most powerful weapon for forcing potentially responsible parties to the table," the proposal says.

Failure to comply with the decision of the arbitration panel would "result in heavy civil penalties, as well as the imposition of joint and several liability by EPA," the proposal says.

Mr. Bailey said the proposal would "result in faster, better cleanup at far less cost to our society."

A study commissioned by the AIA concluded that litigation costs associated with the cleanup of about 1,800 of the nation's worst hazardous-waste sites would range from \$3.5 billion to \$6.4 billion.

Mr. Bailey also repeated many of the insurance industry's concerns over the current Superfund liability provisions, which he said encourage selection of responsible parties "based not on actual contribution to the pollution hazard, but rather on the ability to pay."

And, he said, responsible parties are looking to shift these costs to their insurers.

Mr. Bailey also said courts are finding coverage for pollution liability in policies that were never intended to cover such risks. While the industry will continue to contest such judicial interpretations of policy language, "there is a significant chance that we will continue to lose more of these cases than we will win," he said.

Aetna is now receiving Superfund-related claims at the rate of almost two a day, he said. "And this, we believe, is just the tip of the iceberg, since cleanup activity has really just begun."

Mr. Bailey also said pollution liability insurance for contractors that clean up hazardous-waste dumps probably will not be available unless the current Superfund liability scheme is changed.

He said if all liability for a dump site were channeled to the owner/operator of the site, then pollution liability coverage would probably be available from the private sector for waste generators,

haulers and cleanup contractors.

However, he added, even with such changes, the private sector would "be unable by itself to provide coverage for site owners. This is because of the near certainty that leakage will occur and the open-ended nature of the resulting liabilities."

While Mr. Bailey did not have a ready solution to this problem, he pointed out the federal government has worked with the insurance industry in the past on a number of hard-to-insure risks, like nuclear liability, the Swine Flu inoculation program, flood insurance, crime insurance and riot reinsurance.

Ruling on vets' profit-sharing to stand

CINCINNATI—A federal appellate court ruling prohibiting mandatory retroactive profit-sharing contributions by employers to veterans for the time they spent in the military will not be pursued further in the courts.

U.S. Department of Labor attorneys who represented two employees of Chemi-Trol Co. Inc. of Gibsonburg, Ohio, conferred with Justice Department counsel and decided against seeking U.S. Supreme Court review of the ruling, handed down in February by the 6th U.S. Circuit Court of Appeals in Cincinnati.

The workers also chose not to pursue the case independently.

In its decision, the 6th Circuit overturned a lower-court ruling that granted retroactive contributions for time spent in the military to two veterans who returned to their jobs at Chemi-Trol (BI, March

4). The appellate court ruled that Chemi-Trol's profit-sharing plan represented short-term compensation for work performed and not a reward for length of service. And, the veterans' right to contributions under the plan were subject to "a significant contingency" when they entered the military.

Therefore, the benefits could not be considered "perquisites of seniority."

The appellate court's ruling reversed a decision by the U.S. District Court for the Northern District of Ohio. That court had found that profit-sharing contributions are perquisites of seniority, which are protected by federal laws requiring that veterans be re-employed with the same status and benefits they would have enjoyed had they not left their jobs to join the armed forces.

Rating system

Continued from page 3

In designing its new system, the California workers compensation rating bureau interviewed about 4,000 construction employers with employees in 21 construction classifications out of the state's 425 total classifications, said Leo Souza, bureau president.

"We had to determine the number of employees by wage rate," Mr. Souza said.

The new system uses a complicated computation to determine a "line of demarcation," he explained.

The term is used to describe the dividing line that determines which employees' salaries will be considered high for the purpose of determining workers compensation rates, and which will be considered low, according to Mr. Souza.

In addition, this line of demarcation would be reviewed and amended annually, Mr. Souza explained.

To equalize the rates, a higher

manual rate will be applied to employees' salaries that fall below the demarcation line.

For those that are above the line, a lower manual rate will be applied.

However, there would be a limit imposed of 10% on how much a rate could be either increased or decreased.

Although this new system is considered a pilot program and will be used only for the six construction classifications, the new rating system ultimately may be used in other classifications as well, according to Mr. Souza.

For instance, in the state of California, restaurant employees are placed within a single classification.

Yet, fast-food restaurants have a different risk exposure and safety

record, and these restaurants pay employees a salary that is far different than, for example, salaries paid by hotel restaurants, according to Mr. Souza.

Mr. Souza also estimates it will take two years to determine whether this new "split" system works.

In addition, Mr. Souza reminds employers that, because the new system is designed to even out the premium inequity, implementing it will not result in lower workers compensation costs for all construction employers.

In fact, he said, about half of the employers will pay higher premiums and half will pay lower premiums.

California's new construction rating structure, along with other adjustment rating plans, do not either increase or decrease the amount of total premium collected in a state.

The plans just redistribute the total premium burden among employers, according to Robert Hilton, senior vp of the National Council

on Compensation Insurance, a national workers compensation rate-making and research organization based in New York.

The NCCI is responsible for preparing and administering rates in 32 states.

Independent bureaus, like the one in California, handle this job in the other jurisdictions.

The compensation insurance council also has looked at the inequities within construction classifications.

In addition, the organization recently designed a loss-ratio adjustment program.

The program provides for the use of an additional credit or debit factor on top of experience modification credits or debits when an employer's workers compensation premium is calculated (BI, May 13; Sept. 24, 1984).

The NCCI's new system took effect July 1 in Oregon, Illinois and Maryland.

Several other state insurance departments are considering implementing the new system.



Mr. Souza

A.J. Gallagher dies at age 92

ROLLING MEADOWS, Ill. —Arthur J. Gallagher, founder and chairman of the 10th-largest U.S. insurance brokerage firm, died July 23 at the age of 92.

Arthur J. Gallagher & Co. in Rolling Meadows has grown from two employees in 1927 to 1,100 currently. The brokerage has 76 offices in the United States and overseas, said Mr. Gallagher's son, Robert E. Gallagher, president of the firm.

Mr. Gallagher "was the originator of many of today's accepted risk management concepts, and his company is known throughout the insurance industry for its innovative approaches to technology and service," Robert Gallagher said.

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update

Strike follows canceled benefits

Continued from page 2

cancellation of the contract included cancellation of the insurance.

