

# Business Insurance

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## Ergonomics hearings in 3 cities slated for July

WASHINGTON—U.S. Labor Secretary Elaine Chao says she plans to “identify a final course of action” on ergonomics by September.

Ms. Chao announced last Thursday that the Labor Department intends to hold three public hearings next month—in Washington, Chicago and a California site to be determined—on the issue of workplace repeti-

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## Ruling could spur captive growth

# IRS walks out on ‘economic family’

By GAVIN SOUTER

### Tax milestones

Key rulings on deductibility of premiums paid to captives.

**1977—The Internal Revenue Service issues Ruling 77-316**, stating that a policyholder, its noninsurance subsidiaries, and its captive form one “economic family.” Premiums paid within the economic family are not deductible.

**1989—Humana Inc. vs. Commissioner.** The 6th U.S. Circuit Court of Appeals rules that while parent companies can not deduct premiums paid to a captive, their subsidiaries can.

**1995—Malone & Hyde vs. Commissioner.** 6th Circuit rules that the parent guaranteed the captive’s performance and the captive was thinly capitalized, so the arrangement could not be construed as insurance.

**1997—Kidde Industries Inc. vs. United States.** U.S. Court of Federal Claims ruling effectively extends the Humana precedent nationwide.

**2001—IRS Ruling 2001-31.** The IRS concedes that the courts have rejected the economic family theory and states that IRS inspectors will no longer invoke it.

WASHINGTON—The Internal Revenue Service’s decision to drop its long-standing position that premiums paid to captives are not deductible under the so-called “economic family” theory should prompt more policyholders to take the deduction and could spur captive growth.

The decision, which was issued June 4 as Revenue Ruling 2001-31, is regulatory recognition of an issue that has already been decided by the courts, but it could still lead to changes in the use of captive insurers, experts note. Captive owners and the IRS will now be free to focus on other issues, such as the capitalization of captives.

The ruling overturns the stance that the IRS first took 24 years ago in Revenue Ruling 77-316.

In that 1977 ruling, the IRS took the position that in the case of related-party risks, if such risks are insured or reinsured by a related insurance company—one in the same “economic family”—the premiums involved cannot be deducted from federal taxes because the risk was not shifted from the policyholder.

Since then, though, courts have ruled on the tax deductibility of premiums in several cases, but

See IRS on page 31

# Tobacco firms face new liability to health plans

By MICHAEL BRADFORD

NEW YORK—Tobacco companies’ exposure to liability for health plans’ costs of treating smoking-related ailments may increase in the wake of a recent jury verdict.

A federal court jury in New York last week awarded Empire Blue Cross & Blue Shield \$17.8 million to reimburse its smoking-related treatment costs. There are more than a dozen other such lawsuits pending in the same court by Blues plans from across the country.

The decision signals a new assault on tobacco companies. In the first case in which an insurer has successfully sued the tobacco industry, several cigarette makers were found guilty of deceptive trade practices and were told to pay Empire Blue Cross & Blue Shield the multimillion-dollar award.

The jury decided the tobacco companies were responsible for the health plan’s costs in part because the companies had misled plan subscribers about the risks of smoking. New York-based Empire has about 4.3 million subscribers.

In another recent court action, a state court jury in California added to the tobacco industry’s woes when it ruled that Philip Morris Inc. must pay a smoker with lung and brain cancer \$3 billion. New York-based Philip Morris said that it will appeal the verdicts in California and New York, and the other defendants involved in the Empire Blues case have said that they will appeal that

verdict as well.

In New York, cigarette makers still face claims from at least 13 Blues plans from various states that were plaintiffs in a suit originally filed in 1998. Empire’s claims in that suit were the first scheduled for trial before Judge Jack B. Weinstein, who had previously ruled that each plan’s claims must be heard separately. He has yet to set trial dates for the other cases.

The outcome is encouraging to plaintiffs’ attorneys in the case.

“We would have liked to have seen a little more money, but this is a victory,” said Paul J. Bschorr, an attorney with the New York law firm of Dewey Ballantine L.L.P., which is representing Blues plans in the New York litigation.

“It’s the opening wedge,” he said of insurers’ press to recover health care costs from tobacco companies.

Cigarette makers dodged a bullet in the Empire case when the jury rejected the health plan’s charges of common-law fraud and racketeering. Under federal law, courts may award treble damages for racketeering claims.

The tobacco companies argued in the trial that Empire had not been harmed because it passed its costs along in the form of higher premiums. Defendants included Lorillard Tobacco Co., Philip Morris, R.J. Reynolds Tobacco Co., Brown & Williamson Tobacco Corp. and Liggett Group Inc.

See Tobacco on page 31

# Are errors unreported?

## Controversial HHS report faults HMO practices

By JOANNE WOJCIK

A new study that says health maintenance organizations are not reporting medical errors to the National Practitioner Data Bank may not be telling the whole story, industry experts say.

While lambasting managed care for focusing on cost rather than quality, the report fails to acknowledge that other factors may be contributing to the deterioration of the nation’s health care system, the experts point out.

The report by the inspector general of the Department of Health and Human Services, released last month, said that from September 1990—when



the data bank was launched—through September 1999, managed care organizations reported only 715 adverse actions, and

that 84% of managed care organizations never reported a single adverse action.

Adverse actions are disciplinary actions taken against doctors for incompetence or misconduct. The data bank also receives reports of malpractice payments from malpractice insurers.

The two most likely explanations for the low level of reporting, the report finds, are the plans’ limited focus on clinical oversight and their reliance on downstream entities, such as hospitals, physician practice groups and state licensing boards, to monitor practitioners.

While the report did not ex-

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**INSIDE**



● **Building-products maker USG Corp. is mulling its options in the face of asbestos liabilities. PAGE 4**

● **Risk managers should refresh their knowledge about the hazards created by workers being exposed to excessive heat. PAGE 6**



● **The IRS was wise to abandon its longstanding position that premiums paid to captives are not deductible under its so-called "economic family" theory, this week's editorial says. PAGE 8**

● **A British appeals court has ruled that insurance-backed film financing bonds are insurance policies and are not guarantees of payment. PAGE 23**



PHOTO: ZUMA PRESS

● **The government of the Galapagos Islands will file a claim for as much as \$60 million with the insurers of a tanker that spilled oil off the islands in January. PAGE 23**



● **An Assn. of Risk & Insurance Managers of Australasia conference examined the state of public sector risk management in Australia. PAGES 23-27**

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**UPDATES**

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five-stress injuries. "We are bringing everyone to the table to get this important issue moving forward and resolved," she said in a statement.



Ms. Chao

PHOTO: KRT

"Defining the best approach for ergonomics injuries is not a simple process, and we need everyone's voice heard in the process." Ms. Chao previously set six principles that the department will use as a basis for creating any ergonomics standard: prevention, flexibility, sound science, cooperation between OSHA and employers, feasibility and clarity. The Occupational Safety and Health Administration issued a national workplace ergonomics standard last November, but Congress took the unprecedented step of legislatively revoking it in March. Congress' action prohibits the Labor Department from issuing a substantially similar standard, but Ms. Chao has been under congressional pressure to reopen the issue and draft a new standard. Legislation has been introduced that would require the Labor Department to issue a new standard within two years of that bill's enactment into law.

► **CAT REINSURANCE RATE HIKE** The average cost of property catastrophe reinsurance in the United States increased for the first time in seven years at Jan. 1, 2001, renewals, according to Paragon Reinsurance Risk Management Services Inc. Prices for the coverage increased 7.2% over the January 2000 renewals, said the Minneapolis-based unit of Benfield Blanch Holdings Inc. The increase is the first since the spike in property cat prices following Hurricane Andrew in 1992 and the Northridge quake in 1994, Paragon said. Paragon started its catastrophe price index in 1985 at a baseline of 1,000. It peaked in 1994 at 2,470, and in 2001 it stood at 1,730. The index is based on a sample of more than 150 companies with nearly 500 treaties, representing about 40% of U.S. property catastrophe premiums, according to Paragon.

► **HIH BAILOUT TO GROW** The Australian government has increased its bailout package for policyholders of defunct HIH Insurance Ltd. to \$640 million Australian (\$325.5 million). Previously, the government had committed \$500 million Australian (\$254.3 million), which is largely confined to personal lines and small-business policyholders of HIH. The funds committed to the bailout will be paid out over four years, said Joe Hockey, minister for Financial Services and Regulation. About 30,000 people will benefit from the bailout package, he said. HIH went into provisional liquidation earlier this year, after suffering heavy losses. Late last month, the provisional liquidator estimated that the insurer could be insolvent by up to \$4 billion Australian (\$2.03 billion).

► **SECRECY BAN PROPOSED** Two bills that would ban secrecy agreements in certain settlements of litigation gained ground last week in California despite aggressive lobbying by insurers and businesses. The two companion bills, supported by plaintiff attorneys, would force parties to lawsuits to reveal settlement information involving such issues as product liability and environmental hazards. In the California Senate, S.B. 11, sponsored by state Sen. Martha Escutia, D-

Montebello, won approval last Wednesday. In the Assembly, A.B. 36, sponsored by Assemblyman Darrell Steinberg, D-Sacramento, won approval Thursday. Sen. Escutia's bill would apply to unfair insurer claims practices while the Assembly version was amended to exclude that issue. Opponents say the bill would provide public access to all information provided during the civil discovery process and force companies to disclose intellectual property details simply because of unproven allegations.

► **REINSURER RESULTS IMPROVE** U.S. reinsurers' premium volume grew and their combined ratio improved in the first quarter of this year, according to the Reinsurance Assn. of America. Reinsurers posted a 106.4% combined ratio for the first quarter, compared with 112.4% reported by a similar group for last year's first quarter, according to a report by the Washington-based RAA. The combined ratio for the quarter ending March 31 reflects the results of 30 reinsurers, which together posted a 76.5% loss ratio and a 29.9% expense ratio. Including the non-U.S. affiliate operations of CNA Re and St. Paul Re yields a combined ratio of 105.8% for the group, according to the RAA. The U.S. reinsurers reported \$6.68 billion in net premiums written for the first quarter, an 18.7% increase over the comparable period in 2000. Including the non-U.S. affiliate operations brings the 2001 first-quarter total up to \$6.92 billion, the RAA said. The entire group of reinsurers tracked by the RAA reported \$555.9 million in net income for the first quarter, while policyholder surplus totaled \$25.33 billion. For the first quarter of 2000, a comparable group of reinsurers reported net income of \$269.1 million and policyholder surplus of \$23.69 billion.

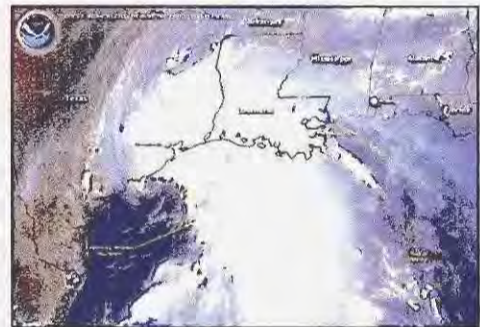


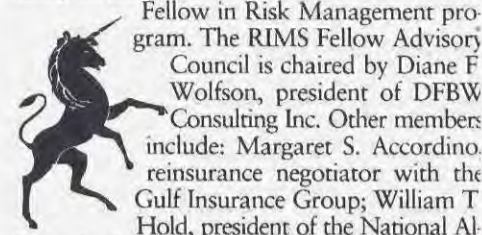
PHOTO: OSHA

► **Tropical storm Allison was the first named storm of the 2001 Atlantic storm season.**

► **MORE HURRICANES FORECAST** The Atlantic and Gulf coasts may be in for a more active hurricane season than initially predicted, one of the nation's best-known hurricane forecasters says. In a forecast released last week, William Gray, a professor of atmospheric science at Colorado State University, and his team increased their estimate of the number of named tropical storms likely to form during this hurricane season to 12 from the 10 projected in April. Seven of those storms will grow into hurricanes, according to the researchers, who had predicted six hurricanes in April. The team set the probability of landfall somewhere on the U.S. coastline during this hurricane season—which began June 1 and runs through Nov. 30—at 69%. The average for the last century is 52%. For the East Coast, including peninsular Florida, the team set the probability of landfall in 2001 at 50%, well above the last century's average of 31%. The Gulf Coast from the Florida Panhandle to Brownsville, Texas, also faces an above-average likelihood of a hurricane making landfall—39%, compared to last century's 30% average. "Information obtained through May indicates that the 2001 Atlantic hurricane season will likely be above average though not so busy as the 1995, 1996, 1998, 1999 and 2000 hurricane seasons. However, the 2001 season should be considerably more active than the average for the hurricane seasons during the recently ended" period of low activity that lasted from 1970 through 1994, according to the team. Among the reasons for this year's above-

average activity are the anticipated development of a weak El Niño this summer and above-average rainfall in Africa, according to the researchers.

► **RIMS FELLOW ADVISORS** The Risk & Insurance Management Society Inc. has created an advisory council to guide the development and administration of its RIMS Fellow program, the recently revised and renamed version of the former



Fellow in Risk Management program. The RIMS Fellow Advisory Council is chaired by Diane F. Wolfson, president of DFBW Consulting Inc. Other members include: Margaret S. Accordino, reinsurance negotiator with the Gulf Insurance Group; William T. Hold, president of the National Alliance for Insurance Education & Research; and Daniel H. Kugler, director of risk management at Snap-On Inc. Also on the panel are: Debra L. Rodgers, director-risk management at Saint-Gobain Corp.; John F. Roskopf, senior director at Aon University; Heather A. Zomar, manager of the risk and health division of the city of Surrey, British Columbia; and Lance J. Ewing, senior director-risk management at GES Expositor Services Inc. The newly named RIMS Fellow program replaces the FRM designation requirement of three college-level elective courses with attendance at six two-day RIMS workshops, among other changes. The RIMS Fellow Advisory Council will identify and recommend workshop topics, provide input on their content and establish guidelines for non-RIMS risk management programs that qualify for RIMS continuing education credits and workshop equivalencies.

► **BRIEFLY NOTED** Element Re, a unit of XI Capital Ltd. in Bermuda, will provide Dallas-based Atmos Energy Corp. with a policy insuring the gas distributor against revenue losses caused by warmer-than-normal winter temperatures in several U.S. cities. The policy, placed by Aon Risk Capital Products, has an aggregate limit of \$60 million....Waltham, Mass.-based Private Healthcare Systems Inc. has received certification from the National Committee for Quality Assurance for its medical management services. PHCS, a nationwide PPO network has more than 6.5 million enrollees....Seven insurance industry trade groups want state regulators to improve the way they conduct statutory financial examinations for monitoring insurer solvency. In a white paper, "A Call for Change," the associations' recommendation include more training for state exam staff, standardization of methods for conducting such exams and greater cost control of the exams. The seven groups are the Alliance of American Insurers, the American Council of Life Insurers, the American Insurance Assn., the National Alliance of Life Cos., the National Assn. of Independent Insurers, the National Assn. of Mutual Insurance Cos. and the Reinsurance Assn. of America....Less than a year after its IPO, Watson Wyatt & Co. and its employees said they will sell nearly 3 million additional shares of company stock to the public. In a registration statement filed with the Securities and Exchange Commission, Watson Wyatt said it will issue 104,285 shares, while employee shareholders will sell 2,845,715 shares. Washington-based Watson Wyatt said it expects the net proceeds from the sale of its newly issued shares to be about \$1.7 million, which it will use for general corporate purposes. The price of the shares which are listed on the New York Stock Exchange, has climbed about 57%—to \$22 per share—since the October IPO. About 73% of Watson Wyatt stock is held by employees; after the secondary offering is complete, employees will hold about two-thirds of the shares. **E**

► **To get breaking news as it occurs, visit Business Insurance's free online Updates at [www.businessinsurance.com](http://www.businessinsurance.com). All of the material in the Updates column as well as other content in this week's issue, is generated from daily news postings that appeared on the Web site in the previous week.**

# Pension reform allows bigger inflation boost

By JERRY GEISEL

WASHINGTON—When it comes to the maximum benefits that employers can provide through pension plans, the improved fiscal health of the federal government is making a huge difference.

President Bush last week signed into law a tax-cut package that will significantly increase maximum pension benefits and contributions, as well as liberalize how future benefit and contribution increases will be calculated (*BI*, June 4).

For example, under the new tax law, known as the Economic Growth and Tax Relief Reconciliation Act of 2001, the maximum annual per-employee con-

tribution to a defined contribution plan next year will rise to \$40,000 from \$35,000.

In addition, that \$40,000 limit will increase in \$1,000 increments, rounded down to the nearest \$1,000, to match increases in the Consumer Price Index. For example, if the CPI increases 5% next year, the 2003 maximum contribution limit would be \$42,000.

That is a big change from the old law—passed in 1994—that permitted the annual contribution limit to increase only in \$5,000 increments, rounded down to the nearest \$5,000. If, for example, inflation produced a \$7,000 increase in the maximum contribution limit, after rounding the actual permitted

increase only would be \$5,000.

The inflation trigger is cumulative; if not large enough in one year to trigger an increase, it would be added to succeeding years until it is of sufficient size.

Lowering the trigger for inflation adjustments will mean maximum contribution limits will rise faster compared to increases under current law.

Similarly, the new law liberalizes the indexing methodology for determining how much employee salary can be included in calculating pension benefits and contributions.

Under the old law, the first \$170,000 of an employee's salary was included in determining pension benefits and

See **Pensions** on page 30

# Cap on 'front pay' rejected

Bias claimant can seek higher amount for future lost wages

By MARK A. HOFMANN

WASHINGTON—A unanimous U.S. Supreme Court decision that 1991 amendments to the Civil Rights Act of 1964 do not cap so-called "front pay" in employment discrimination cases—though disappointing to employers—may have a relatively limited impact.

That's because a number of federal appeals courts have already held that the Civil Rights Act's \$300,000 cap on compensatory damages does not apply to front pay, which are basically future lost wages.

While employers would have preferred that the Supreme Court more broadly apply the cap in its June 4 decision in

*Sharon B. Pollard vs. E.I. du Pont de Nemours & Co.*, "it's not a major blow in one sense," because of the actions of several lower courts, said Stephen A. Bokart, executive vp of the National Chamber Litigation Center Inc., in Washington. The center handles litigation for the U.S. Chamber of Commerce and filed a brief in this case in support of DuPont.

DuPont had argued that the front pay amounted to compensatory damages under the amended Civil Rights Act. The 1991 amendments capped such damages at \$300,000.

Sharon Pollard claimed she was fired after refusing to return to a hostile work environment in which she would be subject to sexual harassment

that DuPont allegedly failed to correct. She sought \$800,000 in damages, of which nearly half was for front pay. She argued that front pay was not compensatory damages, but instead replaced reinstatement as a form of equitable relief "in situations in which reinstatement would be inappropriate."

A U.S. District Court held that Ms. Pollard, who had worked at a DuPont plant in Tennessee, had been the victim of sexual harassment and awarded her more than \$107,000 in back pay and benefits and \$300,000 in compensatory damages, subject to the cap on front pay. In its decision, though, the District Court called the \$300,000 "insufficient to compensate" Ms. Pollard.

A three-judge panel of the 6th

See **Front pay** on page 30



# Rates hikes symptomatic

By MICHAEL PRINCE

Faced with skyrocketing losses, medical malpractice insurers are pushing through rate increases not seen in years.

