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Self-funding of HMOs on the rise

Rate hikes, tax savings spur employer interest

By JUDY GREENWALD

More employers are moving to self-insure their health maintenance organization coverage.

While many large employers have incorporated at least some elements of self-insurance into their health plans for many years, this generally has included preferred provider organizations rather than HMOs. Now, employers of all sizes are moving toward self-insurance, spurred by hardening rates, the opportunity to save on premium taxes and the appeal of exemption from state regulation under the Employee Retirement Income Security Act.

According to William M. Mercer Inc.'s annual Mercer/Foster Higgins National Survey of Employer-sponsored Health Plans, the percentage of employers that self-insure their HMO coverage more than doubled in 2001, to 13% from 6% the previous year. Those that self-insure their point-of-service plans increased last year as well, to 15% from 7%.

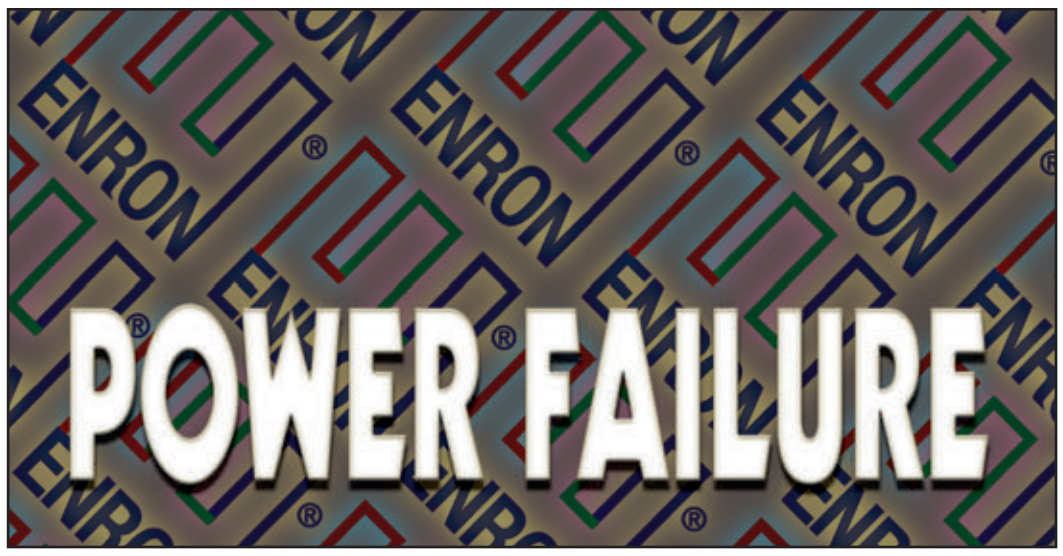
In a continuing trend that began last year, "the HMOs have finally reached a point where they have to drive their rates up to reflect their current cost of claims and administration, and the PPOs have the same problem," said Arnold M. Katz, the president of third-party administrator Brokerage Concepts Inc. in King of Prussia, Pa.

At the same time, insurers that offer stop-loss coverage, which self-insured employers often obtain to cap their losses, are "making profits again, and, as such, becoming a little bit more accommodating," said Mr. Katz. That development further enhances self-insurance's appeal, he said, predicting that, over the next 12 to 24 months, "you'll see a real swing back to self-insurance."

In the mid- to late 1990s, "it was a bit more of a buyer's marketplace," with the HMOs, in particular, trying to increase their insured population and offering competitive rates, said Rich Stover, a principal with Buck Consultants Inc. in Secaucus, N.J. Consequently, he said, it made sense, in certain situations, for employers to insure their health coverage.

But over the past few years, "with both the in-

See SELF-FUNDING/page 22



Enron D&O claims, litigation surge in wake of collapse

By DOUGLAS McLEOD

As Congress begins its post-mortem of Enron Corp. and the company's creditors spar over its affairs in bankruptcy court, insurers with nearly $2 billion in Enron insurance and surety exposures are bracing for claims and, in some cases, launching legal efforts to avoid liability.