But, Mr. Frankel says the contract requires coverage be extended for 30 days if the contract is canceled, and it requires negotiations between the company and the union after the 30 days.

He said the union has filed court challenges to the contract rejection and cancellation of the insurance and coverage extension.

Wheeling-Pittsburgh officials could not be reached for comment. The company filed for Chapter 11 bankruptcy April 16.

Audit firm told to pay \$11 million

WASHINGTON—A federal District Court jury found accounting firm Alexander Grant & Co. liable for \$11 million in damages payable to the trustee of the defunct Auto-Train Co. in connection with audit reports for the years 1978 and 1979.

The verdict, handed down July 16 in U.S. District Court here, included \$5 million for the 1978 audit and \$6 million for 1979, said John Walsh, with the New York firm of Cadwalader Wickersham & Taft, which represented the trustee in bankruptcy.

The jury found Grant liable for breach of contract, negligence and fraud on the audits for both years, said Mr. Walsh.

However, the jury also found Grant not liable for 1977 and 1980 audits, said Grant General Counsel James Strother.

Auto-Train, a railroad carrier that carried passengers and cars between Virginia and Florida, ceased operations in 1981.

Mr. Strother said Grant is asking the court to enter a judgment in its favor despite the verdict, to order a new trial or to reduce the verdict. He said the verdict was the largest award ever against Grant, but he declined to discuss Grant's insurance.

Robins class-action plea denied

RICHMOND, Va.—A.H. Robins Co. Inc., former manufacturer of the Dalkon Shield intrauterine device, will have to defend punitive damage claims case-by-case rather than in one proceeding.

U.S. District Judge Robert H. Merhige last week denied Robins' motion to create a mandatory class action for punitive damages.

Robins has said a single proceeding is the only fair way to resolve punitive damage claims and that continued punitive damage awards could exhaust its financial resources.

While expressing disappointment over the ruling, a Robins spokesman said the company is pleased that the judge encouraged the parties to devise a procedure to fairly and expeditiously conclude this litigation and that the judge will assist in this.

The spokesman said Robins has not decided whether to appeal.

As of March 31, Robins had disposed of more than 8,700 cases and claims for \$341.6 million but 4,500 cases were pending. At that time, it had \$62 million in insurance remaining. "Obviously, that figure is lower now," the spokesman added.

Robins has lost 32 of 59 Dalkon Shield trials and has been assessed a total of \$24.8 million in punitive damages by 11 juries.

BankAmerica claim pending

SAN FRANCISCO—A third potential claim is pending against BankAmerica Corp.'s canceled directors and officers liability insurance in connection with \$95 million in pretax losses incurred last year through a subsidiary bank's involvement with allegedly fraudulent mortgage-backed securities.

The third claim may result from a derivative shareholder suit filed July 19 in Chancery Court in Wilmington, Del., on behalf of the corporation by International Apparel Associates, a New York City marketing consultant with common stock in the corporation.

BankAmerica's \$100 million of D&O insurance from Employers Insurance of Wausau and First State Insurance Co. was canceled effective April 15 by Wausau and May 15 by First State.

The derivative shareholder suit was preceded by a letter dated April 9 demanding that directors and officers bring suit themselves against bank officials because of the losses, says Richard D. Greenfield of Haverford, Pa., International Apparel's attorney.

The first claim against the D&O cover was filed in March by the bank, to recover its \$95 million loss (BI, March 11). The bank gave notice of the second potential claim when a shareholder suit filed April 11 charged top officials with negligence and mismanagement.

Although the derivative shareholder suit was filed after the insurance expired, BankAmerica met reporting requirements for coverage under the policy because it notified Wausau, the primary insurer, of the April 9 letter through broker Johnson & Higgins, said a Wausau executive. BankAmerica also has a 12-month claims discovery period that began April 15, the executive said.

The derivative shareholder suit charges the parent company and Bank of America, its wholly owned subsidiary, were "grossly negligent or reckless," breached their fiduciary duty, wasted assets and failed to establish guidelines or policies to ensure loan quality.

As a result, the bank suffered a breakdown in lending and operating procedures that caused the huge loss, the suit says.

The suit seeks an unspecified amount of damages.

Unable to find replacement D&O coverage, BankAmerica has formed a Cayman Islands captive insurer (BI, April 29.)

Spokesmen for BankAmerica and First State declined comment.

House panel hikes PBGC rate

WASHINGTON—The House Ways and Means Committee last week approved a deficit-reduction package that includes an increase in the premium that employers with defined benefit pension plans pay to the Pension Benefit Guaranty Corp.

The committee approved an increase in the annual termination insurance premium to \$8 per plan participant from the current \$2.60. The increase would be effective Jan. 1, 1986.

Several other committees still must consider the premium hike.

D&O coverage

Continued from page 1

(BI, July 22).

Financial institutions may be hardest hit, but they certainly aren't alone.

According to brokers and underwriters surveyed by *Business Insurance*, other industries having a particularly hard time finding D&O coverage include electric and nuclear utilities; start-up high-tech businesses, like those in California's Silicon Valley; wildcat oil and gas drilling operations; research and development enterprises; real estate developers; highly-leveraged businesses; petrochemical companies; and steel companies.

"Who wants to write a D&O policy on a steel mill that hasn't made a profit in 10 years? However proficient the directors and officers may be, their best efforts may not be enough in an industry that has so little economic viability," explains Terry Van Gilden, manager of Chubb Corp.'s national executive protection department in Warren Township, N.J.

Chubb's Federal Insurance Co. subsidiary currently has a capacity of \$30 million per D&O risk, down \$5 million from about a year ago. And, Mr. Van Gilden points out, it is rarely committing that much capacity to a single risk.

Chubb was the second-largest writer of D&O insurance last year, controlling 14% of the market, according to Wyatt's most recent biennial study of the D&O market (BI, Jan. 21).

Other large D&O underwriters are also cutting back.

L.W. Biegler Profit Center, a unit of Crum & Forster, which Wyatt ranked as the fifth-largest D&O insurer with 8% of the market, has cut capacity for all professional liability insurance, not just D&O coverage, to \$5 million per risk, down from \$20 million.

Biegler also stopped writing D&O coverage for banks and savings and loans about a month ago, brokers say.