At renewals, insurers are increasing rates for medical malpractice liability coverage from 30% to 100% and raising policyholders' retentions in an effort to restore underwriting profitability.

Those moves follow deteriorating underwriting results and rising combined ratios on the line, which have been caused largely by soaring jury verdicts against hospitals and doctors and insurers' inability to raise rates during the competitive soft market, insurers say.

"The marketplace is going through a lot of change right now," said Judy Hart, vp and marketing leader at GE Employers Reinsurance Corp. in Overland Park, Kan., which writes medical malpractice coverage on a primary basis for doctors and dentists, and on an excess basis for hospitals.

This year will see ERC making its largest rate hikes in a decade for medical malpractice coverage, after experiencing some of its worst underwriting results on the line in 2000 since the mid-1970s, she said.

"There is a general level of concern with the entire health care (insurance) market," noted

## Med mal trends

U.S. medical malpractice insurance performance

Year	Net premiums written <sup>1</sup>	Combined ratio <sup>2</sup>
1990	\$4,014,622,000	101.9%
1991	\$4,067,803,000	99.0%
1992	\$4,133,567,000	123.4%
1993	\$4,370,812,000	104.5%
1994	\$4,780,537,000	94.2%
1995	\$4,800,552,000	96.4%
1996	\$4,875,486,000	102.6%
1997	\$4,892,496,000	103.5%
1998	\$5,145,066,000	111.9%
1999	\$5,104,147,000	125.8%

<sup>1</sup> After reinsurance transactions, excluding state funds.

<sup>2</sup> Before dividends to policyholders.

Source: A.M. Best Co.

Michael Ragan, a vp with CNA Financial Corp. in Chicago.

The St. Paul Cos. Inc., the largest writer of medical malpractice insurance in the United States, is

See **Malpractice** on page 29

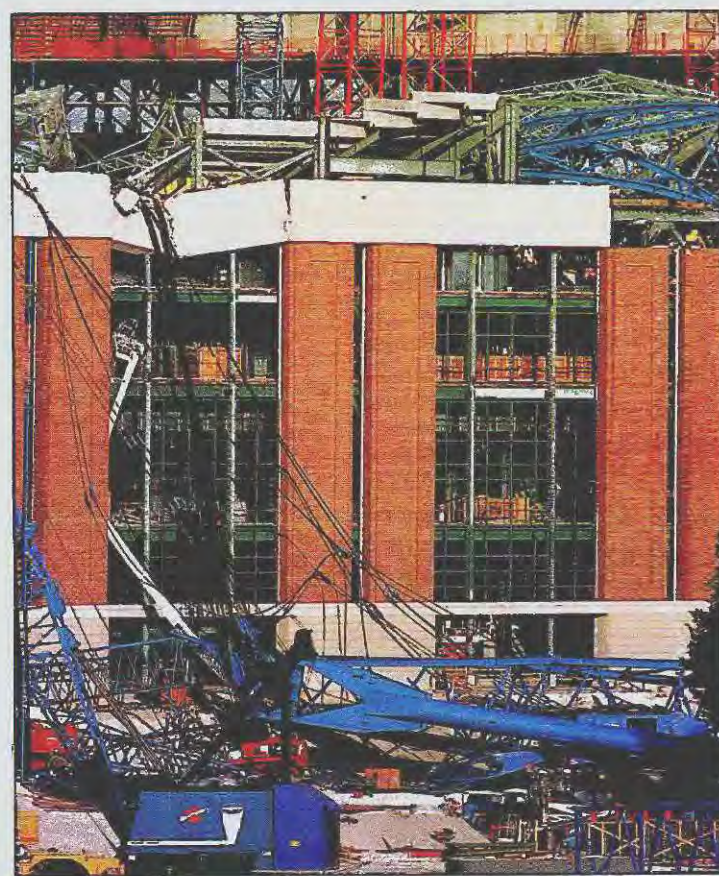


PHOTO: RELTERS

The 1999 collapse of a crane during the construction of Milwaukee's new stadium killed three and delayed its opening by a year.

## Avoiding operator error

# Crane risks demand better training

By JOANNE WOJCIK

KEYSTONE, Colo.—Cranes are the most critical, expensive and dangerous pieces of equipment used in construction, yet few operators are trained and certified to use them, according to a construction safety expert.

And a surprising number of crane operators can't even read the manufacturers' load charts that specify the maximum weight a crane can lift, said Dale Daul, risk control consultant in the construction division of St. Paul Insurance Co. in Minneapolis.

"From a loss control standpoint, the crane is the most dangerous piece of equipment" on a construction site, Mr. Daul told insurance underwriters attending the 71st annual meeting of the Inland Marine Underwriters Assn., held June 2-5 in Keystone, Colo.

"You're lucky if you don't kill somebody," he said, adding that crane accidents affect all lines of coverage—property, general liability and workers compensation.

Crane accidents cause the most-severe construction losses, he said, pointing to the July 14, 1999, accident at Miller Stadium in Milwaukee, Wis., that killed three, caused more than \$100 million in property damage and delayed the stadium opening for nearly a year.

Despite the danger, only a handful of states require

crane operators to be trained and tested, Mr. Daul said. And the Occupational Safety and Health Administration's requirements for crane operators haven't been updated since 1968, before the introduction of computerized cabs that are even more difficult to operate.

"A lot of the older operators have learned to operate cranes by this," he said, slapping the seat of his pants. "Yet the guy that cuts my hair has a license. Isn't that scary?"

Because of the lack of licensing or certification requirements for crane operators, Mr. Daul recommends that underwriters who provide insurance on cranes require that their operators complete a voluntary program developed by the National Commission for the Certification of Crane Operators.

The Fairfax, Va.-based commission is an independent nonprofit corporation formed in 1995 to develop effective performance standards for safe crane operation.

The Certified Crane Operator examinations, introduced in 1996, are competency-based exams reflective of crane operator knowledge and expertise. The written examination program consists of a core exam in crane operation as well as four crane specialty examinations.

See **Cranes** on page 28

# USG says Chapter 11 among options to cut liability

By DOUGLAS McLEOD

CHICAGO—A rising number of asbestos claims is forcing building products maker USG Corp. to consider "strategic alternatives," including a possible Chapter 11 bankruptcy filing, the company announced.

Bankruptcy filings by several other large asbestos defendants over the last 18 months have made USG a bigger target for plaintiffs' lawyers unable to sue other companies that are under Chapter 11 protection, USG said.

"Plaintiffs' lawyers have sharply increased their settlement demands to (non-bankrupt) de-

fendants, including USG's subsidiary, U.S. Gypsum," a maker of wallboard and other materials, Chicago-based USG announced.

"We have repeatedly said we cannot shoulder the liability of other companies," William C. Foote, USG's chairman, president and chief executive officer, said in a statement. "We are examining every alternative that will stop the value drain that is occurring as we are forced to pay more than our fair share of the liability."

Those alternatives include arranging new bank financing and a possible Chapter 11 filing, the company confirmed.

USG's asbestos injury costs, ex-

cluding insurance recoveries, will grow to an estimated \$275 million this year from \$162 million in 2000 and \$100 million in 1999, according to the company's Securities and Exchange Commission filings.

Insurers today are bearing only a fraction of this burden: USG has exhausted all but \$81 million of its liability limits available for asbestos losses, and the company's insurers will reimburse only about \$37 million of this year's expected \$275 million in costs. This translates to a net cost to USG of \$238 million, substantially higher than the \$62 million net cost USG bore in 2000, its SEC filings report.

Its approach to asbestos claims management has also changed with the new flood of claims. As settlement demands have risen, USG "has recently begun to attempt to manage its asbestos liability by contesting, rather than settling, a greater number of cases that it believes to be non-meritorious," the company reported in its first-quarter 10-Q filing. "As a result, in the first quarter of 2001, U.S. Gypsum agreed to settle fewer personal injury cases, although at a significantly higher cost per case, than it has in the past."

U.S. Gypsum was a defendant in 96,000 pending personal injury cases as of March 31 and had

agreed to settle another 54,000 cases that will be closed over time, the company reported. It received 13,000 new personal injury claims in the first quarter, up from 12,000 in the first quarter of 2000, and was named in 53,000 new claims last year, up from 48,000 claims in 1999, according to SEC filings.

The new claims, meanwhile, are coming as several of USG's frequent co-defendants have shielded themselves from the litigation by filing for Chapter 11 protection.

Asbestos defendants that have filed for bankruptcy since January 2000 include Armstrong World Industries Inc., Owens Corning, Pittsburgh Corning Corp., Babcock & Wilcox Co., W.R. Grace & Co. and a successor corporation to GAF Corp.

"The impact of the recent bankruptcies on U.S. Gypsum's average settlement costs in early 2001 has been significant and U.S. Gypsum has become one of the primary target defendants in the asbestos litigation generally," the company said.

"We continue to believe that appropriate legislation would provide the best solution to the asbestos problem," Mr. Foote added in his statement. "We are making progress on the legislative front, but the process is not moving as quickly as we hoped."

U.S. Gypsum began selling asbestos-containing products in the 1930s, but had discontinued those products or removed asbestos from their formulas by 1972, according to the company.

Last year, Berkshire Hathaway Inc. bought a 14.98% stake in USG as part of a series of acquisitions in the building products industry. **BI**

## EBC Awards deadline approaches

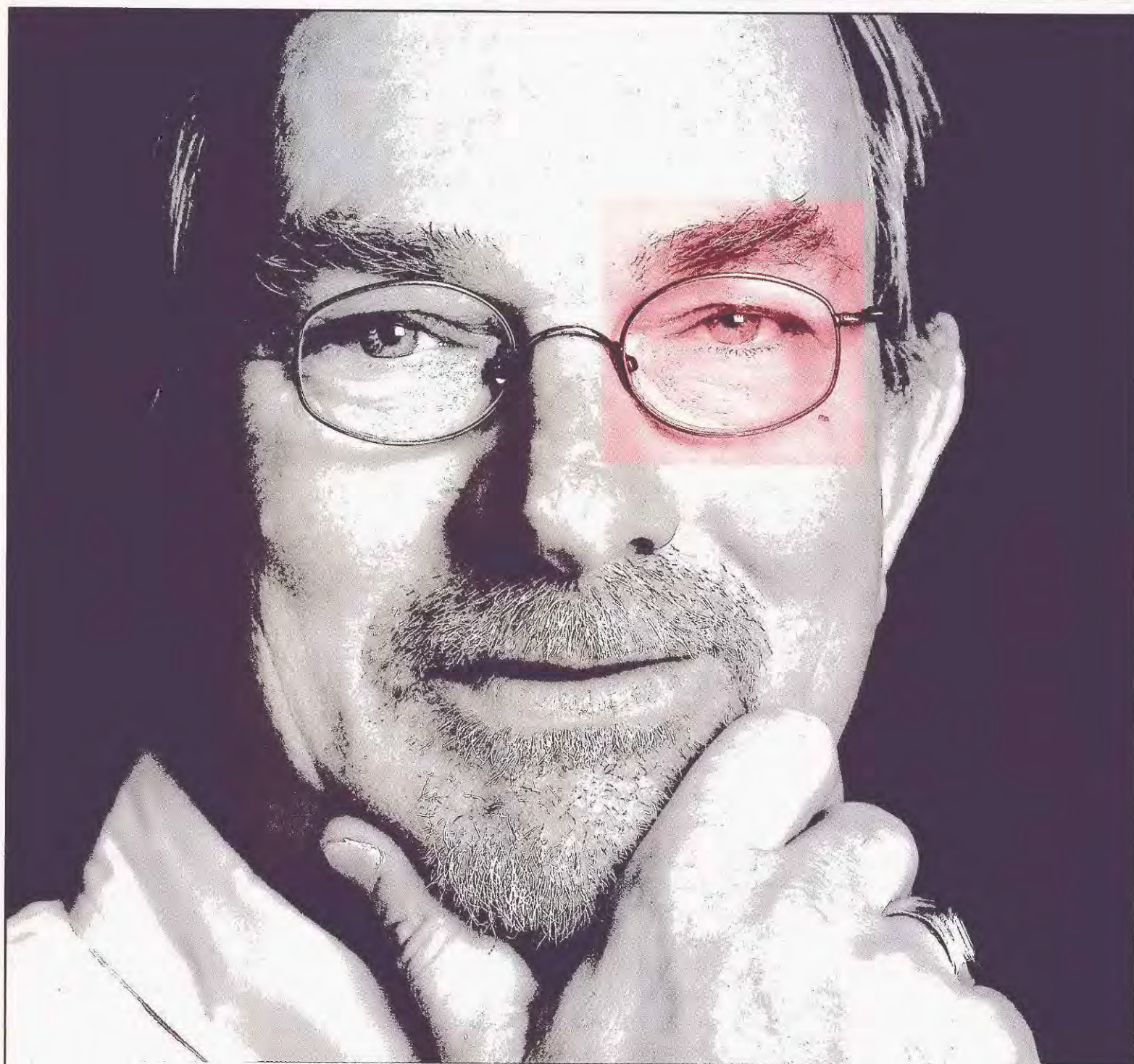
NEW YORK—The deadline for entries in *Business Insurance's* 29th Annual Employee Benefits Communication Awards competition is approaching.

The EBC Awards acknowledge excellence in communicating employee benefit programs. All companies in the United States and Canada are eligible to enter their own benefit communications programs. There are no restrictions as to the size of company or cost involved in the preparation of the program.

Employee benefit consulting firms are also invited to submit programs on behalf of their clients. Winners will be announced in the Nov. 19 issue of *Business Insurance* and honored at a Nov. 19 luncheon at The Grand Hyatt in New York.

The deadline for completed entries is June 29.

Entry forms and rules for the competition can be printed from the BI Events section of the *Business Insurance* Web site, at [http://businessinsurance.com/bi\\_services/bi\\_events.php3](http://businessinsurance.com/bi_services/bi_events.php3), or can be obtained by calling Barbara O'Brien, Promotion Manager, at 212-210-0780. **BI**



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What can we do to help you?

# Keeping heat hazards from rising

By MEG FLETCHER

As summer temperatures soar, risk managers may need to refresh their knowledge about the hazards created by workers' exposure to excessive heat as well as techniques to prevent illnesses and treat them if they occur.

"I believe all industries with workers exposed to heat...have, or should have, a plan in place to educate and, if necessary, respond to heat stress injuries," said Billie Fae Fuschi, director of workers' compensation for Methodist Healthcare in Memphis, Tenn.

Methodist Healthcare hospi-

tals, for example, provide warning posters and bulletins for groundskeepers, incinerator operators, laundry and kitchen workers to increase their awareness of the symptoms of excessive heat exposure, said Ms. Fuschi, who also chairs the Risk & Insurance Management Society Inc.'s External Affairs Team. In addition, should a worker become overheated, he or she has ready access to a hospital emergency room, she added.

Symptoms of excessive heat exposure initially include dehydration and cramps. If a worker's condition progresses to heat exhaustion, he or she may have a

headache and feel tired and nauseous as well as giddy. If the warning signs are not caught in time, a worker may suffer heat stroke, which includes symptoms of hot dry skin and a high temperature. A worker may also suffer convulsions, lose consciousness and ultimately die, unless prompt medical attention is sought by a supervisor or co-worker.

"Working in hot environments can be dangerous," the Occupational Safety and Health Administration warns employers in a recent statement. The combination of heat, humidity and physical labor can lead to summertime

fatalities, especially in construction-related industries, as well as year-round deaths in hot indoor environments such as foundries and bakeries, the federal safety agency stated.

"In 1999, 34 workers died and 2,420 others experienced heat-related occupational injuries and illnesses serious enough to miss work," OSHA reports.

To help prevent heat stress-related illnesses and deaths, OSHA has developed a laminated warning card in English and Spanish that is available free to employers intending to distribute them to their workers. It provides quick reference about heat-related injuries, including warning signs and prevention tips, which include:

- Encourage workers to drink plenty of water, about one cup of cool water every 15 to 20 minutes even if they are not thirsty, and to avoid alcohol, coffee, tea and caffeinated soft drinks that dehydrate the body.

- Help workers adjust to the heat by assigning a lighter workload and longer rest periods for the first five to seven days of intense heat.

- Encourage workers to wear lightweight, light-colored, loose-fitting clothing.

- Use general ventilation and spot cooling at points of high heat production.

- Train supervisors and first-aid workers to recognize and treat the signs of heat stress and be sure all workers know who has been trained to provide aid. Permit workers to interrupt their work if they become extremely uncomfortable.

Employers use a variety of systems for monitoring heat levels, which vary in sophistication.

One OSHA approach factors in humidity as well as temperature (see chart).

Another, more technical approach is used by Minnesota's OSHA-qualified safety program, as well as some branches of the U.S. military.

Minnesota's is the only OSHA-qualified state program that has a heat stress rule, but it applies only to indoor workplaces, said Bill Marquardt, a Lapeer, Mich.-based health and safety specialist for the American Federation of State, County & Municipal Employees. About 250,000 of the union's 1.3 million members nationwide face heat-related exposures in such jobs as highway and park maintenance as well as prison bakeries and laundries.

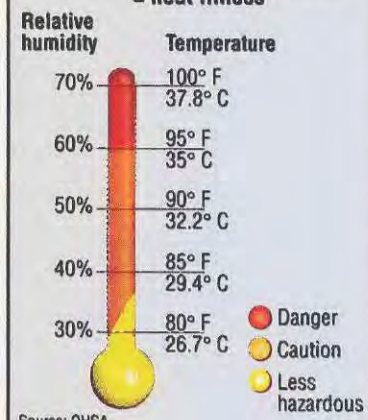
The Minnesota OSHA rules use a "wet-bulb globe temperature index" that measures the combined effect of air temperature, air speed, humidity and radiation as well as the difficulty of the work being performed.

Specialized equipment is available to provide these analyses.

For a copy of OSHA's Heat Stress Card in English or Spanish, visit OSHA's Web site, [www.osha.gov](http://www.osha.gov), and follow the link for Newsroom and then Publications. Fill out the order form online or fax your request to Publications at 202-693-2498. You can also call 202-698-1888.

## The heat equation

High temperature + high humidity + physical work = heat illness



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## OPINIONS

# Tax stance long overdue

U.S. COMPANIES HAVE WON a significant victory in their battle with the Internal Revenue Service to deduct premiums paid to captive insurer subsidiaries, but that does not mean they are free from tax scrutiny.

That is because, while it may have abandoned its rigid and unpopular opposition to insuring risks with a related entity, the IRS will continue to scrutinize captive insurers to make sure they are valid risk transfer mechanisms. The agency will be seeking, in particular, to ensure that captives are adequately capitalized and are underwriting professionally.

We expect that most captives will pass muster. For those that cannot, the IRS's new stance should serve as notice to companies to get their captives into shape, so that they can be used as intended without being mired in tax-related fights with the IRS.

While companies, insurance regulators and the courts have long regarded captives as valid risk financing mechanisms, the federal tax agency has more often viewed them with mistrust. In fact, it has labeled many valid captive arrangements as shams designed to obtain deductions for premiums and to shift income to offshore

tax havens.

Now, perhaps, that prejudiced—and unjustified—view is changing.

As we report on page 1, the IRS, in a ruling last week, dropped its long-standing position that premiums paid to captives are not deductible under the so-called "economic family" theory. That ruling is an overdue regulatory recognition of a position that has already been decided by the courts.