Enron lawyers have asked a bankruptcy judge to approve $30 million in advances from directors and officers liability and fiduciary liability insurers to cover Enron officials' legal costs during government investigations and litigation with angry shareholders and ex-employees.

The company has $350 million in D&O coverage and up to $95 million in fiduciary and employee benefits liability limits. Both programs are led by Bermuda-based Associated Electric & Gas Insurance Services Ltd.

Meanwhile, several insurers are trying to rescind a series of surety bonds under which they guaranteed Enron's performance on $2 billion of oil and natural gas deals with a pair of JPMorgan Chase Bank affiliates based in Jersey, Channel Islands.

Chase has sued the insurers to recover $1.36 billion on behalf of the Jersey companies, Mahonia Ltd. and Mahonia Natural Gas Ltd., which prepaid Enron for future oil and gas deliveries

See ENRON /page 20

Calif. employers locked out of talks over comp increase

By ROBERTO CENICEROS

SACRAMENTO, Calif.—Employers and insurers say California Gov. Gray Davis is poised to sign legislation that would increase workers compensation benefits, a move employers have opposed.

And although employers complain that they had little opportunity to shape the legislation, it appears that some of their concerns may be addressed by lawmakers.

The governor spent a recent weekend negotiating with labor representatives and claimants' attorneys over the contents of legislation that would increase workers comp benefits. But employers and insurers complain that they were excluded from the meetings. As of late last week, they expressed fears that lawmakers would quickly adopt legislation that would increase benefits.

Senate President Pro Tem John Burton, D-San Francisco, had introduced a bill, S.B. 1156, that many employers opposed because they feared it would increase workers compensation costs by $3 billion. But late Friday, another measure was introduced, replacing the Senate bill.

That bill would mandate $2.5 billion in cost in-

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Late News

DOL probing Enron 401(k) lockout

The U.S. Department of Labor is investigating the three-week lockout Enron Corp. imposed last year on 401(k) plan participants when it changed plan administrators. During the lockout period—which occurred at a time when Enron's share price was plummeting—participants were not allowed to make changes to their investments, such as selling Enron stock they had purchased with salary deferrals. While such lockout periods are not specifically addressed in federal pension law, the Employee Retirement Income Security Act does require plan sponsors to administer plans in a reasonable way and in the best interests of participants, said Ann Combs, assistant secretary of the Labor Department's Pension and Welfare Benefits Administration.

Georgia-Pacific to take asbestos charge

Georgia-Pacific Corp. said last week it expects to report a $221 million after-tax charge for the fourth quarter of 2001 for costs related to its asbestos liabilities. The Atlanta-based paper products company, which faced about 62,000 pending asbestos liability claims at the end of 2001, based the charge on projections of its asbestos liabilities through 2011. Georgia-Pacific said it expects to recover most of these liabilities from its insurers over the next 10 years.

IRS extends pension deadlines

The Internal Revenue Service, responding immediately to newly signed legislation granting it the authority, is extending funding deadlines for employers whose pension plans were directly affected by the Sept. 11 terrorist attacks. The deadline for employers that were not directly affected also was extended. Under IRS Notice 2002-7, those employers that were directly affected by the Sept. 11 attacks—for example, those that had a plan administrator located in New York City—and that had pension contributions due between Sept. 11, 2001, and Feb. 11, 2002, now have until Feb. 12, 2002, to make their contributions. For other pension plans in which the deadline for

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NEWSPAPER

Spotlight on

EMPLOYMENT RISK MANAGEMENT

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Inside

Buyer awareness of pollution voids cover

Environmental cleanup costs are not covered under a comprehensive general liability policy if the former property owner was aware of the contamination before buying the coverage, the Washington Supreme Court has ruled. **Page 4**

New 401(k) safeguards needed

The plight of Enron Corp.'s 401(k) participants should spur congressional efforts to protect employees' retirement savings, Senior Editor Douglas McLeod writes in Commentary. **Page 6**

Pilots' example deserves emulation

The quick move by airline pilots to pay the COBRA health care premiums of their laid-off colleagues should inspire Congress to speed up its efforts to provide health care premium subsidies for workers laid off since Sept. 11, one of this week's editorials says. **Page 8**