"We are assessing our position in the D&O financial institution field," explains Richard E. Stone, Biegler's chairman, who declined to comment further.

Los Angeles-based Harbor Insurance Co., whose parent Continental Corp. was ranked by Wyatt as the nation's third-largest D&O underwriter with 11% of the market,

has reduced its limits to \$5 million from about \$10 million a year ago, several sources say.

Harbor officials declined to comment on its capacity.

CNA Insurance Cos., which severed its underwriting relationship with Stewart Smith East Inc. and began underwriting on its own last February, can now mount up to \$15 million per risk, according to Roger E. Lumpp, vp-financial markets in Chicago. Last year, CNA could provide \$25 million in capacity.

Although the company will consider writing D&O insurance for businesses in all industries, the majority of its D&O policyholders are mid size financial institutions with assets of \$50 million to \$2 billion.

First State Insurance Co., a Hartford Insurance Group unit, has the capacity to write \$5 million, but temporarily stopped writing new D&O business about a month ago. The moratorium will probably continue for another 60 days, says Mr. Kalainoff at Cameron & Colby, First State's underwriting manager.

First State has between 200 to 300 D&O policyholders, he says.

Officials at the largest U.S. D&O underwriter, American International Group Inc., did not return phone calls. An AIG executive, however, spoke recently on D&O insurance problems at an American Bar Assn. meeting in London (see story, page 30).

Sources say AIG can now mount about \$20 million in capacity, down from \$50 million.

The reduced capacity among the largest D&O underwriters has been compounded by the withdrawal of smaller players, whose business collectively represents about 13% of all D&O coverage written in the United States, according to Wyatt.

Indianapolis-based American States Insurance Co., for example, wrote about 600 D&O policies until "absolutely dreadful" loss experience forced it to stop writing the coverage early this year, says Executive Vp Robert Anker.

The D&O business produced a loss ratio of 222% in 1984, says Mr. Anker. Most policyholders were given a 90-day non-renewal notice.

Midland Insurance Co. also stopped writing D&O insurance in the first quarter, as part of its move to focus on specialty lines, like short-line railroad and stevedore risks, explains Lawrence P. Johnsen, secretary and general

counsel.

In March, the New York-based insurer stopped renewing its D&O policies and canceled others mid-term, "where underwriting reasons justified it," says Mr. Johnsen.

Employers Insurance of Wausau stopped writing D&O coverage in May, after it used up the capacity it had allotted for that line for this year, a spokesman says.

The Home Insurance Co. in New York stopped writing D&O policies last November. It declined to comment further.

These four companies follow the exit of Evanston, Ill.-based underwriting manager Shand, Morahan & Co., which stopped writing D&O insurance in March 1984.

Several smaller markets, though, are still writing D&O coverage.

Western Employers Insurance Co. in Santa Ana, Calif., can mount up to \$10 million in D&O capacity, sources in the market say. Western Employers officials would not comment on their capacity.

Chicago Underwriting Group, an 18-month-old underwriter, has the capacity to write \$3.5 million, but will not write D&O coverage for financial institutions or insurance companies. CHUG writes on behalf of its parent, Old Republic Insurance Co.

"Insurance companies are on the verge of having some of the same problems industrywide that the banks are now," says Vp Marty Perry, explaining that many more insurers could become insolvent in coming years.

Stewart Smith East on July 1 initiated a two-month moratorium on new D&O insurance business to "pace" itself before upcoming reinsurance renewals in December, says Vp Stephen Sills in New York.

"It's not unusual now to write in one month what we wrote in a whole year," he says.

Stewart Smith began binding D&O policies in February for Forum Insurance Co. in Schaumburg, Ill., a unit of Montgomery Ward Insurance Co., after its relationship with CNA ended. The company has the capacity to write up to \$10 million per risk.

Stewart Smith also continues to bind new D&O policies for less risky, non-profit entities on behalf of Calvert Insurance Co. in New York. It has capacity of up to \$5 million for these risks.

Royal Insurance Co. in New York

Continued on next page



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D&O coverage

Continued from previous page

York still offers D&O insurance to both for-profit and non-profit entities, but its limits have been reduced to only \$2 million per risk, according to a spokesman, down from the \$10 million it offered as recently as last December.

St. Paul Mercury Insurance Co. reduced its D&O limits to \$5 million from \$15 million this month, according to St. Paul Cos. Inc., its parent. The insurer writes through wholesaler Swett & Crawford Group in Los Angeles.

RLI Insurance Co., a contact lens insurer in Peoria, Ill., began writing D&O insurance five years ago and continues to write it today, with expectations of taking in \$15 million in D&O premium this year.

The company can mount up to \$5 million per risk, but only insures hard-to-place risks that have been turned down by other insurers, explains Donald R. Fischer, president of RTC Underwriting Services Inc., RLI's underwriting manager in Hasbrouck, N.J.

Hit by the capacity crunch, buyers are apparently scrambling for excess insurance to fill out their D&O coverage.

RLI is "constantly" asked to use its \$5 million capacity to write an excess layer for a large, Fortune 100 account, reports Mr. Fischer. But he "steadfastly refuses" and says he intends to use the capacity only for primary coverage.

Mr. Sills notes that most of the D&O coverage written by Stewart Smith is excess, not primary, coverage. Of 40 submissions reviewed recently, 35 sought excess coverage.

"It's best to allocate what limited resources we have to writing on an excess basis. There's such a dearth of capacity that it almost doesn't make sense to write primary," he says.

As a result of the capacity crunch in the United States, many D&O buyers are looking to London.

Brokers say they can currently place about \$15 million to \$20 million of D&O coverage in the London market, about the same capacity London has provided for the past several years.

"The London market is still far more stable because they have managed their business better over the last five years," said Colin Mar-

shall, director of the North American division of Lloyd's of London broker Minet Holdings P.L.C.

London was not a big player in the D&O market during the past several years because many underwriters said rates were too low. Now, North American business is flooding London and much of it is being placed, brokers say.

"Business has increased 100%, maybe 200%," said Mr. Marshall. "We are getting 20 new submissions a week and, if the price is right, we can place it," though he said it is hard to place poor risks, such as financially troubled companies.