The ruling reverses the economic family stance the IRS first adopted 24 years ago. In 1977, the IRS took the position that, in the case of related-party risks, if such risks are insured or reinsured by a related insurance company—one in the same economic family—the premiums involved cannot be deducted from federal taxes, because risk has not shifted from the policyholder to the insurer.

Since 1977, though, several courts have ruled on the tax deductibility of premiums in captive cases, basing their rulings on a variety of other tests, such as balance sheet tests.

"No court, in addressing a captive insurance transaction, has fully accepted the economic family theory," the



IRS ruling notes.

We're glad to see the IRS finally recognizes that fact. We think the decision was long overdue, but at least risk managers now can benefit from that stance as the insurance market hardens and captives become a more attractive risk financing option.

## LETTERS

## Article overstated downsides of arbitration agreements

To the editor: Gerald Maatman gives a very thorough analysis of the current state of binding arbitration agreements in employment (*BI*, April 16). He also provides some benefits and liabilities created by an employer using them. It is my understanding that there are some issues within these that need a little clarification.

His advantages are OK as written, but I would add several more. One is that rulings in arbitration cannot be cited as precedent. This is a two-edged sword in that bad rulings are not applied but neither are good rulings. Another advantage is the discouragement binding arbitration places on the plaintiff bar. Where binding arbitration exists, most plaintiff firms will proceed with only the very best cases. This will have a meaningful effect on litigation costs and expenses. These savings will apply to the defense side as well. The employer and employee both win because expenses are lowered.

The disadvantages listed may be somewhat overstated. Mr.

Maatman says arbitration leads to claim proliferation. I would require empirical evidence to support that notion before accepting it. Given the retardant effect binding arbitration has on the plaintiff bar filing spurious actions, it would hardly seem possible that the number of incidents would rise. If they do, the problem is not related to arbitration. Instead, it is a risk management/employment relations problem, and very likely, the incident reports are nothing more than a symptom of a much deeper causal problem within the organization.

Mr. Maatman lists as his second disadvantage that arbitration proceedings play loose with the rules, such as statutes of limitation. How he can say or imply that the courts are more consistent is beyond belief. Simply look at the lawsuits now clogging our courts, from lead paint to secondhand smoke, and there simply is no basis for listing this as a disadvantage. The rules of evidence are more relaxed in an arbitration proceeding. The idea is to promote an equitable settlement for both

sides. Courts are restrained in this. The idea of binding arbitration is equity, not tort. This is an advantage, not a disadvantage, of binding arbitration.

I also respectfully disagree that class actions will be brought as a result of binding arbitration. Since each case is sealed, it will be more difficult to allege a class action. Again, I would like more than hearsay offered as evidence to support this proposition. As for the Equal Employment Opportunity Commission, the problems Mr. Maatman outlines are present, but they are also present in the absence of binding arbitration. Binding arbitration neither creates nor accentuates the problem.

Finally, I can understand the concerns all practicing attorneys have about employment binding arbitration. It will reduce their income. Is this bad?

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## SPOTLIGHT

# Market conditions putting squeeze on public entities

By ROBERTO CENICEROS

It has grown significantly harder for public entities renewing their coverage to escape sizable rate increases and tougher underwriting standards, say risk managers, brokers and insurers.

In response, buyers are increasing their deductibles, purchasing lower limits, or considering market alternatives such as purchasing pools, these market observers say.

"The hard market is truly here in spades," said Lewis Leigh, executive director of the Washington Cities Insurance Authority, a purchasing pool based in Renton, Wash. "Over-

all, property is much worse than liability; you can't protect yourself as well."

Liability rates are up, but property insurance is the hardest-hit line, especially in catastrophe-prone areas, other risk managers, insurers, and brokers agree.

Take, for example, the city of Anaheim, Calif. Despite a good loss history and participation in a joint purchasing arrangement, the city this year would have seen a 100% premium increase had it purchased the same limits it bought a year ago on an all-risk property policy with difference-in-conditions coverage for earthquake damage.

And even though all its buildings

are either new or retrofitted to modern earthquake standards and engineered to "highly protected risk" standards, the city also would have received less-favorable terms and conditions than under its policy that expired in May, said Tom Vance, risk manager for Anaheim. So, instead, the city dropped its earthquake limits from \$80 million to \$12.5 million to cover more than \$500 million in property values.

"It's abysmal," Mr. Vance said. "We're a good account, and yet we are seeing big increases. It's just the market."

Earthquake insurance availability difficulties have particular significance for Mr. Vance. He helped the

Federal Emergency Management Agency develop rules about two years ago that would have required public entities to purchase property insurance in order to qualify for disaster assistance (*BI*, June 21, 1999). Opponents, particularly in California, helped scuttle such measures. They argued that it would be an impossible mandate to meet in a hard market for earthquake coverage.

"This is exactly what the groundswell of opposition against FEMA rules and regulations was all about in California—market conditions like this," Mr. Vance said.

Property pricing is also up in areas that are not prone to catastrophes, although not as severely, insurers re-

port. Accounts are seeing rate increases that are averaging 10% to 20%, while casualty prices are up 5% to 15%, said Bill Rhode, vp of The St. Paul Cos. public sector services in St. Paul, Minn.

"In our particular case, we certainly are taking a stronger stand in our property pricing than in our casualty (pricing)," Mr. Rhode said.

Insurers, brokers and risk managers attribute rising rates, in part, to a contraction of insurers that underwrite public entity business. Reliance Insurance Co., for example, is no longer a market player, and in January The St. Paul Cos. purchased the municipality book of

See **Market** on page 14

## PRIMA names new president

Debra Carson foresees improved ties with members, industry

By MICHAEL BRADFORD

Debra Carson wants to build on the intimate relationship that the Public Risk Management Assn. has with its members and to forge closer ties with other organizations as she assumes the top post at the association.

Ms. Carson, who will become PRIMA's president at the group's annual meeting this week in Chicago, said her upcoming term will find her working on those and other goals. She succeeds Dan Pliska, who is ending his one-year term.

Ms. Carson, who is risk manager for the city of Longmont, Colo., said her relationship with PRIMA "has been built on membership intimacy. I've had a strong alliance with PRIMA and a long-term relationship. They have fulfilled my needs as a public risk manager."

The organization, she said, "is the very best resource for a public risk manager—I want to continue to build on that."

Arlington, Va.-based PRIMA has a responsibility to continue offering cutting-edge products and programs to its members, Ms. Carson emphasized. "There's a huge membership focus," that concentrates on developing top-notch educational offerings and services and helping public entity risk managers develop needed skills.

One way PRIMA can meet its goal of providing new and worthwhile tools is to partner with other groups, Ms. Carson said. Educational offerings are being developed in conjunction with the Public Entity Risk Institute, the Risk & Insurance Management Society Inc. and other risk management groups, she said.

Ms. Carson said she would like to see PRIMA partner with organizations like the Insurance Institute of America, which has begun offering a version of its Associate in Risk Management designation to public entity risk managers.

"We're building stronger relationships internationally," she pointed out. "We're recognizing that the world is getting so much smaller. Global risk management is so



PHOTO: ART PAOLINI

Ms. Carson

important to us. We're learning from each other." Public entity risk managers "are doing things faster and better in some areas than we are, and we are doing it faster and better in other areas," she said.

PRIMA is sharing information with the Assn. of Local Authority Risk Managers in the United Kingdom and the Sydney, Australia-based Assn. of Risk & Insurance Managers of Australasia.

The relationships are yielding insights, such as one gained from Devon, England-based ALARM regarding

See **PRIMA** on page 14

## Government Risk Management

Civil rights exposures becoming a concern

page 18

Spotlight Editor: Dave Lenckus

# More school districts confronting campus violence

By DAVE LENCKUS

On a late spring morning, David S. Brewer's son gathered his books from a table in his high school cafeteria, where he had been hanging out for a while before heading to his first class of the day. Minutes after he left, Kipland P. Kinkel burst into the cafeteria and opened fire on the remaining students, killing two and wounding about two dozen more.

The tragedy at Thurston High School in Springfield, Ore., three years ago was ironic as well as frightening and sad for Mr. Brewer,

whose son was not injured in the shooting.

For at least four years prior to the shooting, Mr. Brewer, risk manager for the neighboring Eugene, Ore., School District, had been developing an anti-violence program for the district's 18,000 students. Thurston High School is not part of the 40-school system in Eugene. But shortly before the shooting, officials at the high school had obtained a copy of the anti-violence program that Mr. Brewer developed.

As in Eugene, many school officials nationwide for years have been concerned about the potential of violence erupting on their campuses

and have looked for ways to prevent it from occurring.

A plethora of organizations has studied the problem and developed programs to combat it. Many of these organizations have sites on the World Wide Web that outline anti-violence programs and list the various traits that students with a propensity toward violence may exhibit.

A random group of officials from small schools to sprawling districts say school officials nationwide are tackling the issue. Still, they acknowledge that they and other school officials continue to learn more about the problem—from the

extent of the violence on their campuses to the strengths and weaknesses of their anti-violence programs.

Some anti-violence experts maintain that some school officials have much work ahead of them, including accepting the notion that such a tragedy could occur on their campuses.

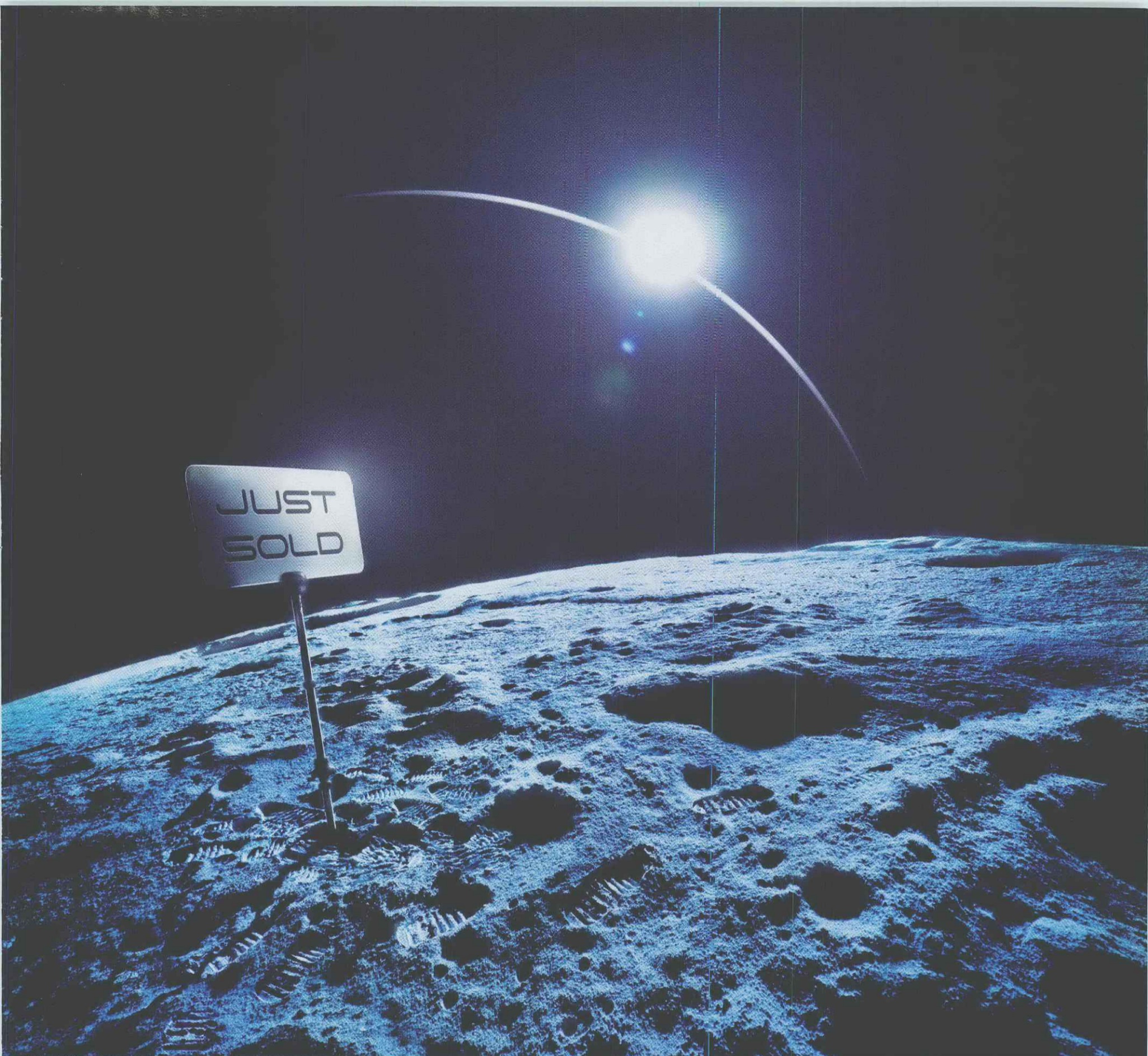
"I have yet to go to a school system with adequate policies, training and guidelines in place to handle a crisis," said David L. Salmon, president and a law enforcement adviser/risk manager with consultant Operational Support Services Inc. of Spring, Texas.

"They're not focused on prevention. They're focused on containment after it occurs," Mr. Salmon said.

Other experts say that the responses by schools vary considerably.

"I hear of some schools doing a lot, and I've heard of others that don't acknowledge the problem," said Tonja Nansel, a postdoctoral fellow at the National Institute of Child Health and Human Development, which is part of the U.S. Department of Health and Human Services.

From 1992 through mid-May  
See **Schools** on page 16



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## SPOTLIGHT

## Market

Continued from page 10  
business formerly administered by PENCO from Willis North America Inc. Previously, The Hartford Financial Services Group Inc. underwrote the municipality business for the Nashville, Tenn.-based administrator.

Reinsurer and insurer demands for improved profitability also are factors in the increased rates, market observers say.

Schools are likely to find renewals even tougher than municipalities, because there are fewer insurers interested in writing that business, brokers and insurers agree.

As for liability insurance, monoline policies for coverages such as public officials liability and educators legal liability are drying up, said Daniel Cullen, Detroit-based vp of Marsh Inc.'s public entity group. Even when purchased as part of a package, rates are going up and limits are coming down for public officials liability coverage, depending on the entity's loss history and just how aggressive an underwriter is about winning the account, Mr. Cullen said.

A year ago, property accounts in some regions may have escaped the increased scrutiny of underwriters tightening up their standards, said Gene Levine, manager of custom underwriting for Coregis Insurance

Co. in Chicago.

"I would say now, pretty much everyone is starting to do more-diligent underwriting," Mr. Levine said. Coregis officials would not comment on the average price increases they have seen.

But Mary Breighner, FM Global's operations vp for education and public entities in Cincinnati, said increases of 15% to 20% are common on property coverage for high-quality accounts in noncatastrophe areas. Similar accounts coming off three-year rate guarantees might see increases of 30% increase, she said.

Additionally, insurers are requiring buyers to submit detailed records of their property values and

their property construction standards. In past years, underwriters abandoned those practices. But no longer, several insurers say.

With so many accounts shopping their coverage in search of better rates, underwriters also can favor those providing the greatest detail about their properties, Ms. Breighner said. That means risk managers must now start earlier in preparing their accounts for quote submissions.

One silver lining is an increased attention to risk management practices, Ms. Breighner said. With rising prices, risk managers are increasing their deductibles. With their entities taking on greater risk, risk managers find it easier to get their bosses' support for risk loss prevention practices, she explained.

On average, clients are seeing increases of 10% to 15% for property coverage, with few capacity problems, except in areas such as Florida, where windstorms are a possibility, said Steven A. Ring, managing director of the public entity and scholastic division for Arthur J. Gallagher & Co. in Itasca, Ill. Rates in Florida may be up 30% to 40%, with slight difficulty finding coverage for some small layers of excess coverage.

"It's not a huge problem," Mr. Ring said. "But we are getting stretched more than we have in a long time for getting the capacity filled out." Casualty rates, on average, also are up 10% to 15% without capacity problems, he said.

Risk managers, insurers and brokers all agree that, along with Southeast coastal areas susceptible to hurricane damage and other catastrophe regions, accounts in the Seattle area will now experience greater-than-average increases for property coverage, because of the earthquake that shook the area in March.

Based on reports from meetings with European reinsurers, earthquake coverage rates will increase 100% in the Seattle area, said Mr.

Leigh, the pool manager.

To escape insurer rate increases, more buyers are inquiring about coverage through his pool, Mr. Leigh said.

Brokers and other pool managers say they also are getting more business.

"We are seeing a lot more opportunities to work on accounts where alternative market strategies are what clients are looking for," said Arthur J. Gallagher's Mr. Ring.

With many renewals set for July 1, the number of public entities—schools and municipalities—calling to ask about being added to public entity pools managed by Aon Corp. has quadrupled from a year ago, said Cindy LaMantia, managing director of Aon's public sector alliance in Chicago. The situation is reminiscent of the mid-1980s, when policyholders flocked to pools, Ms. LaMantia said.

"Say, last year we looked at six adds to a program; this year we are looking at 24," she said. "What I find most amazing is quite a bit of it is unsolicited. Although we are marketing, many, many of the entities that are looking are coming to us."

Insurers point out that pools also are facing higher pricing for reinsurance and excess coverage that they eventually will have to pass on to their members.

Pool managers agree. But many public entity pool managers experienced the hard market of the 1980s. Consequently, they have diligently built up their reserves in preparation for such market conditions, said Harold Pumford, chief executive officer in Prague, Okla., for the Assn. of Governmental Risk Pools, which promotes pools.

The pools can use those reserves to increase their retentions while relying on their relations with public sector entities to minimize losses by enforcing stringent risk management practices, he said.

Mr. Pumford said that most pools are prepared to expand their membership. **BI**

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## PRIMA

Continued from page 10  
efficiency audits, according to Ms. Carson. "They are doing efficiency audits of every governmental service; they look at whether or not it is cost-effective," she said of her counterparts in the United Kingdom. "I think that is important for all of us to look at. We do a lot of benchmarking, and that is important from our side. But they are a little ahead of us on the efficiency audits."

In return, PRIMA members can teach U.K. risk managers "a lot about how to deal with public officials liability" and other issues that are emerging in that part of the world, Ms. Carson explained.

PRIMA is attempting to increase the number of its chapters, at a time when the association's membership is evolving, Ms. Carson said. "We're transitioning... We're having a generational change" as younger risk managers come into the profession, she said.

Members have long networked and shared "collective wisdom" at the association's national meeting and during government risk management seminars, Ms. Carson pointed out. "But we have very strong chapters," she noted, and

"we're trying to promote more chapters and provide them with educational tracks" that are relevant to the needs of today's public sector risk managers.

PRIMA's membership is healthy, according to Ms. Carson. The organization has 35 chapters, the same as a year ago.

"I think what people like about PRIMA is the sense of culture," said Mr. Carson. "We are a fairly tight group, and we've been sharing that collective wisdom for many years now."

Ms. Carson said she has plans to make this year's PRIMA conference a little more fun than those in the past. She has come up with a way to get attendees out of the classroom for some hands-on learning.

"Rather than just going to the seminar courses, we're also going to do some educational outings," she explained. "On Tuesday and Wednesday afternoons, there will be some site visits."