Reacting to suggested reforms

Proposals to modernize the way Lloyd's of London operates have drawn a mixed response from participants in the 314-year-old market. **Page 17**

U.K. airline terror cover to end

London insurance market participants say that private insurers will be able to provide sufficient terrorism coverage for airlines when the U.K. government's program ends, but they note that the cost of the coverage may be high. **Page 17**

Departments

REPORTING WEEKLY ON CORPORATE RISK, EMPLOYEE BENEFITS AND MANAGED HEALTH CARE NEWS

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CONTINUED FROM PAGE ONE

making contributions fell between Sept. 11 and Sept. 23, 2001, the date for making contributions was extended to Sept. 24, 2001. The Victims of Terrorism Tax Relief Act of 2001, which President Bush signed last week, gave the IRS authority to extend the deadlines. The legislation also allows employers to make certain tax-free payments to the families of employees killed in terrorist attacks.

Chamber urges terrorism insurance backstop

The creation of a federal mechanism to guarantee coverage for losses stemming from future terrorism attacks ranks high on the list of the U.S. Chamber of Commerce's policy priorities for this year, according to the group's president. Senators need to "clean out their in-box," Chamber President and Chief Executive Officer Thomas Donohue told an audience of business lobbyists and others at a discussion of the business, political and economic outlook for 2002 last week. "We need a federal backstop to make sure that companies and other organizations can still get terrorism insurance," he said. Otherwise, the national economy, particularly commercial real estate, could stumble.

NAII opposes ruling on diminished value

Insurers are arguing that a Louisiana district court ruling that automobile insurance policies include coverage for diminished value could, if it stands, drive up insurance prices in the state. Although the ruling reached in March in *Floyd vs. Republic Lloyd's* dealt with a personal lines policy, if it is not overturned on appeal, the diminished-value concept might also apply to commercial auto coverages, according to the National Assn. of Independent Insurers. "That's a concern of ours," said Greg LaCost, counsel for the NAII. The NAII earlier this month filed an amicus brief in the case. The NAII argues that insurers are liable for the lesser of either the actual cash value of stolen or damaged vehicle or the amount to repair or replace the property with property of like kind and quality. Coverage does not include costs associated with any perceived decrease in the value of the vehicle, the group stated.

Late News

Profits, revenues rise at UnitedHealth

UnitedHealth Group Inc. posted profits of $913 million in 2001, a 29.5% increase over the prior year. Total revenues at the Minneapolis-based health insurer advanced 30.5%, to $23.45 billion. "We enter this year on a platform of outstanding 2001 results, strong and selective new business sales, and an ongoing focus on operational improvements," Chairman and Chief Executive Officer Dr. William W. McGuire said in a statement. Dr. McGuire projected continued growth in 2002.

ADA modifications unlikely: NAM official

Congress likely will not tackle changes to the Americans with Disabilities Act any time soon, so courts will have to continue clarifying the scope of that law, says an official of the National Assn. of Manufacturers. "A political remedy would be very difficult, given the current makeup of Congress,"

Quentin Riegel, deputy general counsel of NAM, said at a discussion of the ADA Friday in Washington. "I think we have to live with it the way it is." Mr. Riegel noted that the high court will hear a case next month—*Chevron U.S.A. vs Echazabal*—that has the potential to expand the ADA if the justices agree that the law requires employers to place workers in jobs that can threaten their health or even their lives, or face charges of illegal discrimination.

CNA expects $1.6 billion loss

CNA Financial Corp. said Friday that it expects to post a $1.6 billion loss for 2001 when it releases its full results next month. Losses stemming from the destruction of the World Trade Center, the collapse of Enron Corp., reserve strengthening and restructuring costs all contributed to the loss, which compares with a $1.2 billion profit in 2000, a CNA statement said. In particular, CNA took a $2.1 billion aftertax charge in the second quarter of 2001 to increase its loss reserves.