The main London market for primary D&O coverage is an insurance facility established by Lloyd's brokers C.T. Bowring & Co. Ltd., Willis Faber P.L.C. and Minet.

The facility, which offers primary D&O limits of \$10 million, is led by Richard Lawrence, a Lloyd's of London underwriter for non-marine syndicates managed by Merrett Syndicates Ltd. Other markets participating in the facility are the Wetherell Syndicate at Lloyds and H.S. Weavers (Underwriting) Agencies Ltd.

Although the facility was set up by Minet, Bowring and Willis Faber, any Lloyd's broker can place business with it.

Minet, Willis Faber and Bowring are now trying to arrange for the facility to write another \$10 million D&O layer excess of the \$10 million now offered, London brokers say.

The policy offered by the facility is written on a claims-made form, and defense costs are included within policy limits.

Merrett's Mr. Lawrence says that London D&O underwriters may change the wording of their policies at the end of the year, but he would not elaborate.

However, Mr. Marshall said the new policy forms may include all extra endorsements that have been added to D&O coverage in the past five years. One of these endorsements, Mr. Marshall said, excludes coverage for claims arising from pollution and environmental impairment losses, he noted.

U.S. D&O markets are also imposing their own exclusions.

For example, underwriters are more frequently excluding coverage when a corporation sues its own directors or officers, or when

one director or officer sues another director or officer.

Such suits gained attention earlier this year when San Francisco-based Bank of America sued six officers in connection with a \$95 million loss triggered by the bank's involvement with allegedly fraudulent mortgage-backed securities.

At the same time, the bank sued its two D&O insurers—Employers Insurance of Wausau and First State Insurance Co.—claiming that its \$100 million in D&O coverage should respond to the loss (BI, March 11). The two insurers later canceled the bank's coverage.

Of particular concern to financial institutions is an increasingly unavoidable policy endorsement that excludes coverage against claims brought by a governmental agency.

This "regulatory exclusion" has arisen from attempts by the Federal Deposit Insurance Corp. to use D&O insurance proceeds to reimburse depositors of failed banks or savings and loans. "The probability of it being present on a new or renewal policy increases daily," says CNA's Mr. Lumpp.

Between 30% to 40% of RLI's financial institution policyholders are now subject to the regulatory exclusion, estimates Mr. Fischer.

Others say the exclusion is beginning to appear in policies for other industries subject to government regulation, like electric power.

At least one underwriter hopes to cash in on policyholders facing that exclusion.

Santa Monica, Calif.-based wholesaler NAS Insurance Services was finalizing a legal expense policy last week that would reimburse directors or officers for money spent defending claims brought by a governmental agency, like the FDIC.

The coverage, designed not as a replacement for D&O insurance but as a supplement to it, will be written by underwriters at Lloyd's, says NAS Vp Maurice H. Sidy.

NAS is offering limits of up to \$100,000 per director, with a deductible equal to 10% of limits and a 10% coinsurance requirement. The policy excludes claims alleging environmental infractions.

Underwriters note the current turbulence in the D&O market is almost inevitable following years of cut rates.

"Very simply, the coverage has been underpriced," says Chubb's Mr. Van Gilden.

Chicago Underwriting Group's Mr. Perry says rates in 1983 and 1984 were only about 20% of what they were in 1979. So if last year's rates are tripled, which is often the case, policyholders are still being charged only 60% of what was charged in 1979, he reasons.

Warren G. Brockmeier, vp-risk management services at Wyatt in Chicago, estimates that D&O premiums 18 months ago were only 20% to 25% of what they should have been.

Others point out that many buyers receiving big rate hikes today are renewing policies issued in 1982, when policies with a three-year term were common.

That kind of policy "is not going to be around long," says Mr. Lumpp, who says CNA ceased offering three-year policies earlier this year unless the insurer has the right to an annual review.

But poor pricing did not create today's market conditions by itself. Recent lawsuits and court decisions have placed demands on D&O policies that were never intended, underwriters say.

"More and more things are chipping away at the basic premise of the coverage," says Mr. Van Gilden.

He explains that the intent of D&O coverage is to respond to suits arising from true mismanagement of an operation. But suits are so prevalent that the coverage is becoming "a business judgment E&O policy."

Reinsurance restrictions reduce D&O capacity

By STACY SHAPIRO

LONDON—The directors and officers liability insurance market has a "fundamental problem," a broker says: "The market is disappearing very rapidly."

The D&O market's contraction "puts the corporations in a very serious position. . . . There is going to be a dramatic increase in premiums," explained William K. Brown Jr., senior vp of the service industry division of Marsh & McLennan Inc.

"And, it's going to get worse," Mr. Brown said.

Reinsurance capacity for D&O risks was cut back in January "just as though it were severed with a guillotine," added Joseph P. DeAlessandro, president of National Union Fire Insurance Co. of Pittsburgh, Pa., an American International Group Inc. unit.

"Without the capacity—the reinsurance—the primary market's ability to write the limits that we have heard of before are out," he said. "Obviously, there isn't any single organization that can write \$100 million—\$50 million even. We depend clearly on the ability of reinsurance to grow the capacity that we offer in the marketplace."

Mr. DeAlessandro and Mr. Brown made their remarks at a session on the directors and officers liability insurance market at the American Bar Assn. conference in London earlier this month.

Besides Mr. DeAlessandro and Mr. Brown, panelists included two leading London D&O underwriters, David Foster, underwriter for the Wetherell syndicate at Lloyd's of London, and Richard Lawrence, underwriter for non-marine syndicates managed by Merrett Syndicates Ltd.

Mr. DeAlessandro said last year's D&O market "bears no resemblance to the market that we are in today. Last year it was a give-away market. It was sort of the last days of Rome, when they knew something was going to burn tomorrow. . . ."

"At Jan. 1 this year, the entire world changed, in D&O and in other forms of insurance, but clearly in D&O. . . . Capacity just ceased," he said. For example, Mr. DeAlessandro said, companies that had \$200 million of D&O coverage last year are now "maybe getting \$50 million. I don't know if 50 is the right number—it might be \$20 million. And, in 1986, ladies and gentlemen, it may be \$10 million or even less."

Rates for D&O coverage are rising 200% to 300%, said M&M's Mr. Brown. "And that is not unusual. Increases may be substantially more," he said.