Attendees will be taken to locations in the Chicago area to learn how public entities approach certain risks. On the list of places to visit are the Chicago Fire Department Academy, the Chicago Transit Authority's bus and rail control center, O'Hare International Airport's oper-

See PRIMA on page 16

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## SPOTLIGHT

## Schools

Continued from page 10

2001, 240 students and adults were killed in shootings on or near school grounds in the United States, according to statistics compiled by the Westlake, Calif.-based National School Safety Center, a nonprofit organization created by a 1984 presidential directive to promote safe schools. That number includes 56 suicides.

Stabbing deaths ranked second, with 44 students and adults dying from wounds they received at school, according to NSSC statistics.

While no one suggests that any level of violence at schools should be tolerated, various experts point out that the problem has not reached epidemic proportions. They note that the two dozen to four dozen violent deaths at schools nationwide each year over the past decade represent a tiny fraction of the tens of millions of school students nationwide.

"Schools still are the safest place for our children," said school and workplace violence expert Philip D. Burns, president of SyTech Research Inc. of Tulsa, Okla., and the author of "Multiple Victims Multiple Causes." In addition, statistics from the federal departments of Education and Justice indicate that

school violence has decreased in recent years.

Still, many schools are implementing or strengthening their anti-violence programs—with good reason.

At least 236 lawsuits were filed against schools in the past two years over violent incidents, most of them in state courts, according to Mr. Burns. He added that those numbers likely do not reflect many other claims that parochial schools settled quickly.

While about 37 states have laws giving schools total immunity from liability for violent acts, school officials may not enjoy the same protection, said attorney David J. LaBrec, who heads the government-

tal practice group for Strasburger & Price L.L.P. in Dallas. A handful of states provide schools with no immunity from liability, and about a half-dozen states cap schools' liability, he said.

Meanwhile, many states have passed laws requiring schools to develop anti-violence programs, though experts say those laws often give schools a great deal of discretion.

Another significant problem for schools is that, while reported violent acts have been waning, assaults and bullying remain a problem.

Mr. Burns, who often provides free consulting to schools that suffer violent incidents, said his firm's

research shows that a total of 2,000 assaults occur every day in schools nationwide.

And, according to a study the NICHHD released recently, bullying is a "substantial" problem in schools.

But while bullying is one measure of violent behavior, it also encompasses abusive and aggressive behavior that is not necessarily violent, explained the NICHHD's Ms. Nansel, the study's lead author. Therefore, additional analysis of survey data must be completed before researchers can determine whether there is a direct correlation between bullying and the type of school violence that has made national headlines in the past

decade, Ms. Nansel said. That analysis should be completed and published within a year, she said.

Indeed, "there's not one opinion as to the best approach" schools should take to prevent violence, "because no one has been able to define what's causing it," Mr. LaBrec said.

Still, "as a profiled group," school-violence offenders carry out attacks on schools to "punish society for wrongs committed against him or her," Mr. Salmon said. "They're not taking it anymore."

Such anecdotal material is why many of the schools that are addressing the violence problem are devoting at least some of their ef-

Continued on next page

## PRIMA

Continued from page 14

ational command center and other sites.

The outings, Ms. Carson noted, are geared to an "adult learning experience. We're all used to sitting in an office day in and day out, and it will be nice to go out" for a close-up look at risk management techniques in practice.

Like many of her colleagues, Ms. Carson came to public risk management unintentionally. "I had no idea I would end up in risk management," she said.

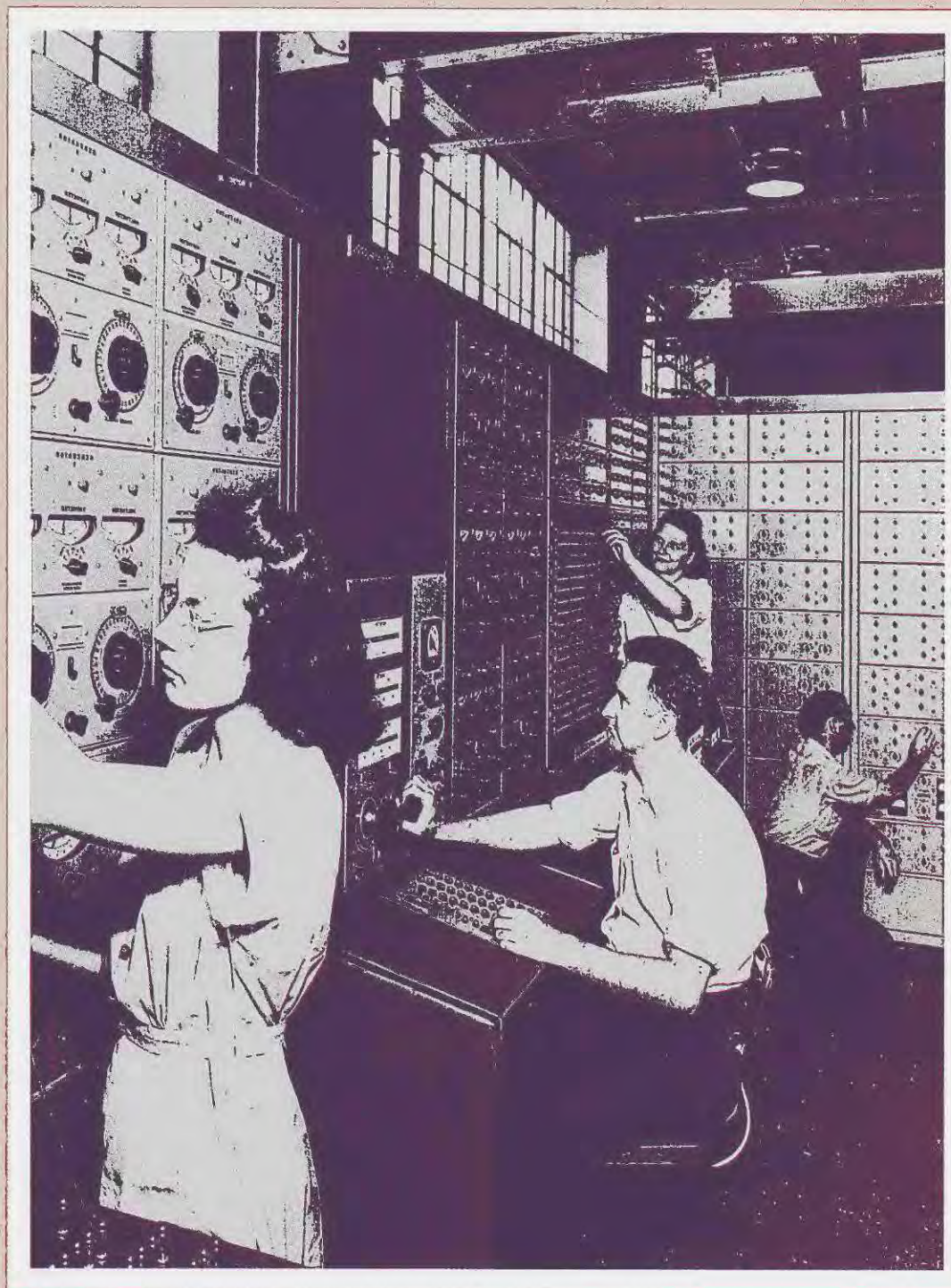
"So many of us have the same story," she said in recalling her career thus far. In the mid-1980s, Ms. Carson worked as an administrative assistant to the treasurer of the University of Colorado. "Risk management came under the treasurer, and I worked my way up."

The job involved a lot of public relations-type work, she said. "The PR and finance I was pretty well prepared for; the safety side was the part I picked up." She was named risk manager for the University of Colorado in the mid-1980s.

Ms. Carson's education includes a bachelor's degree in finance with a minor in economics from Regis University in Denver. With regard to risk management, "I got my education through PRIMA," and through earning the Associate in Risk Management designation, she noted.

Since 1991, she has been risk manager for the city of Longmont.

Her job has taught her that public entity risk management is "a people business," Ms. Carson said. "Your first job is public relations. For the folks you work with—both inside the entity as well as in the community—realize that you are in this for their benefit. This isn't something you do for yourself. It's a job you do on behalf of others." **BI**



*Continued from previous page*  
forts to preventing bullying.

In the Eugene School District, the program Mr. Brewer has developed and now markets to school districts nationwide is multifaceted, but a chief goal is to prevent bullying.

The district has established policies that prohibit threats and assaults and outline the consequences, including expulsion, for violators.

But to prevent the problem from reaching that level, the district has implemented many programs at its elementary schools to help students learn at a young age how to handle conflict with each other constructively as well as to deal appropri-

ately with their own emotional struggles.

The Denver-based Colorado School District Self-Insurance Program began developing programs to combat bullying and various forms of harassment after the April 1999 shooting at Columbine High School near Littleton, Colo., said Cheryle Sullivan, executive director of the pool. More than 300,000 students are enrolled in schools that belong to the pool, including the 90,000 students enrolled in Denver's public schools. Columbine is part of the Jefferson County School District, which does not participate in the pool.

The pool shares the programs with pools in other states, Ms. Sul-

livan said.

Some small schools also are taking preventive steps, even if their anti-bullying or anti-violence programs are not as extensive as those at large schools.

At Redeemer Lutheran School in Tucson, Ariz., for example, principal Patrick Walker began addressing the issue after a parent survey revealed some concerns about verbal intimidation on the school playground.

In February, Mr. Walker brought in anti-violence consultant Daniel J. Heidt, of Caldwell, Idaho-based Preventive Measures, to speak to the elementary school's 105 students about the importance of respecting each other.

In a separate session, the consultant—who also has been a bodyguard for many celebrities—urged parents not to dismiss teasing and bullying as a part of school life. "If you allow that, you endanger everyone," Mr. Heidt said.

Some other schools are not fashioning their own anti-bullying programs; instead, they are turning to a program implemented successfully in Norway during the 1980s and now made available by the Center for the Study and Prevention of Violence at the University of Colorado in Denver.

Norway's Ministry of Education launched the program in primary and junior high schools in 1983 after a newspaper article on the sui-

cides of three young boys subjected to severe bullying triggered a public outcry. A study of program results among 2,500 students in Bergen, Norway, during the mid-1980s showed the program helped reduce bullying by 50%.

According to the CSPV, the multipronged program's basic message is that bullying will not be tolerated and that violators will be disciplined.

But the program also strives to develop for students a school and a home environment characterized by warm, positive involvement by adults. All students must participate in most aspects of the program designed to create a positive school environment by teaching students skills in managing relationships, anger and conflicts.

Liberty Middle School in Ashland, Va., implemented the program in February 2000.

A year before the program began, the school's 1,200 students were reluctant to speak about bullying problems, said Katie Moffett, the school's guidance director. After the school adopted the program, students became far more open in communicating about bullying problems with teachers and even police themselves at times, she said.

The school is formally evaluating the program's effectiveness.

Another step many schools are taking to deter violence is maintaining a campus security force staffed with either local police or private security personnel.

The Eugene School District uses specially trained youth police officers, and schools in the Colorado self-insurance pool use a combination of local police and private security.

Mr. Walker of Redeemer Lutheran School plans to have a local Drug Abuse Resistance Education police officer on campus at least once a week during the next school year to conduct anti-drug-abuse classes and to help supervise the playground. Mr. Walker said he also hopes the police presence will make children feel more comfortable about talking to adults and the officers about their problems.

Mr. Salmon cautioned schools that they cannot legally transfer their supervisory and disciplinary authority to the local police who patrol school grounds. Schools can transfer that authority to security officers, though, because the officers, unlike local police, are school employees, he said.

Many schools are not stopping at trying to prevent crises from developing. Those schools also have developed detailed plans about how to react to incidents of violence.

Under the Eugene School District's program, a school would respond, depending on the situation, with:

- A directed evacuation of all students from the school.
- The directed movement of some students and staff to a safer interior location if their original location and the school's campus were to become unsafe.
- A lockdown, from one classroom to the entire school, to keep danger outside.
- A room clearing, in which the students would leave the room for a predetermined location but the teacher would remain to handle the crisis.

See **Schools** on next page

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## SPOTLIGHT

## Schools

Continued from previous page

The Colorado School District Self-Insurance Program also has developed an emergency management plan with evacuation and classroom lockdown procedures.

Messrs. Burns and Salmon, the school violence consultants, noted that many schools make the mistake of never practicing their crisis management plans.

McKay High School in Salem, Ore., and police and fire units from the city and nearby jurisdictions conducted a crisis drill in early May, and it demonstrated some of the weaknesses as well as the strengths of the crisis response plan, said Harold Burke-Sivers, security coordinator for the Salem-Keizer School District.

For example, the school has to figure out how to account better for all of its 1,900 students, considering that some may be off campus at

lunch during a crisis or may flee the school in their own cars and take some friends during an emergency.

Other still-unresolved issues include how to respond during a lockdown situation when the fire alarm sounds to evacuate the building and whether to lock in or evacuate students in mobile classrooms when a crisis erupts in the school's main building.

As schools move to prevent and respond to violent attacks on their campuses, Mr. Salmon recommends that school officials prepare for the problem to shift to school buses, where security is not as tight and drivers may be untrained to deal with such crises.

The Eugene School District has taken a step in that direction by outfitting all school buses with video camera boxes. Not all buses have video cameras at all times, but students have no way of knowing when they are being taped, the district's Mr. Brewer said. **BI**

## Crisis plans call for practice drills

Experts on bullying and violence in schools strongly suggest that schools practice their crisis management plans, just as they conduct fire drills. The following points are suggestions on fine-tuning such plans:

- Upgrade intercom systems so that students and staff in all areas of the school can be alerted about an emergency and how to respond.

- Make sure doors can be locked from inside classrooms during a lockdown situation to help reduce the risk to teachers and staff, who otherwise would have to step outside of classrooms to lock doors.

- Evaluate whether windows on classroom doors are small enough to prevent an intruder from breaking into a classroom during a lockdown.

- Ensure that community police and fire departments have detailed school maps so emergency personnel can quickly plan how to respond during an incident.

- Consider how to account for all students, including those who drive and may be off campus for lunch or who may have fled with friends in their cars during the crisis.

- Have a way to get information out to parents quickly, usually through a campus radio station or local radio and television stations.

- Arrange for police and fire officials to be present during lockdown and evacuation drills to evaluate the school's performance.

- Keep the plan simple so it is easier to remember during a crisis. Consider providing teachers and staff with pocket-sized laminated cards listing the plan's key points.

- Recruit as crisis counselors community leaders with whom students are all ready familiar, such as ministers and sports coaches.

More information about programs to address bullying and violence, as well as those to help schools recog-

nize potentially violent situations and individuals, are available at the following Web sites and through their links to other sites:

- The Federal Bureau of Investigation, found at [www.fbi.gov/publications/school/school2.pdf](http://www.fbi.gov/publications/school/school2.pdf).

- The National Assn. of Attorneys General and the National School Boards Assn., at [www.keepschoolsafe.org](http://www.keepschoolsafe.org).

- The National Conference of State Legislatures, at [www.ncsl.org/programs/cyf/sv.htm](http://www.ncsl.org/programs/cyf/sv.htm).

- The National School Safety Center, at [www.nssc1.org](http://www.nssc1.org).

- The University of Colorado's Center for the Study and Prevention of Violence, at [www.colorado.edu/cspv/blueprints/model/ten\\_bully.htm](http://www.colorado.edu/cspv/blueprints/model/ten_bully.htm).

- Gavin De Becker Inc., at [www.gdbinc.com/mosaic\\_retro.htm](http://www.gdbinc.com/mosaic_retro.htm).

—By Dave Lenckus

## Civil rights liabilities draw preventive measures, ADR

By DOUGLAS McLEOD

Public risk managers are facing a wider array of civil rights exposures than ever before, from police liability to sexual harassment and Americans with Disabilities Act claims.

They are combating the losses, though, with more-aggressive and sometimes more up-to-date versions of long-established practices: employee training, active claims management and—where possible—negotiation, including alternative dispute resolution, risk managers, consultants and legal experts say.

"We are more vulnerable," observed Dan Hartman, risk manager for the state of Oregon in Salem. "Our tort claims act, our

judges all seem to be tending toward what plaintiffs want."

To avoid big judgments, Mr. Hartman and others say, risk managers have to work harder at training and using ADR when the circumstances allow it.

The types of exposures troubling city, county and state risk managers vary from one entity to another.

For many, the biggest threat comes from law enforcement liability, including claims for wrongful arrest, excessive use of force and other violations of due process rights, said Allen Hyman, managing director and practice leader of Marsh Inc.'s public entity group in Fort Lauderdale, Fla.

Excessive force claims, he added, come in "big-time waves"

and often are exacerbated by a high-profile police brutality case.

Last month, the City of Chicago agreed to pay \$18 million in an out of court settlement with the family of LaTanya Haggerty, who was killed by a police officer who mistook her cellular telephone for a gun. Ms. Haggerty had been a passenger in a car driven by her boyfriend, who

pulled away from a traffic stop and was chased by police.

Along with wrongful death claims such as the Haggertys', law enforcement entities also face employment-related racial or ethnic discrimination claims and sexual harassment and discrimination claims, with the latter group generating more big-dollar judgments and settlements lately,

noted Donald Zoufal, chief legal counsel for the Illinois Department of Corrections and a former general counsel for the Chicago Police Department.

A growing problem with defending these cases, he added, is the expanding volume of documentation public entities must produce in discovery as plaintiffs try to show that a particular incident is part of a "custom, policy and practice" of the public entity, a finding that would extend liability to the entity.

"The discovery burden has increased exponentially," Mr. Zoufal said. "You end up producing more discovery that ultimately may be more damaging."

In an effort to limit discovery, Chicago has experimented in a couple of cases with conceding

potential liability under the legal doctrine of *respondiat superior*, which holds a public entity liable for the actions of its agents. This move could ultimately reduce award and settlement amounts by containing damaging information, Mr. Zoufal suggested.

Employment-related exposures, meanwhile, are the biggest threat for many public entities, according to some risk managers and consultants. Along with sexual harassment, these claims can include wrongful termination and discrimination in granting promotions, noted Dorothy Gjerdrum, a risk management specialist with Arthur J. Gallagher & Co. in Minneapolis.

"This is almost always No. 1" among clients' risks, she said.

See **Civil rights** on page 20

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## SPOTLIGHT

## Civil rights

Continued from page 18

While public entities' top concerns may vary, their approaches to preventing and mitigating losses are often similar and include several long-established techniques.

Most experts note the importance of establishing and maintaining policy and procedures manuals to guide employees' actions.

For law enforcement entities, for example, this would include policies governing the use of force and police pursuits, Mr. Zoufal said.

"I find it hard to believe that a

municipality would not have a use-of-force and pursuit policy, although some do not," he said.

"There's a lot of joking about the voluminous nature of policy and procedures manuals" used by police departments, Marsh's Mr. Hyman observed. "You get a look at those documents and say you might as well read the Encyclopedia Britannica."

But when a claim arises, the first thing lawyers for both sides do is consult the manuals to see if written procedures were violated, he said.

Another idea for preventing employment-related claims is a risk management hotline, through which supervisors could consult with a risk manager or legal

counsel before firing an employee, Ms. Gjerdrum said. Supervisors often act in the heat of the moment, and a hotline would provide a break for a supervisor to go over an employer's policies and determine whether—for example—the supervisor had given the employee required warnings or reprimands, she explained.

Public entities also need to be smarter about whom they recruit for supervisory jobs. Oregon's Mr. Hartman observed. Often, a person who is a good technician is promoted to a managerial spot for which he or she has no particular talent, and the manager's lack of "people skills" can antagonize subordinates, he said.