Briefly noted

Dan Hartman, chief risk officer for the state of Oregon and the 2001 *Business Insurance* Risk Manager of the Year, will retire Jan. 31. Succeeding him is David Hartwig, who will become administrator of the state's risk management division. Mr. Hartwig, 53, served as director of business services and, before that, director of risk management and benefits for Marion County, Ore., from 1987 until late 2001...**Lloyd's of London** has appointed Jeremy Pinchin to a new role, special counsel for Sept. 11, with responsibility for ensuring the efficient payment of claims stemming from the terrorist attacks. Mr. Pinchin is a lawyer, a former board member of Sedgwick Group P.L.C. and a current nonexecutive director of SOC Group P.L.C. He will report directly to Lloyd's Chairman Sax Riley.... Regulators in Delaware and Guam have approved **terrorism exclusions** for commercial lines policies, bringing the number of approving U.S. jurisdictions to 49—including 46 states, the District of Columbia and Puerto Rico—according to the Insurance Services Office Inc.

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All the material in the Late News 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.

'Heir apparent' Eslick to succeed to top posts

Mizel retires as USI chairman, CEO

By JUDY GREENWALD

SAN FRANCISCO—Bernard H. Mizel, chairman and chief executive officer of USI Holdings Inc. since its formation in 1994, is retiring, effective immediately.

David L. Eslick, who has been president and chief operating officer of USI since 1998, succeeds Mr. Mizel, 66, who will become chairman emeritus.

USI, which operates out of 77 offices in 21 states, held the No. 9 spot in *Business Insurance's* 2001 ranking of the world's largest insurance brokers, based on $359.7 million in brokerage revenues in 2000. Earlier this month, USI and Minneapolis-based Ceridian Corp., which offers payroll and human resources services, announced an alliance that will permit the two companies to offer a wide range of outsourcing services.

Mr. Mizel said in a written statement, "I am very proud of what we've accomplished since the founding of USI. Beginning with the vision of providing a single distribution point for middle-market customers' insurance-related financial services needs, we have built the sixth-largest brokerage firm in the country in just over seven years."

Mr. Mizel's decision to leave now is the culmination of a process, said Mr. Eslick. "Barney has stated to people for quite some time that I'm his heir apparent. We've been working through that process, with me taking more and more responsibilities as we've gone along." In light of the things USI has already accomplished and what it plans to accomplish in the future, "we felt now is a good time," he said.

Mr. Mizel

Mr. Eslick

"I don't see any dramatic changes," said Mr. Eslick of his assumption of Mr. Mizel's position. "I see us continuing to stay focused on our fully-integrated distribution strategy" and on other key strategies, including the Ceridian partnership, he said.

Under Mr. Mizel, USI has been known for its entrepreneurial approach, and that will continue, said Mr. Eslick. "The company has been built around a process of finding people that have a strong entrepreneurial spirit and, frankly, granting a lot of authority and responsibility to those people to make the right decisions to further the growth of the company, and we would definitely continue to embrace that concept," while also incorporating within it some of the company's strategic decisions. This way, "we can balance the best of both sides," said Mr. Eslick.

Mr. Mizel began his insurance career in 1959 as an account executive with the San Francisco brokerage firm of Levin, Knox & Co. Four years later, he purchased the San Francisco-based broker Albert M. Bender & Co. He sold it in 1978 to Bache Halsey Stuart, remaining as chairman and CEO of the entity, which was renamed Bache Insurance Services.

When Prudential purchased Bache and spun off the brokerage operations to Jardine Insurance Brokers, Mr. Mizel remained as president. He left Jardine in 1984 to form San Francisco-based American Business Insurance, which was subsequently purchased by Acordia Inc.

Mr. Eslick, who turns 43 this week, was president and CEO of ABI's Cincinnati operation before he joined USI in 1978.

PHOTO: TROY GOMEZ

About 80,000 football fans are expected to attend the Super Bowl, which will be played Feb. 3 in the Louisiana Superdome.

City ready for convergence of Super Bowl, Mardi Gras

By RODD ZOLKOS

NEW ORLEANS—New Orleans officials facing the dual risk management challenges of the National Football League's Super Bowl and the annual Mardi Gras celebration in February are basically viewing the situation as an extra-long Mardi Gras.

The Super Bowl's convergence with Mardi Gras occurred when the NFL rescheduled its playoffs after postponing its regular-season Sept. 16 and 17 games following the Sept. 11 terrorist attacks.