D&O underwriters also are skeptical about writing coverage for a three-year period, as they have in the past.

"The three-year policy is a thing of the past," Mr. DeAlessandro said. "Am I right?"

"Only under very exceptional circumstances," Merrett's Mr. Lawrence agreed.

"Exceptional in that we have a guarantee that there aren't going to be any claims," Mr. DeAlessandro added, amid laughter.

Underwriters also are becoming more skeptical about covering a company's directors and officers for their involvement on other companies' boards.

"We insure corporations and had several of their board members asked to serve as watchdogs on several corporations who were not subsidiaries," explained Mr. DeAlessandro. "With the approval of the board, they sat on the (outside) boards and we extended the coverage of our initial corporations to the other corporations."

"In two of these instances, we have claims of up to \$20 million where there is no other D&O cover and those individuals are the only ones with coverage," he said. "I suggest to you that we are in bad shape on both of those things. So, from my view, doing outside directors is going to be a difficult thing to do."

Some D&O underwriters say they may withdraw from the market altogether if they are sued by policyholders.

In March, San Francisco-based Bank of America sued six officers in connection with a \$95 million loss triggered by the bank's involvement with allegedly fraudulent mortgage-backed securities.

At the same time, the bank sued its two D&O insurers—Employers Insurance of Wausau and First State Insurance Co.—claiming that its \$100 million in D&O coverage should respond to the loss (BI, March 11). The two insurers later canceled the coverage.

"We are partners with the corporation and with the directors and officers who are insured in that we have a commonality of interest in providing the insurance," Mr. DeAlessandro said.

"Once that partnership barrier is destroyed, once we are not operating on the same team, once it becomes 'we' and 'they,' once we are fair game in the litigation world, I submit to you and I suggest to you that there's going to be a rapid change in the availability of this cover at any price and in any market," he said.

One member of the audience, however, suggested that D&O underwriters are not offering sufficient protection to buyers.

"When you come down to the events that give rise to litigation, is there any coverage or are you fellows going to run away from it?" the member of the audience asked. "My suggestion to you is that you are not offering a product."

Mr. Foster, the underwriter for the Wetherell syndicate, replied, "I would say for the first time that we are attempting to offer a product. What we have been for the last few years, many thanks to a lot of members of the American Bar Assn., is a deep pocket, an offer of a product that you can buy, lock up in a box and in five years time, take it out and say 'Gee, my refrigerator has turned into an automobile. Isn't it terrific. It's something I never knew I had. I can claim on this.'"

Merrett's Mr. Lawrence agreed. "What we are trying to do is get back to the position we were in 10 years ago, when everyone clearly understood. . . . what they were paying for. And frankly, unless you get back to that balance, there just won't be a D&O market."

Other members of the panel at the ABA conference were Tony Outwaite, division director of C.T. Bowring & Co. Ltd. in London; Joseph E. Barrett, partner with Yeager & Lang in New York; Joseph Johnston, partner with Drinker, Biddle & Reath in Washington; and Louis Schauer, partner with Lord, Bissell & Brook in Chicago.

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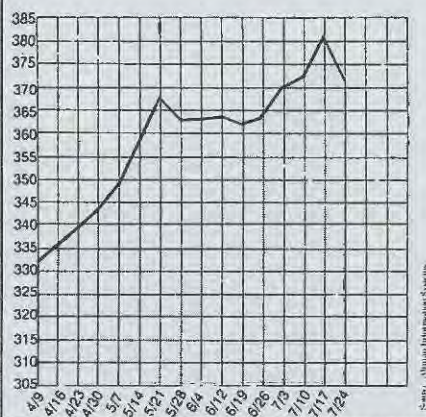
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BI Insurance Index



After setting a record high for three consecutive weeks, the *Business Insurance* stock index dropped sharply during the most recent trading period. The *Business Insurance* index of insurance industry stocks closed at 371.8 points on July 24, down 9.3 points from the record high of 381.1 points set July 17. A total of 16 stocks posted gains, 38 stocks declined and four stocks were unchanged. The biggest gains were posted by United Fire & Casualty Co., up 11.4%; Great-West Life Assurance Co., up 7.6%; Emmett & Chandler Cos. Inc., up 6.8%; Kansas City Life Insurance Co., up 6.2%; and Hartford Steam Boiler Inspection & Insurance Co., up 5.7%. The biggest losses were posted by SRI Corp., down 13.7%; SAFECO Corp., down 9.6%; Chubb Corp., down 9.4%; USF&G Corp., down 8.7%; and Nobel Insurance Ltd., down 8.5%. The *Business Insurance* index fell 2.4% for the trading period. In comparison, the New York Stock Exchange composite fell 2.1%, the Standard & Poor's 500 also fell 2.1%, and the Dow Jones 30 Industrials fell 0.7% for the same trading period.

Use caution in interpreting most-recent insurer results

By MYRON M. PICOULT

Special to Business Insurance

THE CURTAIN HAS closed on the second act of the 1985 Property/Casualty Charade Review, and participants and observers are anxiously awaiting the critiques.

Throughout this week, there will be a continuing plethora of pencil, pen and computer commentaries.

The aura of anxiety is somewhat fascinating. For the next several quarters there should be no major surprises. Premium volume is expanding rapidly—in the 18%-20% range—and some improvement in underwriting experience should manifest itself in the second half of 1985 and beyond for perhaps a few years.

Perhaps the anxiety is a function of the sense that much, if not everything, has been discounted in most property/casualty equities at current levels.

While it will be easy to get caught up in the good premium numbers and improving bottom-line earnings results, it would be wise for investors to review what this industry is all about.

The next major piece of news to come will be either evidence that several major companies have shortchanged reserves or the first signs of increased competition in standard commercial coverages and the topping of adequate increases in the regulated personal lines arena.

There is no question that a fair number of management teams are indebted to Wall Street for the rise in their stocks and the reception to stock and bond offerings. Hence, managements are expected to play the gallery for a while.

It is late in the game for many property/casualty equities, and caution is the password.

More than anything else, the superb absolute and relative performance of the stocks

Myron M. Picoult is senior vp and senior insurance analyst with Oppenheimer & Co. in New York. He is the past president of the Assn. of Insurance & Financial Analysts and a member of the New York Society of Security Analysts. His column appears the fourth Monday of every month.