Oregon recently paid \$100,000

to settle one such case in which a supervisor became the target of several women on his staff, Mr. Hartman said.

"You've got to have some common sense and make sure you hire people with management ability," he said.

Once policies and procedures and a training program are in place, the supervision and discipline of employees who violate the rules is also a key element in preventing losses, Mr. Zoufal said.

"You can train people from now until the cows come home, but if you don't enforce that with some kind of supervisory sanction, you are going to have trouble," he observed. "Great ideas unimple-

mented are of no particular use."

Once a claim arises, aggressive claims management is the most-important tool in cutting public entities' liability costs, experts agree.

Among larger public entities, "I know a lot of risk managers are more involved in managing claims than they were five years ago," Ms. Gjerdrum said, noting that risk managers are working with legal counsel and pursuing ADR sooner than in the past.

With law enforcement claims, "early investigation and good communication with your police department is a key," said Gretchen Beatty, risk manager for the City of Fullerton, Calif.

Public entities must also make sure they select outside attorneys not just on the basis of cost but also on whether the lawyer is experienced at handling a particular type of claim, she said.

Experts offer mixed opinions, though, on whether ADR is an effective tool in handling civil rights claims.

"There's a lot more ADR going on," observed Mr. Hyman. He added, though, that civil rights claims often involve situations that are highly emotional for both sides, and that public officials, in particular, sometimes feel they have followed the letter of the law and that settling would violate principles.

"Oftentimes, the issues involved for a party are not settleable," Mr. Hyman said. "That makes it very hard to resolve a dispute like this without adjudication."

Fullerton's Ms. Beatty also expressed skepticism over handling law enforcement claims through ADR.

"I don't think it's entirely successful," she said, suggesting that when the city feels it must defend a case, it follows through with that decision.

Ms. Gjerdrum said, though, that ADR is an effective tool, in part because civil rights cases are often so emotionally charged. Often, she explained, the motivation of these lawsuits is emotional rather than economic: the injured party wants an apology or wants to see a city's policies and procedures changed.

In these cases, ADR "responds a little more to the real causes (of a complaint) than money," Ms. Gjerdrum said. "ADR can be very effective."

As a case in point, she noted her own previous experience managing an insurance pool covering an association of New Mexico counties. With loss prevention steps and aggressive claims management—including ADR—the pool saved an estimated \$300,000 in claims costs for expenses of about \$30,000, she said.

"We held our claim costs so much lower than those of sister pools...because we were much more aggressive in using ADR and early intervention in claims," Ms. Gjerdrum said.

Mr. Hartman agreed, noting that Oregon state government has a formal ADR program that was pushed by Gov. John A. Kitzhaber.

"It's quicker, and it's cheaper," Mr. Hartman said.

"Our most-expensive cases are the ones where we feel we are right," he said. **BI**

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Assurance Generales de France S.A. has named Jean-Philippe Thierry chairman and chief executive officer, succeeding Antoine Jeancourt-Galignani. Mr. Thierry joined Paris-based AGF at the beginning of last year, after having worked as chairman and managing director for Generali France, a unit of Assicurazioni Generali S.p.A. Since 1996, Mr. Thierry has been president of the Federation Francaise des Societes Anonymes d'Assurances, the French Federation of Insurance Societies. Mr. Jeancourt-Galignani, who has been with AGF since 1995, is leaving to become president of Gecina, a French real estate company....London-based credit and political risk broker **Berry Palmer & Lyle Ltd.** has acquired Assurance des Investissements Internationaux S.A., a French political risk broker. The purchase of AII from L'Assurance Universelle, France's largest credit insurance broker, is part of BPL's strategy to expand its global network. In February, BPL announced an alliance with Export Insurance Agency Inc. of Walpole, Mass., to form Global, a franchise of independent brokers specializing in trade credit coverage...**Hannover Re Group** of Hannover, Germany, reported record profits for 2000, the result of a tax change and strong organic growth. Net earnings rose 81% to 365 million euros (\$344.0 million) in 2000, but that result was increased by a one-time gain of 219 million euros (\$206.4 million) from the lowering of the German corporate tax rate to 25% from 40%. Without that benefit this year, Hannover Re forecasts that 2001 net income will fall 37% to about 230 million euros (\$216.8 million). Consolidated gross premiums rose 24.1% to 8.3 billion euros (\$7.82 billion) in 2000....As part of a review of Lloyd's of London operations, Moody's Investors Service Ltd. has revised its ratings on a number of syndicates. The performance rating of **syndicate 1009**, an energy and aviation syndicate managed by Markel Syndicate Management Ltd., was lowered to B from B+. Moody's assigned its A1 insurance financial strength rating to **Amlin syndicate 2001**, the underwriting vehicle of Amlin P.L.C. It also left unchanged its B+ performance rating on syndicate 2001, but improved the outlook on the rating from negative to stable. Moody's changed the status of the B performance rating of **Alleghany Underwriting Ltd. syndicate 376** to "negative outlook" from "under review for possible downgrade." The change was prompted by the appointment of a new chief executive and proposed changes to the syndicate's business, Moody's said....**ING Groep N.V.**, based in Amsterdam, Netherlands, is taking a majority stake in Seguros Comercial America of Mexico City for \$791 million. ING will buy an additional 45% of SCA stock, taking its holding to 87%....Standard & Poor's Corp. has raised its long-term counterparty credit and insurer financial strength ratings on **Iron Trades Insurance Co. Ltd.** to A+ from A-. S&P said the change is based on support from QBE Insurance Group Ltd., which acquired the London-based insurer last year.

## U.K. sets precedent for bond insurance

By SARAH VEYSEY

LONDON—A recent court ruling underscores a key difference between claims payment practices in the insurance industry vs. the capital markets and the risks that such differences can create for the issuers of insured notes, as well as their creditors.

The U.K. Court of Appeal last month upheld a High Court ruling stating that, under U.K. law, insurance-backed film financing bonds are insurance policies and are not unconditional guarantees of payment.

The precedent-setting decision stems from litigation in the U.K. courts last year brought by HHH Casualty & General Insurance Co. Ltd., after London-based film company Flashpoint Ltd. sold six bonds under the name Hollywood

Funding. HHH is a unit of insolvent Australian insurer HHH Insurance Ltd.

The insured notes were intended to finance several films, including the Academy Award-winning "Gods and Monsters," and called for the securities to be paid with proceeds from the films.

HHH, which backed Hollywood Funding notes 1, 2 and 3, paid a claim under its policy backing the bonds when Hollywood Funding 2 defaulted. HHH then tried to obtain reimbursement from its London-based reinsurers—New Hampshire Insurance Co. Ltd., which is a subsidiary of American International Group Inc., and Independent Insurance Co. Ltd.—and took them to court when they refused to pay.

The reinsurers argued that HHH should not have paid the claim because it could have asserted various

misrepresentations, breaches of warranty and coverage defenses. The reinsurers, in particular, charged that Flashpoint did not finance as many films as promised.

They claimed that HHH paid a claim not covered under its policy and, as a result, that they were not obliged to reimburse HHH. The High Court backed the reinsurers and ruled that HHH had not been obliged to pay the claim since the insurance backing of the bonds did not constitute an unconditional guarantee of payment. And last month, the Court of Appeal in London upheld that decision.

The ruling now is being used by Lexington Insurance Co. to justify an investigation after the default of Hollywood Funding 5, which it insured, before it pays the claim.

Lexington, also a subsidiary of AIG, said its policy was virtually

identical to the HHH policy. "Lexington did not pay or reject the claim," AIG stressed in a written statement. "Instead, as is customary in the case of property and casualty claims, Lexington responded that it needed to investigate the matter further. The insured trustee for the noteholders commenced an action against Lexington in the English courts, which is pending," the statement continued.

AIG pointed out that the High Court and U.K. Court of Appeal decisions in the HHH case provided a "strong confirmation that Lexington's actions have been entirely appropriate."

AIG said that any confusion about the status of the claims presented to HHH and Lexington arose from the fact that "the policies were not financial guarantee poli-  
See **Films** on page 27

## Project aims to avoid market spiral woes

By EDWIN UNSWORTH

LONDON—Policyholders could see a more stable reinsurance market if a new project designed to reduce costs and claims deadlocks generated by the so-called "London market spiral" proves successful.

A spiral develops when the many London-based reinsurers and Lloyd's of London syndicates reinsure one another, not only keeping the risk within the London market rather than dispersing it but also dramatically increasing the volume of transactions and the resulting costs of pursuing claims. The spiral is exacerbated when some reinsurers cede their own risks and then take on the risks again as retrocessionaires.

The aftermath of the 1988 Piper Alpha oil rig disaster in the North Sea illustrates the effect of a market spiral. Original insurance claims from the loss are estimated at about \$1.4 billion, but the expense of the claims wending their way through the reinsurance market pushed the cost up to \$15 billion. In the wake of the drastic excess-of-loss spiral that occurred in the 1980s, Lloyd's took steps to prevent a recurrence, including more closely monitoring reinsurance arrangements.

And this month, London-based Grant Thornton launched Project Corkscrew, which the financial advisory company maintains can significantly streamline processing in the London reinsurance market and save more than £500 million (\$710.8 million) per year.

Project Corkscrew aims to achieve this by not only greatly reducing the number of transactions being processed among reinsurers for a single risk but also to "crystallize" the balance sheet assets and liabilities in respect to certain losses.

Risk managers have welcomed the project, calling it a move in the right direction if it succeeds.

Alan Fleming, chairman of the Assn. of Insurance & Risk  
See **Spiral** on page 27

## Weighing benefits of outsourcing

By KATE TILLEY

BRISBANE, Australia—Outsourcing can yield significant savings and other benefits, but if the process is not properly managed, it carries many risks, said Wayne Goss, managing partner of the accounting firm of Deloitte Touche Tohmatsu in Brisbane, Australia.

Speaking at the Assn. of Risk & Insurance Managers of Australasia's public sector risk management conference held May 29-31 in Brisbane, Australia, Mr. Goss said that outsourcing, like any other significant business undertaking, has a risk-return payoff.

"Successful outsourcing has the ability to unlock hidden capital and provide new skill sets. However, this is balanced with the risks of hand-  
See **Outsource** on next page



PHOTO: ZUMA PRESS

The Buque Tanquero Jessica, which listed and sank in January, spilled about 240,000 gallons of oil off the Galapagos Islands.

## Galapagos files claim over oil spill cleanup

By GAVIN SOUTER

MIAMI—The government of Ecuador's Galapagos Islands will file a claim for as much as \$60 million with the insurers of a tanker that spilled oil off the islands in January.

But the broker for the tanker owner, Acotramar S.A., claims that the vessel was uninsured due to nonpayment of premium.

Lawyers for the provincial government of the Galapagos Islands on Monday said the government will file a claim for cleanup and containment costs, loss of tourism and fishing revenues, and damage to the environment.

The Galapagos Islands, which lie in the Pacific Ocean off the coast of Ecuador, are rich in exotic plant and animal species and are a world-renowned ecotourism destination. In January, the Ecuadorean oil tanker Buque Tanquero Jessica spilled up to 240,000 gallons of oil near the archipelago.

The islands derive about \$100 million a year in revenues from tourism, and tourism is down about 50% in 2001 as a result of the spill, said Steven C. Marks, a

partner of Podhurst Orseck Josefsberg Eaton Meadow Olin & Perwin in Miami, who is representing the Galapagos Islands.

The cleanup and containment of the spill cost \$10 million, and the environmental damage has not yet been quantified, he said. Under international pollution conventions, the insurer of the Jessica is strictly liable for claims arising from the spill, and the claim will be filed with Air & Sea Insurance Corp., an insurance agency in Miami that placed the coverage in the London market, Mr. Marks said.

But the claim will likely be denied, as the Jessica was uninsured at the time of the spill, said Hadrian Tuck, a partner at Air & Sea.

The owner had not made a premium payment since August 2000, so the coverage was voided, he said.

But under Ecuadorean law, the coverage remains in place regardless of the payment of premiums, Mr. Marks said.

"When you issue a policy of insurance, under Ecuadorean law, it will remain in force the entire policy term, regardless of whether the premium is paid," he said.

## INTERNATIONAL

## Outsource

Continued from previous page  
ing control of a part of the business to an outsider," Mr. Goss said. "The ability to manage the contracting relationship is one of the keys to achieving competitive advantage from outsourcing."

Outsourcing can fundamentally change the way an organization works, he said, explaining that a division that may have been "a sink-hole" for costs will be reviewed more thoroughly when those costs become external.

Another benefit is the ability to remove a function that is not central to an organization by shifting it outside the business. "The benefit is freeing resources, including management time, for more productive uses," Mr. Goss said.

He said the major impediment to successful outsourcing for Australian companies is a lack of skills in managing the process. A recent study by Deloitte and the University of Melbourne found that 60% of responding companies cited a lack of experience as their major problem with outsourcing.

Risk managers should seek help to

manage their contracts with outsourced service providers, he said.

Mr. Goss warned that picking the right partner is essential, because it is difficult to replace a contractor if something goes wrong. "Highly specific knowledge is obtained during an outsourced contract, which takes time to transfer to another contractor or insource again," he said.

In deciding whether to outsource, a risk manager should consider both whether the company has the skills to perform the function in-house and whether the process can be separated effectively from the rest of the company.

Outsourcing functions that are core competencies can represent "huge opportunity costs in the long term." He gave the example of IBM Corp., which outsourced the development of an operating system many years ago to what was then a small company called Microsoft.

Mr. Goss said detailed performance standards with measurable outcomes must be established if outsourcing is to be successful.

In another presentation on outsourcing, Harry Rosenthal, national development manager-claims management for Brisbane-based loss adjuster Wyatt Gallagher Bassett

Pty. Ltd., told the conference that the trend toward outsourcing represented opportunities for risk managers.

The risk management role could be expanded through outsourcing, he said. "Organizations looking at outsourcing models may permit their risk manager the freedom to outsource repetitive aspects of his or her job or work in areas where the risk manager has fewer skills," Mr. Rosenthal said.

"It may be an opportunity to rearrange time constraints and look critically at how the risk manager spends his or her day," he said. **BI**

# Gauging the state of risk management in Australia

By KATE TILLEY

BRISBANE, Australia—A survey of public and private sector organizations in Australia finds that state government agencies are further along the risk management spectrum than private companies or local governments, a risk management consultant says.

The survey also shows that the respondents generally recognize the need for risk management to become an integral part of the way they do business, but none has attained such a fully integrated risk management process, according to Adrian Savage, managing director of Brisbane, Australia-based Queensland Risk Management



Consultants Pty. Ltd.

The respondents said a significant cultural shift is still required before risk management principles are more widely adopted in Australia, he said.

Mr. Savage, a former public sector risk manager, shared the survey results during a session at the Assn. of Risk & Insurance Managers of Australasia's recent public sector risk management conference in Brisbane.

Six weeks before the conference, Mr. Savage surveyed 16 state government departments in five states, 12 local government entities in four states, and nine major, national private sector companies. All organizations had between 200 and 10,000 em-

ployees.

Among other things, organizations were asked whether risk management is an acknowledged component of their culture, and they also were asked to rate their level of progress in risk management as either advanced, moderate, minimal or starting.

Mr. Savage said 25% of state government respondents, 12% of local authorities and 15% of private companies see risk management as an acknowledged component of their organizational culture.

Among state government respondents, 7% described their risk management as advanced, 72% as moderate, 18% as minimal and only 3% as at the starting level.

Within the private sector, 4% of respondents said they were advanced, 20% moderate, 63% minimal and 13% unsure.

Among local government respondents, 78% described their risk management programs at the starting level, with the remainder at the minimal level.

Mr. Savage said a majority of the organizations surveyed are moving to incorporate risk management principles in new projects. A majority also recognize that fully integrating risk management is a better way of doing business and pays off in terms of litigation avoided and public relations improved, he added.

"These organizations have come a long way, but understand how much further there is

to go and that this process may take some time," the consultant said.

Mr. Savage said the challenge for risk managers is to have senior company management understand the value of risk management.

One reason advanced risk management is not more widely in practice is that there is little accountability for it. "Responsibility you can give to anyone; accountability is something you specifically measure," he said. "The number of people who are actually accountable is minimal."

The paper Mr. Savage presented to the conference, which includes the survey results, will soon be available on his Web site at [www.qrmc.com.au](http://www.qrmc.com.au). **BI**

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A photograph of two men on a boat, splashing water. The man in the foreground is wearing a white shirt and sunglasses, and the man behind him is wearing a red shirt. The background is a bright blue sky. A large number '12' is visible on the side of the boat.

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## INTERNATIONAL

# Aussie organizations to benchmark risks online

By KATE TILLEY

BRISBANE, Australia—Following a successful pilot study, the Australian federal government's risk management agency, Comcover, is launching an online benchmarking project this month.

Eric Abetz, special minister of state in the federal government, said Comcover will use Internet technology to collect and dis-



seminate information on risk management performance for organizations in both the public and private sectors. This information will then be used to establish benchmarks, allowing organizations to make comparisons and improve their performance.

"Commonwealth, state and local government bodies and private organizations can use benchmarking to reduce the cost of risk," said Mr. Abetz, who spoke via

a video link to open the Assn. of Risk & Insurance Managers of Australasia's Public Sector Risk Management Conference, held May 29-31 in Brisbane, Australia.

Canberra-based Comcover was set up in 1998 as a self-managed fund for federal government bodies, ending the former federal policy of not insuring government risks.

Comcover currently writes all property/casualty and liability coverage for 170 agencies and it expects

members to implement sound risk management policies.

"All Commonwealth agencies are now accountable for their risks, whereas previously, there was a lack of systematic risk management," he said.

Mr. Abetz said the benchmarking pilot program, conducted in January and February, saw 35 organizations—including five major private companies—provide information on their risk management programs.

The organizations' risk management approaches were assessed on whether they were integrated; had strong commitment and leadership; had a pro-active, positive focus; incorporated risk management into all business processes; aimed for continuous improvement; were audited and documented; were actively communicated; were effectively resourced; included training and education, and whether their approach-

See **Benchmark** on next page

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**BI** Next Issue: June 18  
Closing: June 12

### UNITED STATES BANKRUPTCY COURT SOUTHERN DISTRICT OF NEW YORK

IN RE PETITION OF JOHN GIBBONS, AS ADMINISTRATOR OF NEW CAP REINSURANCE CORPORATION LIMITED, CASE NO. 99-42752 (CB)

PLEASE TAKE NOTICE THAT ON MAY 23, 2001, THE BANKRUPTCY COURT ENTERED AN ORDER (THE "ORDER") CONTINUING THE PRELIMINARY INJUNCTION ORDER, PURSUANT TO 11 U.S.C. § 304, ORIGINALLY ENTERED IN THIS CASE ON MAY 7, 1999. THE ORDER SHALL REMAIN IN EFFECT UNTIL NOVEMBER 29, 2001. A HEARING TO CONSIDER WHETHER THE ORDER SHALL BE CONTINUED, IS SCHEDULED TO BE HELD ON NOVEMBER 28, 2001 AT 2:00 P.M. (THE "RETURN DATE") BEFORE THE HONORABLE CORNELIUS BLACKSHEAR, IN ROOM 601 OF THE ALEXANDER HAMILTON CUSTOM HOUSE, ONE BOWLING GREEN, NEW YORK, NEW YORK. ALL PAPERS SUBMITTED FOR THE PURPOSE OF OPPOSING CONTINUATION OF THE ORDER AFTER THE RETURN DATE SHALL BE FILED WITH THE COURT, WITH A COPY TO THE CHAMBERS OF THE HONORABLE CORNELIUS BLACKSHEAR AND SERVED ON COUNSEL FOR THE PETITIONERS LISTED BELOW, SO AS TO BE RECEIVED AT LEAST FOURTEEN (14) DAYS PRIOR TO THE RETURN DATE. ANY PERSON WISHING TO OBTAIN A COPY OF THE ORDER SHOULD CONTACT COUNSEL TO THE PETITIONERS.