"I think what it really means is that our police and other employees that work a lot during Mardi Gras aren't going to get a break," a New Orleans city government spokeswoman said. "The Super Bowl basically adds a week to Mardi Gras."

Both events occur under the threat of terrorism that has dogged major gatherings in the United States since the September attacks, and the Super Bowl has been tabbed "a national security special event" by federal officials.

Under that designation, the Secret Service has taken charge of Super Bowl security. The Federal Bureau of Investigation, the Coast Guard and the Louisiana National Guard also will be involved.

"Secret Service has basically taken over security for the Super Bowl," the city spokeswoman said. "We have a multitude of agencies, including state police and city law enforcement agencies, who are working closely with them."

The Super Bowl is expected to draw 80,000 fans to the game and another

See NEW ORLEANS/page 22

Pilots' union approves plans to pay COBRA costs of laid-off colleagues

By JERRY GEISEL

Hundreds of the nation's commercial airline pilots who have been furloughed in the wake of the dramatic slowdown in air travel are finding the going smoother in the health insurance market—thanks to the generosity of their fellow pilots.

Pilots represented by the Air Line Pilots Assn. who work at three airlines—America West Airlines, Northwest Airlines and Delta Air Lines—have approved arrangements by which working pilots will pay in full the COBRA health insurance premiums of furloughed pilots for up to a year. Pilots at Continental Airlines now are voting on and are expected to approve a similar COBRA subsidy arrangement.

"We are gratified and proud that our pilots recognize the needs of their fellow pilots in times of hardship," said Elaine Grittner, senior benefits specialist at ALPA-NWA-MEC in Bloomington, Minn., which represents Northwest Airlines pilots.

The way the programs are structured varies from airline to airline. At Phoenix, Ariz.-based America West, each captain on active duty makes a mandatory contribution of $60 a month to a special fund, while each first officer contributes $40 a month. The fund then reimburses furloughed pilots for their COBRA premiums. At Northwest and Delta, the pilot assessments reimburse the airlines for the COBRA premiums, so that furloughed pilots themselves do not have to come up with the cash to pay premiums.

The cost of COBRA premiums can be considerable even for commercial airline pilots, who command top pay. At Northwest, monthly COBRA premiums can be as much as $850 for family coverage. An ALPA spokesman for America West pilots said monthly COBRA premiums for family coverage can exceed $900 a month.

The COBRA subsidy program at the airlines will benefit hundreds of furloughed pilots. For example, at America West, the program is available to 179 currently furloughed pilots, while hundreds of others at Delta and Northwest are receiving or will soon receive the COBRA subsidy.

COBRA, which is short for Consolidated

Omnibus Budget Reconciliation Act, is a 1986 federal law that allows an individual and his or her dependents to continue coverage under a former employer's group health care plan for a limited time.

Under that federal law, an employer can charge a beneficiary a premium equal to 102% of the cost of coverage in the group plan.

Work comp sole remedy in off-hours job site visit in California

By JUDY GREENWALD

FRESNO, Calif.—An off-duty employee who was injured while visiting her worksite is entitled only to seek workers compensation benefits for her injury and cannot sue the employer for negligence, a California appeals court has ruled.

"No good deed goes unpunished," says the Jan. 17 decision by the 5th Appellate District of the California Court of Appeals in Fresno. The ruling overturned a jury award of more than $500,000.

According to the decision in *Paula Wright vs. Beverly Fabrics Inc.*, Ms. Wright had visited the fabric retailer on a day off in June 1998 to sign a condolence card and to contribute money for two employees who had lost family members. While she was there, a shelf started to fall, and Ms. Wright hurt her back when she and two other workers grabbed it.

Ms. Wright later sued Soquel, Calif.-based Beverly Fabrics for negligence. After a trial judge denied the retailer's motion for summary judgment, a jury issued an award of $513,000 in economic and noneconomic damages.

The appellate court reversed that award, ruling that the lawsuit is barred by the workers compensation exclusive remedy doctrine. "We sympathize with Wright and the legal Catch-22 she now faces. However, we conclude the law is clear and reverse the judgment," reads the unanimous decision by the three-judge panel.