Mr. Picoult

may be more a function at this juncture of portfolio managers not paring back or liquidating holdings because they do not know where to put the money.

While we do not quarrel with the ultimate "peak" earnings numbers developed by consensus opinion, we do disagree with the time frame. We think it could take longer to reach the peak if reserve inadequacies are appropriately addressed.

One could argue a delay is a positive factor because it guarantees the sustenance of rate relief and a longer underwriting recovery.

Most managements deny any reserve shortfall, meaningful or otherwise, and many are implying that they are approaching price sufficiency on many "mom and pop" or "main street" risks.

But, you can't have it both ways. An elongated pricing recovery related to reserve strengthening would again underscore that either managements were misleading in their comments or did not know where they were. Neither is a good sign.

As a footnote to this discussion, the Assn. of Insurance and Financial Analysts recently held its 10th annual conference in London. At the conference, it was obvious that the American insurance representatives, for the most part, were emphasizing the income statements, while their British and European colleagues talked about balance sheets—a fascinating dichotomy.

One argument presented to strengthen the theory that commercial insurance rates will continue to rise at a significant pace is the capital shortage in the business. Some observers contend the capital shortage will curtail managements' inclination to gain market share by aggressive pricing.

We do not totally agree. We believe that management teams as well as regulators have generally learned to live with a higher premium-to-surplus ratio.

This is especially the case when underwriting margins are improving and when strong earnings are being generated. Managements then view capital and surplus positions as more adequate than they do at times when underwriting is poor and earnings are slipping.

One other point to consider: If you are a buyer looking for a difficult or esoteric coverage and you cannot buy it, then there is a capacity crunch.

If, however, you are an insurance company that does not want to write the business, how is that a capacity crunch?

Within the past year, and for most com-

panies within the past five months, some \$2.5 billion in capital has been raised. This certainly will not strain the 3-1 ratio of net premiums written to statutory surplus that existed at the end of the first quarter.

It will be interesting to see how quickly—and just where—this money is put to work. New surplus can be used to support new business or to correct reserve miscues.

Frank B. Hall

Broker Frank B. Hall & Co. Inc. was named earlier this month as one of "10 uncommon values" by securities brokerage Shearson Lehman Brothers, a unit of American Express Co.

No other insurance industry companies made the list.

According to the analysis by Shearson, "Frank B. Hall will be a major beneficiary of the dramatic rate increases in the commercial lines of the property/casualty insurance industry today. Rapidly growing commission revenues and relatively fixed costs should mean an exciting earnings story for Hall in years to come."

"Hall has lagged the price recovery of the insurance/brokerage group as a whole because of two troubled subsidiaries. We believe Hall is on the way to solving their problems, and that once it does, the stock will appreciate sharply."

A technical comment by Shearson says: "In 1983 and early 1984, (Hall) lost 41% of its valuation. During 1984 the issue worked its way through a rebuilding process. The recent breakout above \$28 is significant and confirms the stock is prepared for an attack on the \$34 peak of 1983."

Frank B. Hall shares were trading at \$31.875 last week on the New York Stock Exchange.

The other nine "uncommon values," according to Shearson Lehman Brothers, are:

- Associated Dry Goods Corp., a retailer.
- Chi-Chi's Inc., a restaurant company.
- Daisy Systems Corp., a computer concern.
- Eaton Corp., a conglomerate.
- Equitable Resources, a natural gas company.
- Golden West Financial Corp., a California savings and loan.
- International Business Machines Corp., a computer manufacturer.
- Upjohn Co., a pharmaceutical manufacturer.
- Wal-Mart Stores Inc., another retailer.

Fireman's Fund

Fireman's Fund Insurance Corp.'s property/casualty unit reported a second-quarter loss of \$85 million, primarily the result of a \$187 million charge to strengthen reserves for 1983 and earlier years, parent American Express Co. said.

A Fireman's Fund spokesman said the insurer would have shown a \$16 million profit had it not been for the charge.

Separately, American Express announced that John J. Byrne, currently chairman of GEICO Corp., will become chief executive of Fireman's Fund Insurance Corp., the holding company for American Express' insurance operations. The holding company will be spun off later this year when American Express makes a public offering of shares in Fireman's Fund's property/casualty operations (BI, July 1).

Continental

Continental Corp. has declared a dividend of 65 cents per share of common stock and 62.5 cents per share of cumulative convertible preferred stock, Series A and B. Both dividends are payable Sept. 15 to shareholders of record Aug. 19.

Travelers Corp.

Travelers Corp. has declared quarterly dividends of 51 cents per share of its common stock and \$1.04 per share of its \$4.16 Series A convertible preferred stock.

Both dividends are payable Sept. 10 to shareholders of record on July 31.

British Issues

23 July Companies	Price	P/E	Div.	Yield	High—Low
Comm Union	209	N/M	16.9	8.1	215—209
Genl Accident	615	104.2	28.6	4.6	625—615
Gdn Royal Exch	715	20.7	37.1	5.2	725—715
Royal	685	N/M	33.9	4.9	695—683
Sun Alliance	458	22.0	21.1	4.8	467—458

Brokers	Price	P/E	Div.	Yield	High—Low
CE Heath	608	10.0	30.0	4.9	617—608
Hogg Robinson	244	12.4	11.4	4.7	248—244
JH Minet	193	12.6	8.9	4.6	197—182
Sedg Grp	338	14.8	14.3	4.2	353—338
Stew Wrightson	555	14.6	25.7	4.6	572—555
Willis Faber	608	20.8	18.6	3.1	620—608

Source: Philip Olsen/Alan Clifton, Insurance Industry Specialists Kitcat & Aitken Stockbrokers, London