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### UNITED STATES BANKRUPTCY COURT SOUTHERN DISTRICT OF NEW YORK

IN RE PETITION OF MALCOLM L. BUTTERFIELD AND ANTHONY J. MCMAHON, AS JOINT PROVISIONAL LIQUIDATORS OF BELVEDERE INSURANCE COMPANY LIMITED, CASE NO. 98-B-47660 (REG)

NOTICE IS HEREBY GIVEN THAT ON MAY 23, 2001, THE BANKRUPTCY COURT ENTERED AN ORDER (THE "ORDER") CONTINUING THE PRELIMINARY INJUNCTION ORDER PURSUANT TO 11 U.S.C. § 304 ORIGINALLY ENTERED IN THIS CASE ON NOVEMBER 4, 1998. THE ORDER SHALL REMAIN IN EFFECT PENDING A HEARING TO CONSIDER WHETHER IT SHALL BE CONTINUED, WHICH HEARING IS SCHEDULED TO BE HELD ON NOVEMBER 20, 2001 AT 9:45 A.M. (THE "RETURN DATE") BEFORE THE HONORABLE ROBERT E. GERBER, IN ROOM 621 OF THE ALEXANDER HAMILTON CUSTOM HOUSE, ONE BOWLING GREEN, NEW YORK, NEW YORK. ALL PAPERS SUBMITTED FOR THE PURPOSE OF OPPOSING CONTINUATION OF THE ORDER AFTER THE RETURN DATE SHALL BE FILED WITH THE COURT, WITH A COPY TO THE CHAMBERS OF THE HONORABLE ROBERT E. GERBER AND SERVED ON COUNSEL FOR THE PETITIONERS LISTED BELOW, SO AS TO BE RECEIVED AT LEAST FOURTEEN (14) DAYS PRIOR TO THE RETURN DATE. ANY PERSON WISHING TO OBTAIN A COPY OF THE ORDER SHOULD CONTACT COUNSEL TO THE PETITIONERS.

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## INTERNATIONAL

## Benchmark

Continued from previous page  
es encouraged value-based decisions.

The results "sounded a warning about the need for improvement in some areas," Mr. Abetz said. In particular, there was a need for better training, he said, because fewer than 20% of participants said they were committed to providing training in

risk management techniques.

He said Australia was at the forefront of risk management globally, because of the development of the risk management standard, AS/NZS 4360, a generic framework for the application of risk management in all organizations that was jointly developed by the Australian and New Zealand Standards Organizations.

But to get to "the cutting edge," risk managers need to have "the

right monitoring systems in place," Mr. Abetz said.

The pilot study found nine participants had started development of a risk management program, 19 were currently implementing a program, and seven already had programs in place and were "continuously improving their capacity to make sound business decisions" based on the program.

The pilot study found many participants were "still prone to being

reactive to incidents and events, rather than proactive."

Mr. Abetz said many organizations implemented risk management in an ad hoc manner and that their programs often were not "subject to adequate control and regular review. They recognize that auditing, reporting and documenting risk is necessary, but many have yet to put such a regime in place. Organizations still tend to base decisions on the cost of losses, rather than a full

assessment and comparison of risks. Many have not linked risk management to the achievement of business goals and objectives."

Participation in the benchmarking project for the 170 agencies that Comcover insures will be free. The first benchmarking assessment also will be free for other participants but, in the future, they will be charged an administration fee, said Robert Knapp, national manager of Comcover. **BI**

## Fraud-control policy not finalized Down Under

By KATE TILLEY

BRISBANE, Australia—Australia's federal government has been slow to finalize and adopt a new fraud-control policy for the public sector that would revise its earlier policy, implemented in 1994.

The first draft of the new policy was released in June 1999, and the latest draft and guidelines have just been circulated, said Mark Ney, acting Queensland and Northern Territory general manager for the Australian Federal Police, who spoke at the Assn. of Risk & Insur-



ance Managers of Australasia's recent public sector risk management conference in Brisbane, Australia.

Citing Australian Institute of Criminology data, he said fraud in Australia annually costs between \$3 billion Australian (\$1.53 billion) and \$3.5 billion Australian (\$1.78 billion).

The new policy would establish a fraud-trend information network through which agencies can report trends in fraud prevention and detection, and would place greater emphasis on training staff for fraud investigation and prevention, he said.

The policy also would require agencies to conduct fraud risk assessments every two years, though Mr. Ney noted that some agencies should perform such assessments more frequently. "Organizations' risk profiles can and do change unexpectedly. Ideally, the frequency of the reviews should depend on changes within the agency, changes within the community and stakeholders served by the agency, changes in government policy, and changes in technology," he said.

Technology, Mr. Ney said, is one of the principal drivers of the need for an updated fraud policy as well

as for better security measures.

"The Internet has some scary implications for fraud potential. It is much easier to disguise intent...and the identity and location of a perpetrator," he said. The new policy would retain many features of the 1994 regulation but would increase chief executives' accountability for fraud control in their agencies and departments, Mr. Ney said.

The latest draft also "moves away from a strict-compliance approach" to incorporating fraud management into general risk management strategies, he said. Public sector organizations would be expected to go

beyond just conducting risk assessments and integrate fraud control broadly across their operations.

The policy would also adopt the Australian and New Zealand risk management standard as the standard for all risk assessments. Australia's federal government implemented that standard, AS/NZS 4360, in 1995. The policy also would broaden organizations' annual reporting requirements, a change prompted by the federal government's need for better information to respond to fraud through both legislation and resource allocation, Mr. Ney said. **BI**

## Films

Continued from page 23  
cies of the type normally issued in the United States market and did not provide that they would function as the equivalent to such a policy."

U.S.-style financial guarantees normally provide an explicit waiver of all defenses and would give policy issuers an absolute obligation to make payment of a claim. The financial guarantee insurer is obliged to pay the claim and seek reimbursement later if it believes it has defenses against a claim. "Neither the HIH nor the Lexington policies provided for payment in that manner," AIG said.

The transactions were structured and led by investment bank Credit Suisse First Boston. "The issue here is not the refusal by an insurer to pay a claim under its policy," said AIG. "The real issue is whether CSFB understood what it was doing when it approached the insurance market to issue a property and casualty policy that was not drafted as the functional equivalent of a

financial guarantee policy," said AIG. "Additionally, CSFB should be asked to address the standard of care and scope of liability that it undertook in organizing these transactions."

In light of Lexington's action in not immediately paying the claim, Standard & Poor's Corp. last month downgraded its ratings of Hollywood Funding notes 5 and 6. S&P lowered its rating on Hollywood Funding 6's \$100.7 million notes to CCC from AAA.

"The rating action reflects Standard & Poor's understanding that Lexington Insurance Co., a wholly owned subsidiary of American International Group Inc., has notified the trustee for the Hollywood 6 noteholders that it believes that it has no liability under certain of the insurance policies covering the Hollywood No. 6 transaction because a warranty in some of the policies was breached," S&P said in a written statement. S&P added that it had downgraded Hollywood Funding No. 5 to CCC from AAA because Lexington had notified trustees that it would not pay out on a claim under note 5 pending an

investigation.

S&P said that because of the HIH litigation, "there is a substantial risk that the Hollywood 6 notes and the Hollywood 5 notes will not be paid when due." S&P said it would continue to monitor the situation.

"In addition, Standard & Poor's is reviewing Lexington's insurance policies used in other rated capital market transactions where the insurance policy is material to bondholder protection," the statement said. "Standard & Poor's is concerned that given Lexington's position with respect to the Hollywood policies, Lexington may raise defenses to the payment of other insurance policies being used as financial enhancement or credit guarantees on capital market instruments that are inconsistent with the assumptions made by Standard & Poor's in rating the transactions."

Donald Watson, a New York-based director of S&P formerly in charge of reinsurance analysis, warned in a March 2000 commentary, "Financial Guarantees: Beware the Land Mines," that an increase in the number of insur-

ers seeking to write financial guarantees could create problems in the market.

In particular, Mr. Watson's paper warned against risks posed by insurers entering this specialized market for the first time in search of additional sources of premium.

Unlike monoline bond insurers, which specialize in insuring capital markets transactions, traditional insurers first entering this field might not recognize the importance of immediate payment on insured notes, which could cause "debilitating" financial problems for the policyholder or its creditors, he wrote.

"Timeliness of payment, regardless of the form of the financial guarantee, becomes moot if either the insurer or any of its reinsurers decides to challenge the validity of the claim," Mr. Watson wrote.

The S&P commentary, "Financial Guarantees: Beware the Land Mines," can be obtained at: [www1.standardandpoors.com/Forum/RatingsCommentaries/Insurance/](http://www1.standardandpoors.com/Forum/RatingsCommentaries/Insurance/)

## Spiral

Continued from page 23  
Managers, said: "AIRMIC welcomes his innovative move. Anything which helps to eliminate the spiral and to stabilize the market is to be encouraged and supported."

Project Corkscrew relies on a tool called a "rule-based commutation matrix." Using data to determine the reinsurance arrangements between participants, the information or a loss is run through a matrix. The "commitment point"—the point at which payments are agreed upon—for each participant is reached when participants unanimously agree to accept the result. If there is no unanimous agreement, the matrix is rerun without the dissenting participants, which would continue negotiating. Once all par-

ticipants are in agreement, those in "net debtor" and "net creditor" positions square their accounts.

Grant Thornton has given itself until June 29 to raise the £1.75 million (\$2.49 million) it says it needs to fund the project. Each participant will have to subscribe a minimum of £50,000 (\$71,075).

Michael Coldman, general manager of claims for St. Paul Reinsurance Co. Ltd. in London, attended Corkscrew's launch. "We are looking at (the proposal) quite closely to ascertain whether it is something that we would like to support. It's an interesting concept which would require a significant number of reinsurance players to participate in order to have a realistic chance of achieving its aim.... We are studying the proposal, but we haven't come to any conclusion." **BI**



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Weather Insurance Specialists

# Crane

Continued from page 3

After a candidate has passed the written examinations, he or she takes a practical examination demonstrating what has been learned.

Mr. Daul also urged underwriters to make sure that the operators of the cranes they are insuring can read the load charts manufacturers provide.

"Only one of every 500 people who work for proactive contractors over the past 15 years can pass a simple load chart test," he said. "Yet this is the most critical knowledge required of crane operators."

In addition, "the No. 1 petition CCO has is, 'Can we have readers to

read the exam to the crane operators?" Mr. Daul said.

Fortunately, he said, the board will not permit this.

"The board says if there are no 'readers' in the crane to read the load charts to the operator, then no," he said.

Further complicating the situation are the new high-tech, lightweight cranes with sophisticated onboard computer systems.

Many construction firms do not provide computer training to operators, primarily because these workers are often short-timers who move from one job to another when their work is done, Mr. Daul explained.

As a result, "operators are bringing their children to work with them to teach them how to use computers," he said.

But even knowing how to read load charts and operate the crane computers may not be enough to prevent accidents, Mr. Daul acknowledged, pointing to the 1999 Milwaukee stadium catastrophe as an example.

"The crane operator testified that even though the load exceeded the crane manufacturer's specifications, he wasn't concerned, because he's always worked by the seat of his pants," he said.

Mr. Daul showed IMUA members a videotape of the accident taken by an OSHA employee that showed the 480-foot crane, nicknamed "Big Blue," toppling over, sending a section of the retractable roof it was carrying crashing into the stadium wall. Because the roof piece was so heavy and large—it was the size of a

football field, Mr. Daul said—it tore open much of the side of the stadium. Winds gusting to about 30 mph contributed to the accident.

The end result was \$100 million in property damage to the stadium, \$99 million in liability payments to the widows of the three workers who were killed and the loss of the \$10 million crane.

"And this didn't include business interruption," he said. "The stadium didn't open for a year."

The accident is considered to be the worst construction crane accident on record, surpassing the catastrophic 1989 tower crane collapse in downtown San Francisco that killed two bystanders and a 1993 mobile crane accident near Las Vegas that killed three.

While recently discussing the sit-

uation with a contractor who does \$50 million a year in construction work and owns \$90 million in equipment, Mr. Daul learned that "his biggest problem is the tendency of experienced operators to become lazy and not following all the operating and safety procedures," he said.

Also, because of today's low unemployment rate, the contractor is having trouble finding experienced crane operators, Mr. Daul said.

But contractors shouldn't cut corners when it comes to crane operator selection and training, he warned.

"Crane operators aren't the chief cause of accidents," he said. "Who puts the 'dumb operator' in the seat? Crane accidents happen because of poor management." **BI**

## Inland marine outperforming other lines

By JOANNE WOJCIK

KEYSTONE, Colo.—The inland marine market has consistently outperformed other segments of the property/casualty insurance market, and it is expected to continue to do so, according to an insurance industry economist.

But even though it may not be among the fastest-growing lines of business this year as insurers in other lines raise premiums, inland marine underwriters could benefit from the nation's energy troubles, said Robert P. Hartwig, vp and chief economist of the Insurance Information Institute in New York.

"Every single year since 1990—and by a significant, wide margin—inland marine has had better underwriting performance than commercial lines in general," Mr. Hartwig told a group of underwriters gathered last week for the 71st

annual meeting of the Inland Marine Underwriters Assn. in Keystone, Colo.

"This record is absolutely amazing—it's like the best-kept secret in the whole P/C world," he said.

And the market is continuing its stellar performance, with a combined ratio of just 97% projected for 2001, compared with 111% for all commercial lines, Mr. Hartwig said.

Inland marine market profitability, which measured 11.8% in 1999, also exceeds that of other lines of insurance. In fact, Mr. Hartwig noted, in terms of profitability, the inland market in 1999 was second only to the Fortune 500, which had an average profit margin of 15.2%.

Inland marine premium growth also has outpaced that of the commercial lines industry throughout the last decade, according to Mr. Hartwig.

But, he added, that trend slowed

last year: The inland marine market's 5% growth in net premiums matched that of the commercial lines industry as a whole.

"This year, we're expecting relatively robust premium growth industrywide," as insurers try to recover from the longest soft market on record, he said.

"Underwriting losses have gotten gradually worse in the last several years. We paid out \$25 million to \$30 million more in losses than we took in in premium last year," Mr. Hartwig said. "That was the second-largest year since Hurricane Andrew" struck in 1992, he added.

"This is what's driving the hard market. We didn't have a major catastrophe. We're having a major catastrophe on the balance sheet, spilling red ink like almost never before," he said.

Therefore, Mr. Hartwig said to the inland marine underwriters, the

commercial insurance industry "needs those price increases, whereas your underwriting performance doesn't warrant that sort of price increase."

But while the rest of the insurance industry plays catch-up, the inland marine marketplace could see a growth surge as a result of the nation's energy crisis, he suggested.

"As you know, Vice President Cheney has promised a nuclear power plant in every backyard," he quipped. "That might be a positive for the inland marine area."

The inland marine market insures much of the energy infrastructure that will be built, he explained.

"We're going to need to spend our way out of this energy crisis to the tune of hundreds of billions of dollars, and if just a few billion of that could trickle into the inland marine sector, I'm sure you'd like it," Mr. Hartwig said. **BI**

## Rate hikes to aid insurer stock: Analyst

By JOANNE WOJCIK

KEYSTONE, Colo.—A survey of risk managers showing that nearly 90% saw premium increases when they renewed their commercial insurance coverages this year means insurer stock prices will likely improve, an industry analyst says.

And because the increases being sought are more modest compared with those imposed in the last market turn in the mid-1980s, this hard market may last longer than previous ones have, predicts Alice Cornish, vp and senior analyst of equity research at Prudential Securities

Inc. of Boston.

The survey of Fortune 1000 risk managers, done in the first quarter of this year, was released to Prudential clients in March. Prudential conducted the survey to illustrate how the commercial insurance industry could raise prices despite a slowing economy, Ms. Cornish told members of the Inland Marine Underwriters Assn. at its recent annual meeting in Keystone, Colo.

"Investors are extremely interested in insurance pricing," she explained. "The industry's destiny is in the hands of the people determining price."

Because insurers have slashed prices for the last 12 years, their profitability has declined, making their stocks less attractive to investors, Ms. Cornish said.

With the exception of American International Group Inc., "every insurance company stock is selling at a lower valuation today than in 1984 compared to the rest of the stock market," she said.

But, if the industry continues to raise prices over the next few years—this year's premium increases are projected to average between 16% and 19%—insurer stocks collectively will climb an average of

22% by 2003, Ms. Cornish predicted.

By then, insurance prices will be back to 1992 rates, which were 50% to 54% higher than 1997 rates, she said.

"So far, this group appears to be acting responsibly," she said, referring to the 19 companies that act as industry price leaders. "They're not raising prices too much too fast. That means there will be increases for several years."

Insurance is "one of the few economic sectors that has the ability to raise prices now," because "insurance is vitally important to business," she said. **BI**

## Colorado hosts IMUA

KEYSTONE, Colo.—A total of 197 underwriters from throughout the United States attended the 71st annual meeting of the Inland Marine Underwriters Assn., held June 2-5 in Keystone, Colo.

In addition to customary IMUA business meetings, the meeting featured two days of educational programs on issues such as technology, the valuation of works of art and losses involving construction cranes.

Next year's meeting will be held June 1-5 in Oak Brook, Ill.

Founded in 1930, the IMUA serves as the collective voice of the U.S. inland marine insurance industry, providing education, research and communication services to support the underwriting discipline.

Inland marine insurance is generally purchased to insure specialty or unique properties, such as construction, medical and telecommunications equipment, as well as computers, fine art and cargo shipments.

Additional information on the IMUA is available at [www.imua.org](http://www.imua.org).

## Art insurance growing, but standards sought

By JOANNE WOJCIK

KEYSTONE, Colo.—Determining the value of a stolen or damaged piece of artwork as part of an insurance claim can be as sketchy as describing that piece from memory, appraisers and insurance underwriters say.

Part of the problem is a lack of standards for art appraisal work, said Victor Wiener, executive director of the Appraisers Assn. of America in New York.

To remedy this situation, the Inland Marine Underwriters Assn. has published "An Underwriter's Guide to the Valuation of Art, An-

tiques & Collectibles." The guide, prepared by the IMUA's Art and Records Committee, was released at the organization's 71st annual meeting, held June 2-6 in Keystone, Colo.

The IMUA standard includes criteria for determining when an appraisal is necessary, lists the elements of a correctly prepared appraisal and encourages the use of Object ID, an international standard for describing art, antiques and antiquities.

If appraisers adhere to the standards put forth by the IMUA, there will likely be fewer disputes over the value of artwork during both

the underwriting and claims adjusting processes, Mr. Wiener said.