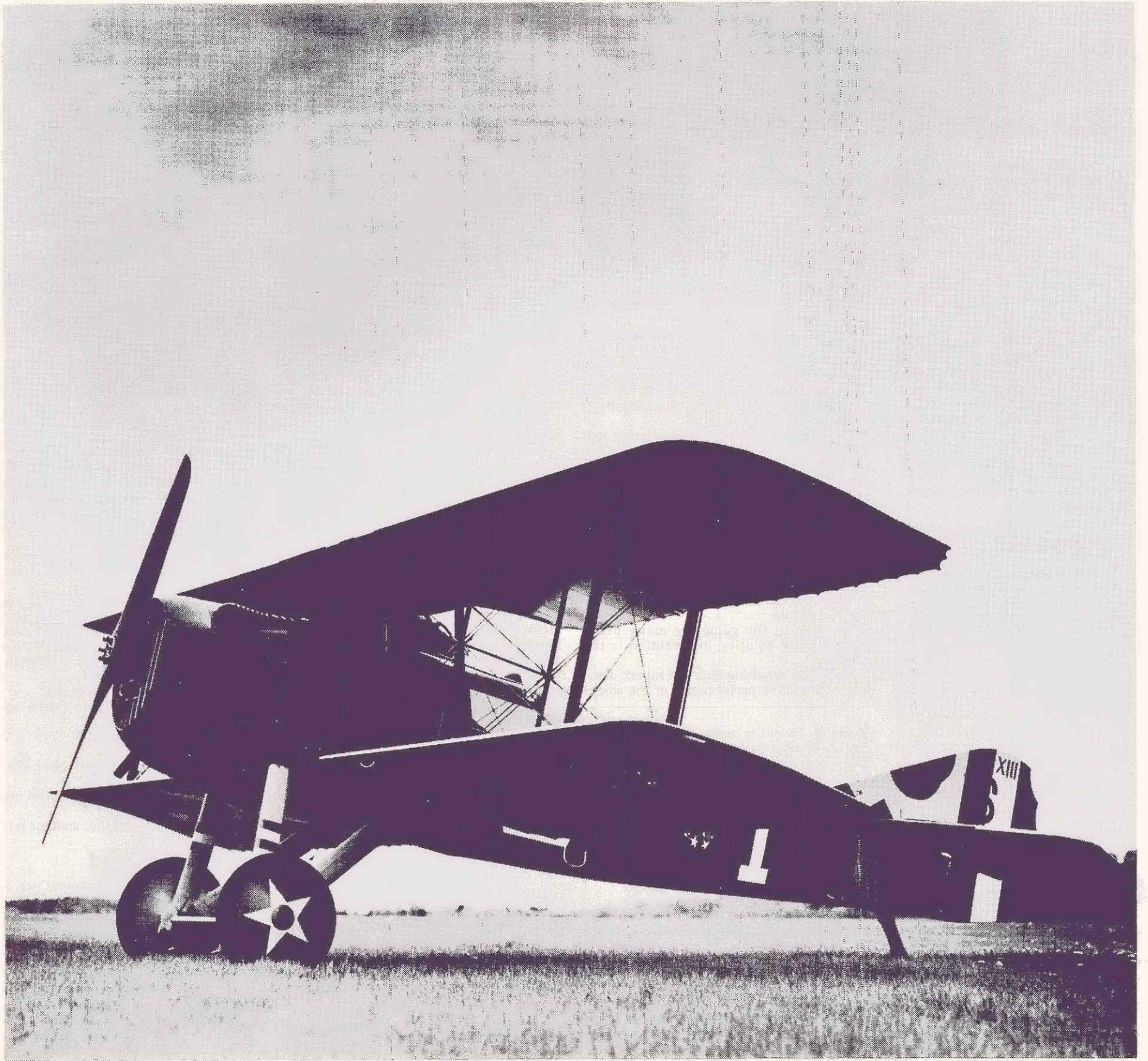
BI Industry Stock Report

July 24, 1985 7/18/85 thru 7/24/85

Brokers	Price	% Chg.	P/E	\$ Div.	% Yld.	High	Low	Vol.(000)
Alexander & Alexander Svcs	NYSE 28.75	0.4	0.0	1.30	3.5	28.88	28.63	886.7
Baldwin & Lyons Inc	NYSE 65.00	-7.1	11.8	0.80	1.2	70.00	65.00	0.7
Corroon & Black Corp	NYSE 48.63	2.1	0.0	1.00	2.1	48.63	47.50	196.9
Cruick E H Cos Inc	NYSE 34.25	0.0	25.8	0.50	1.5	34.50	34.00	38.2
Emmett & Chandler Cos Inc	NYSE 27.50	6.8	131.0	0.00	0.0	27.50	27.00	24.8
Gallagher Arthur J & Co	NYSE 38.75	-7.2	23.2	0.28	0.7	42.00	38.75	35.5
Hall Frank B & Co Inc	NYSE 31.13	-0.4	0.0	1.00	3.2	31.13	30.38	358.1
Harsh & McLennan Cos Inc	NYSE 71.38	-3.9	19.8	2.40	3.4	74.00	71.38	218.4
Poe & Assoc Inc	NYSE 8.00	0.0	0.0	0.80	10.0	8.00	8.00	0.0
Reed Stenhouse Cos Ltd	NYSE 20.75	-1.2	26.9	0.00	0.0	21.00	20.63	24.3
AGENTS/BROKERS	AVERAGE		45.2		2.1			
Conglomerates & Holding Cos.	Price	% Chg.	P/E	\$ Div.	% Yld.	High	Low	Vol.(000)
American Express(Fireman's Fd)	NYSE 44.63	-7.5	15.3	1.28	2.9	46.88	44.63	3,988.2
Anderson (Clayton/PanAm)	NYSE 44.25	-0.6	38.1	1.32	3.0	46.25	43.75	506.2
Araco Inc	NYSE 9.88	6.8	0.0	0.00	0.0	10.50	9.63	1,703.7
Berkley W R Corp	NYSE 18.25	-6.4	0.0	0.32	1.8	19.00	18.00	693.6
CIGNA Corp	NYSE 57.38	-5.0	819.6	2.60	4.5	60.25	57.38	1,023.8
City Investing Co. (Home Ins.)	NYSE 29.50	2.2	4.6	0.00	0.0	30.50	29.25	2,776.5
CNA Fint Corp (CNA)	NYSE 55.50	-4.7	21.3	0.00	0.0	57.63	55.50	444.7
General Re Corp	NYSE 84.50	-7.5	55.6	1.56	1.8	89.50	84.50	719.8
ITT (Hartford Group)	NYSE 32.63	2.8	10.2	1.00	3.1	32.63	30.88	3,105.2
Optimum Hldg Corp	NYSE 6.50	0.0	1.6	0.00	0.0	0.00	0.00	0.0
Sears Roebuck & Co. (Allstate)	NYSE 36.13	-3.7	9.0	1.76	4.9	38.00	36.13	2,558.1
Telephony Inc (Argonaut)	NYSE 261.63	1.5	5.6	0.00	0.0	263.00	257.00	225.7
Transamerica Corp	NYSE 29.25	-6.4	14.3	1.64	5.6	31.00	29.25	416.1
(Occidental & Fred S. James)	NYSE 29.25	-6.4	14.3	1.64	5.6	31.00	29.25	416.1
CONGLOMERATES/HOLDING COS.	AVERAGE		11.1		1.6			
Insurers	Price	% Chg.	P/E	\$ Div.	% Yld.	High	Low	Vol.(000)
Aetna Life & Cas Co	NYSE 45.88	-7.6	23.3	2.64	5.8	48.63	45.88	1,746.1
American General Corp	NYSE 32.88	-7.7	10.7	1.00	3.0	36.00	32.88	1,209.1
Ameri Heritage Life Int'l Co	NYSE 36.13	0.7	10.7	1.20	3.3	36.13	35.50	5.8
American Indty Fint Corp	NYSE 21.25	-3.4	0.0	1.12	5.3	22.25	21.25	41.7
American Intl Group Inc	NYSE 85.00	-4.5	21.9	0.44	0.5	86.75	85.00	627.9
Aneco Reins Ltd	NYSE 1.25	0.0	0.0	0.00	0.0	1.25	1.25	3.5
Avemco Corp	NYSE 29.75	-4.0	13.8	0.60	2.0	30.25	29.50	21.4