The insurance market for valuable artwork is growing, because illicit trade in art and cultural artifacts has increased dramatically in recent years, said Lynne Chaffinch, program manager for the Art Theft Program of the Federal Bureau of Investigation.

Ms. Chaffinch said that the FBI estimates that \$4 billion to \$6 billion in artwork is stolen annually around the world and that the United States is the largest consumer country of stolen art pieces.

But while Hollywood films might suggest otherwise, most art thieves

are not glamorous pilferers like Pierce Brosnan, and the thefts are rarely carefully orchestrated, she said.

In fact, most U.S. art thefts are residential burglaries that rarely involve violence and are perpetrated by individuals who have no common characteristics for law enforcement agencies to use in describing a likely suspect, Ms. Chaffinch said.

She cited as an example a 1996 theft at William Penn's summer home, Pennsbury Manor, in Morrisville, Pa.

Three men gained access to the building by breaking down the door and stole more than 50 items. Be-

cause they were not art experts, they grabbed whatever they could before police arrived, in some cases taking reproductions rather than original artifacts, Ms. Chaffinch said.

The next morning, when news of the burglary hit the papers and local television stations, the thieves panicked and dumped their loot in the Delaware River.

Sometime later, one of the three offered to make a deal with authorities after he was apprehended in another, unrelated, theft.

Fortunately, many of the artifacts were recovered, because the thieves **See Art on next page**

## COMMENTARY

# A true pioneer wins recognition

Many of us who attended the reception held in New York last week by the Assn. of Professional Insurance Women to honor Karen Clark as the 2001 Insurance Woman of the Year thought we understood her contributions to insurance and reinsurance as the founder, president and chief executive officer of Applied Insurance Research Inc.

AIR is the Boston-based risk modeling and technology firm specializing in estimating losses caused by natural catastrophes, weather and climate, which today is essential to underwriting catastrophe risks.

But I, for one, did not really appreciate what a pioneer Karen truly was until I heard Jim Stanard, chairman, president and CEO of RenaissanceRe Holdings Ltd. in Bermuda, eloquently describe her accomplishments before presenting her with the APIW award.

"Karen essentially invented the field of windstorm modeling in the insurance business and has led the development of it for 15 years," Jim told us. Before Karen's work, reinsurance underwriters priced catastrophe reinsurance without the aid of computer models. "In the Stone Age, underwriters would set prices on catastrophe reinsurance by the name of the layer," Jim reminded us. "Depending on market conditions, the first layer might be priced at 25% rate on line, the second at 17.5%, and so forth." And, Jim noted, "smart brokers would get a price cut by renaming what had been the first layer, calling it the second one."

Karen, who holds a master's degree in economics and an MBA from Boston University, changed that with her research of hundreds of meteorological and engineering documents to develop the first probabilistic hurricane model in the insurance industry. The original model was described in "A Formal Approach to Catastrophe Risk Assessment and Management," published in the Casualty Actuarial Society's CAS Proceedings in 1986.

Among those who read that paper was Mike Wacek, now president and CEO of Odyssey Re, at that time an executive at reinsurance broker E.W. Blanch Co.

"Mike was absolutely the first person (other than myself) who became convinced that using scientific, engineering-based probabilistic simulation models to estimate potential catastrophe losses was an idea whose time had come," Karen said in accepting the APIW award. "In fact, even though the methodology had not been fully developed, he was willing to go out on a limb and convince his company—E.W. Blanch—that they should actually pay for its further development," she recalled.

Karen was retained by Blanch to co-develop the first probabilistic catastrophe model that gained widespread use within the U.S. insurance industry. Then Karen formed AIR in 1987 to develop a complete catastrophe risk assessment and management system for reinsurers, which became CATMAP.

Jim Stanard, who also had read Karen's paper, was then an executive at F&G Re, which became AIR's second client. And Jim volunteered some of the F&G Re staff to participate in meetings to design CATMAP, helping Karen package sophisticated scientific statistical models in software that underwriters could readily use when conducting their business.

As Jim presented the APIW award, he noted that "cat modeling, the field that Karen invented in 1985, has been central to the success of RenaissanceRe. So it is with personal gratitude that I am honored to present Karen Clark with the APIW Woman of the Year award."

Karen thanked many other early supporters, her staff and her family for contributing to the success of AIR, which now employs more than 100 people and has more than 200 clients.

Noting that many of her early supporters in the insurance business were males, she commented: "One male stands out particularly—his name is Andrew—Hurricane Andrew, that is." When the gales of laughter died down, Karen quipped, "This one event did more in four hours than I was able to do in four years."

Karen's 1986 paper had predicted annual insured cat losses could exceed \$16 billion. "I don't think that any senior decision-makers in the insurance business thought that numbers like that were possible," recalled Jim. "However, within five years, after Hugo at \$5 billion in 1989 and Andrew at \$15 billion in 1992, computer modeling of catastrophe exposures was considered an integral part of managing an insurance company."

And Karen Clark started it all.

*Publishing Director Kathryn J. McIntyre's commentary appears fortnightly and on [www.businessinsurance.com](http://www.businessinsurance.com). She can be reached at [kmcintyre@crain.com](mailto:kmcintyre@crain.com).*



Kathryn J. McIntyre

## Malpractice

*Continued from page 3*

aggressively raising rates and has said it will stop writing policies on an admitted basis if it can't win regulatory approval for the rate hikes it needs to return the line to profitability.

St. Paul announced last month that it would no longer offer medical malpractice policies on an admitted basis in Georgia and will only write policies there through its surplus lines subsidiary, St. Paul Surplus Lines Insurance Co., which is not subject to rate and form regulation. The insurer noted that it might extend this strategy to other states.

In its first-quarter financial statement filed with the Securities and Exchange Commission, the company stated: "The company's position is to achieve the required increases or discontinue underwriting the business, and, in 2002, be either a large and profitable health care insurer, or a small and profitable health care insurer."

The steep rate increases in the medical malpractice line are due to the large losses that insurers have experienced in recent years, said Geri Riley, assistant vp at Conning & Co. in Hartford, Conn., and author of a recent study on medical malpractice insurance.

"Losses are changing the whole scenario," she said.

In particular, hospitals have seen an increase in the number of million-dollar jury verdicts against them in recent years, Ms. Riley said. In addition, she said, "The size of the lawsuits is increasing dramatically."

The Conning study, among other things, looked at California jury verdicts. In 1999, the last year for which figures are available, there were 38 jury verdicts of \$1 million or more against hospitals in California. That was up 35% from 28 verdicts of that size in 1994. In addition, the average amount paid by insurers for medical malpractice awards or settlements in California set a record in 1999, at more than \$4 million, compared with only \$1.2 million on average in 1998, Conning reported.

Because of large verdicts, insurers' combined ratios for the medical malpractice line are "going up in leaps and bounds," Ms. Riley said. Across the industry, the combined ratio for medical malpractice insurance jumped to 128.3% in 1999, up from 116% in 1998, she said. This is projected to increase to as high as

139% when the final figures are compiled for 2000, she said.

While the problem with large jury awards and big money settlements is felt in many states, it is particularly severe in Pennsylvania, Texas, the Chicago area and Ohio, especially around Cleveland, Ms. Hart said.

"Philadelphia is the most difficult jurisdiction in the country right now," she said.

In Pennsylvania, multimillion-dollar verdicts have become more frequent in recent years. For example, last year in Philadelphia a jury awarded \$100 million in one medical malpractice case, said Dr. Carol Rose, president of the Pennsylvania Medical Society and an anesthesiologist at the University of Pittsburgh Medical Center. While the suit was eventually settled for \$11 million, the size of the original jury award will act to attract more suits and push up the amounts of future verdicts and settlements, she said. The Pennsylvania Medical Society advocates tort reform measures, such as caps on the amounts of damages a jury can award, as a way to restrain escalating jury awards.

On average in Pennsylvania, medical malpractice rates are up 26% with many policies being renewed with 100% rate increases "and some much greater than 100%," depending on loss experience, she said.

The high insurance costs have forced some doctors to retire or leave Pennsylvania to practice in neighboring states, where insurance rates are lower, Dr. Rose noted.

Rates are rising so sharply because soaring jury awards and settlement amounts are driving up insurers' losses, said Michael Klein, vp of underwriting for global health care at St. Paul in St. Paul, Minn.

"Both verdicts and settlements have more than doubled between 1994 and 1999," he said.

St. Paul's combined ratio for medical malpractice liability insurance has shot up as a result. The company's combined ratio on this line for 2000 was 138%. This has worsened this year as the first-quarter combined ratio stood at 170.8%, up from 115.4% from the first quarter of 2000.

St. Paul has moved aggressively to address this problem by pushing up rates. The amount of increase varies by state and by policyholder, with higher increases for those with a poor loss history or in states with a track record of large verdicts and settlements. The amount of increase varies from the single digits "up into triple digits for some of the

more problem accounts," he said.

The current state of the medical malpractice market differs greatly from how it looked for most of the 1990s.

Until 1999 "it was a rich market to mine," as loss ratios were good, said Nancy Aque, practice leader of Marsh HealthSpectrum, a unit of Marsh Inc. in Chicago. But that turned around in the late 1990s as losses started to mount but competition among insurers prevented them from raising premiums. This combination led to insurers' losses.

To return to underwriting profitability, medical malpractice insurers have not only raised rates but also started a renewed push toward stricter underwriting.

"They are going back to underwriting discipline in an extensive way," said John Geisbush, managing director and head of Marsh Global Broking at Marsh HealthSpectrum in Chicago.

The insurers are gathering more information on the physicians and hospitals, their loss history, and also looking at the legal environment of the policyholder's state. This helps to determine the possible losses that might take place, as some states have laws that cap damage awards while others have seen numerous high jury verdicts recently.

"It's a very responsible underwriting that's been going on," Ms. Aque said.

At ERC, the company is taking a closer look at policyholders before renewing their coverage, including a more thorough examination of risk management procedures in place at hospitals, Ms. Hart said.

In response to the rising rates, many hospitals are thinking of starting a captive insurer or moving more risks into an already existing captive, Ms. Hart said.

Ms. Aque said that historically, underwriting losses in the medical malpractice line usually spike up for a few years, then level off. She's not sure whether the losses are still moving up or have started to level off. If the losses have leveled, then the price increases will soon put the insurers back into a profitable position. But if the losses continue to rise, then profits could still be years away, she predicts.

Ms. Riley of Conning does not see the problem going away quickly, as the amount of litigation against doctors and hospitals continues to increase.

"I don't see the litigious environment in the U.S. changing soon," she said. **BI**

## Art

*Continued from previous page*  
had placed them in plastic garbage bags, which remained intact on the river bottom, Ms. Chaffinch said.

Reporting thefts often leads to the recovery of the stolen art objects, Ms. Chaffinch said. And the Internet is making it easier for law enforcement authorities to track stolen items.

The FBI maintains a National Stolen Art File, a computerized index of art and cultural property reported as stolen by law enforcement agencies throughout the world. Lyon, France-based Interpol also has a computerized database accessible via the Web, and the Art Loss Register maintains a private database of stolen items.

For an object to be eligible for entry into the National Stolen Art

File, it must be uniquely identifiable and have historical or artistic significance and it must be valued at \$2,000 or more. Furthermore, the request typically must come through a law enforcement agency, though Ms. Chaffinch said she has occasionally accepted requests from insurance adjusters when they are accompanied by police reports.

But because art is unique and does not usually have serial numbers, it is difficult to track and identify, she said.

To help identify art objects, the J. Paul Getty Trust in 1993 commissioned the development of Object ID, the international standard for describing art, antiques and antiquities.

Object ID, launched in 1997, was created through the collaboration of museums, cultural heritage organizations, police and customs agencies, the art and antiques trade, ap-

praisers and the insurance industry.

Object ID recommends that an owner take photographs and measurements of the piece. The standard advises the owner to document the type of object, the materials it is made of and the techniques used to create it, any inscriptions or markings, any distinguishing features, the piece's title and its subject, the piece's date or period, and the identity of its maker.

Mr. Wiener said he believes that IMUA's new standards also will aid recovery efforts.

"This is going to be especially useful to you as underwriters, because if a work of art is stolen, the chance of it being recovered is greater if there is a codified, systematic way of describing it, so that anyone who deals with art loss recovery can help you or the company that's going to write the check for lost art," Mr. Wiener said. **BI**

## Errors

Continued from page 1

amine reporting by state licensing boards, "prior studies and the health care literature offer considerable basis for questioning the patient protections they afford," the report states.

A spokeswoman for the American Assn. of Health Plans in Washington said managed care plans haven't been reporting to the data bank because they are not required to do so. Instead, plans have been reporting to state medical licensing boards, as required by law, the AAHP spokeswoman said.

"There has been confusion about whether the plans should be reporting directly to the data bank or to the state board of medical examiners or whoever licenses physicians," she said.

HMOs that met with HHS' Office of Inspector General before the report was released were surprised by its findings, given that no law re-

quires them to report to the national data bank, the AAHP spokeswoman said.

In response to the report, the HMO trade association has written to the OIG "to get some clarification," the spokeswoman said. "We asked to have discussions with them, because we feel they underestimated the extent of quality activities and the hurdles plans face in getting information."

Managed care plans "face substantial roadblocks" when they add particular physicians, because peer review laws that protect physicians often limit the availability of information from hospitals and group practices, she explained.

The HHS report comes less than two years after a 1999 Institute of Medicine report suggested that as many as 98,000 deaths are caused each year by preventable medical errors.

The IOM report has been cited by the Business Roundtable's "Leapfrog Group," an employer coalition dedicated to reducing

medical errors and improving the quality of health care through the use of best practices and technology.

Because the HHS report singles out managed care without considering the contribution of the so-called "downstream entities," it is not telling the whole story, health care experts say.

The HHS report "is further evidence of a multistakeholder failure to assume accountability for quality and for safety. But it should not be an occasion for singling out managed care organizations because their performance is not what it should be," said Dr. Arnold Milstein, national health care practice leader for William M. Mercer Inc. in San Francisco and chairman of the Leapfrog Group's standards committee. "You could say the same thing is true for doctors, hospitals, state licensing organizations and for purchasers."

"I'm very supportive of reporting. But it's got to be done in a way that makes sense," said Bruce Bradley, director of managed care plans at

General Motors Corp. in Detroit and a member of the Leapfrog Group.

Recognizing this, Leapfrog's focus has been on the implementation of known best practices, not on reporting, he said.

"The IOM and the National Quality Forum are thinking this through in a very intelligent way. We need to look at that expert dialogue, and, hopefully, that will result in policy that will have the most favorable impact on improving safety and quality—not on pointing blame," Mr. Bradley said.

The Washington-based National Quality Forum is a nonprofit organization of health care providers and consumers created to develop and implement a national strategy for health care quality measurement and reporting.

The organization has been working on "never events," or incidents that never should have occurred, such as the amputation of the wrong leg, Mr. Bradley explained.

Peter Lee, president of the San Francisco-based Pacific Business

Group on Health, the nation's largest employer coalition, was equally cautious about singling out HMOs.

"I think this finding underscores that health plans have been put between a rock and a hard place," Mr. Lee said. "On the one hand, they're backpedaling in the face of the anti-managed care backlash. At the same time, the public and purchasers have heightened their expectations about addressing known quality shortfalls."

"The promise of managed care that purchasers still need to look to is that those health plans will not only have effective preventive medicine and disease management programs but that they will also assure that their networks don't have bad doctors," Mr. Lee said.

Copies of the report, "Managed Care Organization Nonreporting to the National Practitioner Data Bank: A Signal for Broader Concern," are available at [www.hhs.gov/oig](http://www.hhs.gov/oig)

## Front pay

Continued from page 3

U.S. Circuit Court of Appeals upheld the cap, and Ms. Pollard appealed to the Supreme Court.

In its 8-0 decision, the high court defined front pay as "simply money awarded for lost compensation during the period between judgment and reinstatement, or in lieu of reinstatement."

Writing for the unanimous court—Associate Justice Sandra Day O'Connor did not take part—Associate Justice Clarence Thomas noted that although the 6th Circuit was one of the first to take up the issue, other federal appeals courts consequently have not treated front pay as compensatory damages subject to caps.

In his opinion, Justice Thomas said Congress had not intended front pay to be capped under such circumstances. In fact, in its 1991

amendments, Congress intended to expand rather than limit the remedies available under Title VII of the Civil Rights Act, he wrote.

The Supreme Court reversed the 6th Circuit's ruling and sent the case back for further consideration.

"This decision will have an immediate impact where alleged employment discrimination results in a substantial period when an employee remains unemployed," said Quentin Riegel, deputy general counsel of the National Assn. of Manufacturers in Washington. The NAM did not file an amicus brief with the Supreme Court in the case.

"We were disappointed that the Supreme Court did not include future wages within the meaning of 'future pecuniary losses' under the 1991 Civil Rights amendments," since Congress clearly intended to put a cap on both future losses and punitive damages, Mr. Riegel said. "As a result, a former employee who prevails in an employment dis-

crimination case will be entitled to future wages without a specific cap or limit. In some cases this could turn into hundreds of thousands of dollars or more," he said.

Mr. Riegel pointed out, however, that the ruling is not a blank check for victims of workplace harassment.

"A former employee is under a legal obligation to minimize the damages that he or she suffers, and has a duty to return to work or try to find another job. This newfound ability to sue for future wages must not be seen as an excuse to shirk the responsibility to accept reasonable opportunities to work," he said.

The decision is "significant due to the confirmation that the caps don't apply," said Heather Fox, assistant general counsel for National Union Fire Insurance Co. of Pittsburgh, Pa., a New York-based unit of American International Group Inc.

Ms. Fox said the decision "will likely result in increased awards to the plaintiffs" in such cases. "It will give the plaintiffs' bar more bargaining power in the settlement process," she said.

"Front pay can amount to a substantial amount of damages. We would have much preferred that the court had said it was included in the cap," said the Chamber's Mr. Bokat.

However, he added, "The other circuits had already rejected that interpretation, so in most places it's not going to be a dramatic change."

In another case of interest to some employers, the high court unanimously ruled last week, in *Norfolk Shipbuilding & Drydock Corp. vs. Celestine Garris*, that maritime law allows wrongful death suits based on negligence when the victim is not a seaman.

The case began when an employee of a sandblasting company working at a Virginia shipyard was

accidentally killed because of the actions of an employee of another subcontractor. The victim's mother sued the shipyard on grounds of wrongful death based on negligence under general federal maritime law. A district court said no such grounds existed, but the 4th U.S. Circuit Court of Appeals reversed the lower court and the Supreme Court upheld the appeals court. Three justices concurred only in part with the majority ruling, which was written by Associate Justice Antonin Scalia, because of a disagreement over the roles of Congress and the courts in shaping maritime law.

Sharon B. Pollard vs. E.I. du Pont de Nemours & Co., U.S. Supreme Court; No. 00-763, Decided June 4, 2001.

Norfolk Shipbuilding & Drydock Corp. vs. Celestine Garris, U.S. Supreme Court; No. 00-346, Decided June 4, 2001.

## Pensions

Continued from page 3

contributions. That \$170,000 limit will rise next year to \$200,000. Plus, that \$200,000 limit will increase—in tandem with increases in the Consumer Price Index—in \$5,000 increments, rounded down to the nearest \$5,000. That compares to an inflation trigger of \$10,000 set under a 1993 law.

In addition, the new tax law bumps up to \$160,000 the maximum annual employee benefit that can be funded through a defined benefit plan, up from \$140,000 this year. Like the old law, though, indexing will continue in \$5,000 increments.