Business Mens Assurn Co Amer	NYSE 25.50	-1.9	7.0	1.04	4.1	25.50	25.50	63.6
Chubb Corp	NYSE 68.38	-9.4	17.2	2.20	3.2	74.00	68.38	191.5
Combined Intl Corp	NYSE 48.50	-2.0	9.5	2.16	4.5	49.50	48.50	293.0
Continental Corp	NYSE 42.25	-4.0	21.6	2.60	6.2	43.63	42.25	704.5
Crown Life Ins Co	NYSE 167.00	4.4	10.1	0.00	0.0	167.00	160.00	7.2
Durham Corp	NYSE 39.50	-1.3	7.4	1.28	3.2	39.75	39.25	27.1
Farmers Group Inc	NYSE 64.38	-6.0	11.3	1.76	2.7	68.63	64.38	474.1
Freemont Gen Corp	NYSE 26.13	-5.4	0.0	0.48	1.8	27.63	26.13	184.5
Great West Life Assurn Co	NYSE 425.00	7.6	10.9	0.00	0.0	425.00	395.00	0.0
Hamover Ins Co	NYSE 44.00	-4.9	74.6	0.56	1.3	46.88	44.00	70.6
Hartford Steam Boiler Insprtn	NYSE 51.00	5.7	21.9	1.60	3.1	51.50	48.25	34.0
Kans City Life Ins	NYSE 25.75	6.2	10.1	0.87	3.4	25.75	24.25	16.9
Kemper Corp	NYSE 57.25	-6.3	24.7	1.80	3.1	60.25	57.25	111.0
Liberty Corp S C	NYSE 30.00	0.4	14.0	0.72	2.4	30.25	30.00	15.2
Lincoln Natl Corp Ind	NYSE 43.00	-3.9	11.2	1.84	4.3	44.63	43.00	253.7
Mission Ins Group Inc	NYSE 6.38	2.0	0.0	0.00	0.0	6.50	6.25	57.0
Monumental Corp	NYSE 31.00	1.2	20.5	1.30	4.2	31.00	30.38	75.6
Nobel Ins Ltd	NYSE 10.75	-8.5	14.1	0.25	2.3	12.50	10.75	108.9
Northwestern Natl Life Ins	NYSE 29.00	-4.5	6.9	0.80	2.8	30.50	29.00	200.3
Ohio Gas Corp	NYSE 63.63	-4.1	23.6	2.80	4.4	67.63	63.63	179.5
Old Rep Intl Corp	NYSE 39.13	-5.7	9.5	0.74	1.9	41.00	39.13	258.7
Orion Cap Corp	NYSE 27.13	-0.5	0.0	0.76	2.8	27.25	27.00	55.7
Protective Corp	NYSE 22.25	1.1	7.8	0.66	3.0	23.25	22.25	99.7
Provident Life & Acc Ins Co	NYSE 24.25	-2.0	6.8	0.76	3.1	25.00	24.25	458.0
St Paul Cos Inc	NYSE 70.50	-5.1	0.0	3.00	4.3	74.00	70.50	321.6
SAFECO Corp	NYSE 40.25	-9.6	14.4	1.60	4.0	44.38	40.25	658.1
Sri Corp	NYSE 19.63	-13.7	93.5	0.68	3.5	21.75	19.63	122.2
Selbels Bruce Group Inc	NYSE 20.50	0.0	0.0	0.80	3.9	20.75	20.50	32.9
Statesman Group Inc	NYSE 4.63	-2.6	0.0	0.15	3.2	4.75	4.63	98.7
Tokio Marine & Fire Ins Co	NYSE 211.75	3.2	36.6	1.05	0.5	214.75	204.50	19.1
Torchmark Corp	NYSE 49.00	-3.2	10.2	1.20	2.4	50.38	49.00	218.9
Travelers Corp	NYSE 45.25	-7.2	10.9	2.04	4.5	48.13	45.25	1,999.1
United Fire & Cas Co	NYSE 24.50	11.4	0.0	0.80	3.3	24.50	22.00	3.6
United States Fid & Gty Co	NYSE 34.00	-8.7	36.6	2.20	6.5	37.13	34.00	980.0
USLife Corp	NYSE 37.50	-6.0	8.6	1.04	2.8	40.25	37.50	357.1
Washington Natl Corp	NYSE 26.13	1.5	7.7	1.08	4.1	26.50	25.38	59.4
Zenith Natl Ins Corp	NYSE 19.50	1.3	0.0	0.68	3.5	19.50	19.00	134.6
INSURANCE COMPANIES	AVERAGE		19.0		2.2			

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