The bumping up of benefit limits and the liberalization of inflation indexing come after years of lobbying by business groups. They complained that holding down benefit maximums led more companies to set up nonqualified plans through which to provide benefits to higher-paid executives that could not be funded through companywide plans.

Unlike qualified plans, nonqualified plans cannot be advance funded. Benefits are paid as they are due. Also, the Pension Benefit Guaranty Corp. does not insure nonqualified plans. As a result, if a company fails, executives can lose benefits provided through non-qualified plans.

"Nonqualified plans are less secure," said Larry Sher, a principal in the Teaneck, N.J., office of PricewaterhouseCoopers L.L.P.

With employers—thanks to the change in tax law—now being able to fund greater benefits

through qualified plans, executives' pension benefits will be more secure.

Similarly, with executives likely to receive larger benefits through companywide qualified pension plans, their interest in improving plan benefits should increase, which, in turn, would help rank-and-file employees, Mr. Sher said.

Still, even with the improvements in benefit maximums and liberalized indexing, companies won't be able to provide nearly as generous benefits through pension programs as they could in the early 1990s.

For example, back in 1993, employers could consider up to about \$236,000 in employee compensation in computing pension benefits and contributions. But legislation passed that year cut the maximum to \$150,000, which, through inflation adjustments, has grown to \$170,000.

Even with next year's increase to \$200,000, the amount of salary that can be included in pension benefits and contributions will be far below what it was in 1993 without even factoring in the inflation that has occurred since.

Even so, the fact that maximum benefit limits are being lifted is a change in direction from the 1980s and early '90s when massive federal budget deficits led legislators to squeeze dollars out of benefit plans to generate badly needed revenues.

But at a time of budget surpluses, pension plans no longer need to be targeted as a revenue source.

"When it comes to federal benefit policy, budget surpluses are a wonderful thing," said Kyle Brown, an attorney with Watson Wyatt Worldwide in Washington. **B**

## Bias suit rules clarified

By JUDY GREENWALD

PHILADELPHIA—The time period within which a plaintiff must file suit in an employment discrimination case begins only once the federal Equal Employment Opportunity Commission issues its "right to sue" letter, even if that takes several years, says a federal appellate court.

The May 25 decision by the 3rd U.S. Circuit Court of Appeals in *Timothy M. Burgh vs. Borough Council of the Borough of Montrose* involves a black man who filed a complaint with the EEOC in 1995. Mr. Burgh charged the Pennsylvania borough with race discrimination after he failed to get a job with the Montrose Police Department, which hired a white man instead. Mr. Burgh also filed a complaint with the Pennsylvania Human Relations Commission.

In 1998, in response to a request from Mr. Burgh's attorney, the EEOC finally issued a "right to sue" letter permitting Mr. Burgh to pursue his claim in court. A lower court dismissed the suit, stating that Pennsylvania's two-year statute of limitations for personal injury actions applied.

In overturning that decision, a three-

judge panel unanimously ruled that Mr. Burgh should be permitted to proceed with his suit because he did not violate either a federal or state statute of limitations.

On the federal issue, the decision says the EEOC has a minimum of 180 days to investigate a charge before a right-to-sue letter can be issued. The complainant then has 90 days to file suit. Although a civil action is not permitted if a plaintiff waits even one day beyond that 90-day period, "the statute of limitations does not begin to run unless and until there is 'final agency action,' such as the issuance of a right-to-sue letter," says the decision.

The decision also says that although the Pennsylvania Human Rights Commission had issued a letter in 1996 giving Mr. Burgh the right to file suit because it had been more than one year since he filed his complaint, there is no subsequent time limit within which a suit must be filed.

Mr. Burgh's attorney, David S. Dessen, of Dessen, Moses & Sheinoff in Philadelphia, said the court's decision indicates that "you shouldn't be disadvantaged because you let the agency take longer" to resolve a complaint.

# IRS

Continued from page 1

those rulings have not relied upon the economic family theory. Instead, courts have based their decisions on a variety of other criteria, such as balance sheet tests or the individual relationships among various companies within a group, the IRS acknowledges in Revenue Ruling 2001-31.

"No court, in addressing a captive insurance transaction, has fully accepted the economic family theory," the ruling notes.

In particular, three key rulings—the 1987 *Clougherty Packing Co. vs. Commissioner* case, the *Humana Inc. vs. Commissioner* case in 1989, and *Kidde Industries Inc. vs. United States*, decided in 1997—appealed to theories other than the economic family test to address the deductibility issue.

"Accordingly, the IRS will no longer invoke the economic family theory with respect to captive insurance transactions," the ruling says.

The *Humana* ruling has long been regarded as the landmark decision on the deductibility of premiums paid to captives. In that decision, the 6th U.S. Circuit Court of Appeals ruled that although parent corporations cannot deduct premiums they pay directly to their wholly owned insurance companies, their subsidiaries are entitled to tax deductions paid to the captive.

That paved the way for corporations to structure their insurance transactions in a way that ensured that most of the premiums were deductible.

But despite conceding some ground, the IRS will continue to challenge certain captive transactions based on the facts and

circumstances of each case, the agency's recent ruling says.

In particular, the IRS ruling cites *Malone & Hyde vs. Commissioner*, in which the 6th Circuit determined that a policyholder could not deduct the premiums paid to its captive because the captive was thinly capitalized and the policyholder guaranteed the captive's performance, so the transaction could not be characterized as insurance.

*'If there is no nontax reason for establishing a captive, it will still be attacked' by the IRS.*

— Thomas M. Jones  
McDermott, Will & Emery

Revenue Ruling 2001-31 acknowledges the practical consequences of the court decisions, but it may lead to more attempts by captive owners to deduct premiums, said James Cameron, an attorney at Baker & McKenzie in New York.

"It may make some people braver, and some people that are currently giving the money in the captive back to the parent and not taking deductions may look at alternatives now," Mr. Cameron said.

Also, other captive owners that have been unwilling to change their policies on deductions for fear of being accused of making accounting changes may now take the deduction and say the change is based on the IRS' new position, rather than on any change in the company's ac-

counting practices, Mr. Cameron said.

The IRS has conceded much in its latest ruling, but it has carved out an area it will continue to defend in its reference to the *Malone & Hyde* decision, said Thomas M. Jones, a partner at McDermott, Will & Emery in Chicago.

The IRS "will go after people where there are parent guarantees and thin capitalization," he said. "If there is no nontax reason for establishing a captive, it will still be attacked."

But overall, with the new ruling, there will be less need for IRS agents to focus on captive-related issues, Mr. Jones said.

The ruling is an "admission of the way things are," but the IRS "is not throwing up its hands," said Martin Nilsen, counsel at Edwards & Angell L.L.P. in New York.

The ruling should give captive owners greater impetus to ensure that their captives are well capitalized, because the IRS has now made clear that it will watch that issue more closely, Mr. Nilsen said.

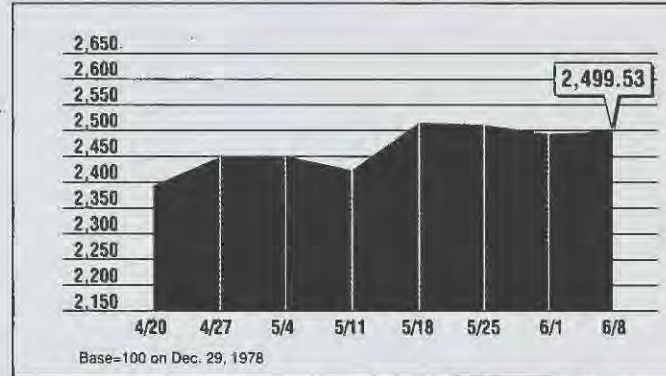
The ruling "has to be a positive for U.S. captive owners," said Alan Cossar, executive director at Aon Insurance Managers (Bermuda) Ltd.

While captive owners will still have to pay attention to the established case law when they set up captives, "it probably means that the IRS will not inspect captives as actively as they did in the past," he said.

The ruling will likely encourage some more-conservative companies to consider forming captives or making more use of the captives they already have, Mr. Cossar said.

"In the past, the tax issue has been a negative against good risk management decisions," he said.

# B/Stock Index - 6/8/2001



	Price	Weekly % change	Year to date % change	Year to date High	Year to date Low	Vol. (000)
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### BROKERS

Aon Corp.	NYS	35.06	1.01	2.36	42.31	28.13	4079
Brown & Brown	NYS	40.90	2.63	16.86	46.10	23.50	105
Clark Bards Holdings	NDQ	20.45	5.09	101.98	24.64	7.25	412
E.W. Blanch Holdings Inc.	NYS	13.50	0.00	-22.58	29.50	6.70	0
Gallagher Arthur J. & Co.	NYS	28.59	5.23	-10.13	34.25	18.22	1352
Hilt, Rogal & Hamilton	NYS	42.63	1.26	6.91	44.16	32.56	112
Keye Group Inc.	NDQ	13.90	0.29	79.35	13.90	5.00	48
Marsh & McLennan	NYS	105.29	0.28	-10.01	135.69	80.30	2730
BROKERS AVERAGE			1.97	20.59			

### INSURERS/REINSURERS

ACE Ltd.	NYS	39.66	4.09	-6.54	43.94	25.94	4217
Accel International Corp.	NDQ	0.07	0.00	-76.42	0.69	0.06	#N/A
Acceptance Insurance Cos.	NYS	5.50	8.70	4.76	6.94	3.70	116
AEGON N.V.	NYS	28.25	6.20	-31.83	43.00	25.92	690
AFLAC Inc.	NYS	32.94	2.62	-8.74	37.47	22.53	5832
America Financial Corp.	NYS	55.00	0.36	-24.14	74.25	46.30	767
Allstate Corp.	NYS	43.86	1.76	0.68	45.90	21.94	10296
Ambac Financial Group	NYS	56.24	1.74	-3.55	64.00	33.66	3226
American Financial Group	NYS	28.40	1.72	6.92	29.00	18.69	426
American General	NYS	44.88	0.94	10.13	46.38	29.40	7544
American Intl Group	NYS	80.76	0.84	-18.06	103.75	72.64	14610
American Safety Insurance	NYS	10.05	0.60	64.08	10.25	3.25	6
Argonaut Group	NDQ	18.20	1.11	-13.33	21.25	13.50	153
AXA-UAP Group	NYS	29.00	3.57	-19.23	40.75	24.58	867
Baldwin & Lyons Inc.	NDQ	21.33	-4.05	-8.26	28.75	15.25	5
Barkley W.F. Corp.	NDQ	43.86	1.29	-7.05	48.75	18.13	345
Berkshire Hathaway Inc.	NYS	67800.00	-0.88	-4.51	74800.00	51600.00	1
Capital Transamerica Corp.	NAS	14.28	-3.77	14.81	15.69	10.31	62
Chubb Corp.	NYS	76.38	2.73	-11.70	90.25	60.44	3583
Cincinnati Financial Corp.	NYS	41.51	-0.48	4.92	42.30	31.00	1586
Citigroup	NYS	50.95	-1.64	-0.22	59.13	39.00	47519
CNA Financial Corp.	NYS	39.40	-0.25	1.68	41.94	32.06	918
CNA Surety	NYS	14.16	0.43	-0.63	14.50	10.38	90
EMC Insurance Group Inc.	NDQ	12.30	4.95	4.68	13.70	8.00	13
ESG Re Limited	NDQ	3.50	2.04	89.83	4.25	1.72	102
Everest Reinsurance	NYS	69.69	3.24	-2.70	74.75	31.69	1012
Fremont General Corp.	NYS	6.76	5.96	140.36	6.97	1.50	1181
Gainco Inc.	NYS	1.56	-7.14	-40.57	5.13	1.10	78
Harleysville Group	NDQ	26.15	0.31	-10.60	30.63	16.13	129
HCC Insurance Holdings	NYS	24.58	-1.29	-8.75	29.66	17.63	1383
ING Groep N.V.	NYS	64.45	1.32	-19.56	83.94	55.84	338
IPC Holdings Ltd.	NDQ	23.00	-0.22	9.52	24.50	12.63	65
Hartford Financial Services	NYS	67.79	1.89	-4.01	80.00	49.44	2908
John Hancock Financial Serv.	NYS	40.00	0.13	6.31	42.00	19.63	6722
Lincoln National	NYS	50.78	2.57	7.33	56.38	35.44	2671
MAIC Holdings Inc.	NYS	15.55	0.00	-6.82	18.50	10.50	100
Markel Corp.	NYS	198.25	2.19	9.53	207.47	133.50	123
MBA Insurance Group	NYS	53.58	3.14	8.42	55.86	32.13	1874
Meadowbrook Insur. Group	NYS	3.83	-1.79	-52.86	8.38	2.45	19
MetLife	NYS	31.48	-1.07	-10.06	36.63	18.13	5260
Mutual Risk Mgmt. Ltd.	NYS	8.47	-0.35	-44.23	23.75	3.40	580
Navigators Group	NDQ	20.75	10.67	55.87	20.75	8.75	117
NYMag Inc.	NYS	21.63	-2.35	14.60	22.70	13.00	20
Ohio Casualty Corp.	NDQ	9.57	6.45	-4.30	11.88	6.13	1337
Old Republic Intl	NYS	29.20	4.77	-8.75	32.06	16.50	2555
Partner Re Ltd.	NYS	55.65	4.08	-8.77	62.50	34.81	584
Penn-America Group Inc.	NYS	10.10	5.00	32.46	10.60	6.69	0
PMA Capital Corporation	NDQ	16.90	-2.26	-2.03	19.03	15.19	36
Philadelphia Cons. Holding	NDQ	32.29	3.46	4.58	33.00	15.63	576
PXRE Corp.	NYS	17.22	0.00	2.04	20.10	12.50	44
RenaissanceRe Holdings Ltd.	NYS	71.10	4.25	-9.21	84.19	41.38	303
RLI Corp.	NYS	41.65	0.85	-6.80	46.16	33.50	45
St. Paul Cos.	NYS	49.77	0.38	-8.36	57.00	33.75	3947
SCOR	NYS	44.00	0.05	-12.44	53.75	39.75	5
SAFECO Corp.	NDQ	27.95	1.75	-14.98	35.88	19.69	4149
SCOPE Holdings Inc.	NYS	19.27	4.84	-18.43	31.40	17.78	NA
Seibels Bruce Group	NDQ	3.00	-1.64	433.33	3.25	0.53	7
Selective Ins. Group	NDQ	25.26	1.00	4.16	26.94	15.25	148
Tokio Marine & Fire	NDQ	49.55	-4.89	-13.07	61.00	45.25	39
Torchmark Corp.	NYS	38.62	1.90	0.47	41.19	24.00	1207
Transatlantic Holdings	NYS	122.80	1.15	15.99	124.45	80.38	38
Trenwick Group Ltd.	NYS	23.15	1.76	-6.70	27.13	13.13	296
Unico American Corp.	NDQ	6.00	3.09	2.13	7.75	5.27	11
United Fire & Casualty	NDQ	30.11	-9.09	52.48	34.52	15.50	44
Unibrix	NDQ	38.18	0.00	-6.02	41.94	27.19	0
UNUM Corp.	NYS	32.03	0.19	19.18	33.75	18.38	4276
Vesta Insurance Co.	NYS	8.99	-8.27	77.58	9.98	4.13	734
XL Capital Ltd.	NYS	81.51	4.77	-6.71	89.25	52.38	2510
Zenith National Ins.	NYS	26.90	-0.74	-8.43	30.70	20.00	182
INSURERS/REINSURERS AVERAGE			1.02	7.67			

### MANAGED CARE ORGANIZATIONS

Aetna Inc.	NYS	26.00	8.79	-36.68	42.69	23.02	6040
CIGNA Corp.	NYS	94.81	1.67	-28.34	136.75	85.50	4267
Health Net Inc.	NYS	19.18	2.57	-26.76	26.94	10.88	1886
Humana Inc.	NYS	10.26	6.76	-32.72	15.81	4.75	5235
Oxford Health Plans	NYS	28.92	5.62	-26.78	42.75	20.19	2623
Pacificare Health Sys.	NDQ	16.81	-10.92	12.07	72.31	9.81	4857
Sierra Health Services	NYS	6.87	13.55	80.79	7.00	2.44	1029
United HealthGroup	NYS	58.23	2.70	5.12	67.40	36.90	8663
Wellpoint Health Networks	NYS	89.77	3.66	-22.11	121.50	68.06	3363
MANAGED CARE COMPANIES AVERAGE			3.82	-9.52			

### ALL COMPANIES

Top advancing issues: Sierra Health Services, Navigators Group, Aetna Inc. Leading decliners, Pacificare Health Systems, United Fire & Casualty. Most active issue: Citigroup. The B/ Index increased 0.2%; the Dow Jones 30 Industrials decreased 0.1%; the S&P 500 went up 0.3%, and the NYSE Composite dropped 0.2%. Average P/E: Brokers, 23.1; Insurers/reinsurers, 26.6; and managed care companies, 15.1.

Source: CNET Investor (investor.cnet.com) Boulder, Colo.

# Tobacco

Continued from page 1

The case "never should have been tried" and will be appealed, Ronald S. Milstein, vp and general

*'It sends a clear message that this can be a viable approach for insurers.'*

— Edward L. Sweda  
Northeastern University

# Big awards and Big Tobacco

Case	Punitive award*	Date
<i>Boeken vs. Philip Morris</i>	\$3 billion	06/06/01
<i>Empire BC/BS vs. Philip Morris et al.</i>	\$17.8 million	06/04/01
<i>Engle et al. vs. R.J. Reynolds et al.</i>	\$144 million	07/14/00
<i>Whiteley et al. vs. Philip Morris et al.</i>	\$20 million	03/27/00
<i>Williams-Branch vs. Philip Morris</i>	\$81 million	03/30/99
<i>Henley vs. Philip Morris et al.</i>	\$50 million	02/09/99

\* At time of verdict. Awards may be reduced or pending appeal.  
Source: Northeastern University School of Law

are always trying to trumpet other cases that were dismissed" as indications that similar suits would face the same fate, he said.

Conversely, Mr. Sweda said, the Empire award could encourage other attacks by insurers on tobacco companies. "At the very least, it sends a clear message that this can be a viable approach for insurers."

At least two similar suits by health plans have been dismissed in Chicago and Seattle.

The \$3 billion award against Philip Morris in California is "bound to be encouraging" to plaintiffs in other individual cases, Mr. Sweda said.

Even if the award were cut by two-thirds, to \$1 billion, "what remains is pretty significant," he added, particularly considering the number of individual cases that have been filed against tobacco companies.

Mr. Sweda said that of the last 23 individual claims against tobacco companies that have reached trial, seven have been successful. "That's in the range of 30%," he said, and considering the thousands of individual claims that cigarette makers face, if they win 70%, that still leaves "a huge number that they would have to pay."

counsel for Greensboro, N.C.-based Lorillard, said in a statement.

Both Reynolds and Brown & Williamson also said in statements that they would appeal the verdict.

The verdict could encourage other insurers to seek to recover health care costs under similar claims, said Edward L. Sweda Jr., senior attorney with the Tobacco Products Liability Project at Northeastern University in Boston.

"It may. The tobacco industry and their friends on Wall Street



## THE GREATEST RISK IS NOT TAKING ONE.<sup>SM</sup>

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