"We find Wright was acting in the course of her employment at the time of her injury and (that) her injury arose out of her employment," the decision states. "Injuries sustained while an employee is performing tasks within his or her employment contract but outside normal work hours are within the course of em-

See OFF-DUTY/page 6

43% say nation's overall state court liability system is 'only fair'

Chamber of Commerce polls lawyers on best, worst state court venues

RANKING OF STATES' LIABILITY SYSTEMS

Corporate attorneys rank the best five and worst five states by key elements

Treatment of tort and contract litigation

BEST	WORST
Delaware	Mississippi
Virginia	West Virginia
Nebraska	Alabama
Washington	Louisiana
Iowa	Texas

Punitive damages

BEST	WORST
Delaware	Mississippi
Kansas	West Virginia
Virginia	Alabama
North Carolina	Texas
South Dakota	California

Treatment of class-action suits

BEST	WORST
Delaware	West Virginia
Washington	Alabama
North Carolina	Louisiana
Nebraska	Oklahoma
Iowa	California

Juries' predictability

BEST	WORST
Delaware	Mississippi
Kansas	Alabama
Nebraska	California
Wisconsin	West Virginia
Minnesota	Montana

Source: Harris Interactive Inc./ U.S. Chamber of Commerce state liability systems ranking study

By MARK A. HOFMANN

Corporate attorneys rank Delaware first and Mississippi last overall in terms of state liability systems, according to a survey released last week by the U.S. Chamber of Commerce.

The ranking stemmed from a survey undertaken late last year for the Chamber by Harris Interactive Inc. and was based on the responses of 824 senior legal professionals at public corporations with annual revenues of at least $100 million. The survey asked respondents to rank individual state liability systems on each of a series of specific factors, ranging from treatment of class-action suits to the competence and impartiality of judges and the fairness of juries.

The rest of the corporate attorneys' top five states following Delaware were Virginia,

See LIABILITY/page 6

Buyer awareness of pollution voids coverage: Court

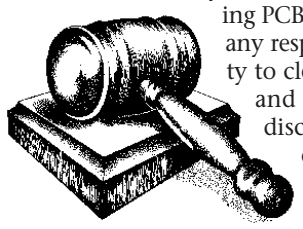
By SALLY ROBERTS

SPOKANE, Wash.—Environmental cleanup costs are not covered under a comprehensive general liability policy if the former property owner was aware of the contamination before buying the coverage, the Washington Supreme Court has ruled.

In the 5-4 decision in *Jerry Overton et al. vs. Consolidated Insurance Co. et al.,* the court ruled that, because Spokane Transformer Co. was aware of the presence of polychlorinated biphenyls—also known as PCBs—on its property prior to purchasing coverage, the contamination should not be considered an occurrence under the policy.

In the case, Spokane Transformer, an electrical transformer manufacturing and repair business, and its two former owners, Jerry Overton and Richard Boyce, were sued for contributions toward the cleanup costs by subsequent owners of the site on which the company had been located.

According to court papers, Spokane Transformer was made aware of elevated levels of PCBs in its soil in 1976, after testing by the Environmental Protection Agency. Mr. Overton, who owned the property at the time, denied the use of any fluids containing PCBs, denied any responsibility to clean it up and did not disclose the contamination to Industrial Indemnity Co. and Consolidated Insurance Co., from whom he purchased CGL policies in 1977 and 1979, respectively.



Spokane Transformer ceased operations and was liquidated in 1979.

Industrial Indemnity and Consolidated Insurance denied coverage for the cleanup costs, and Spokane Transformer later sued the insurers in 1998, alleging breach of contract, bad faith and violation of the Consumer Protection Act.

In reversing a court of appeals ruling, the high court said in its Jan. 17 opinion, "The insurers' denial of coverage was based on a reasonable interpretation of the CGL policies."

The policies, the opinion said, cover only "property damage that is unexpected from the standpoint of the insurer. Since the insurers' investigation revealed Spokane Transformer knew of the PCB contamination before buying the policies, their interpretation and conclusion there was no coverage was reasonable."

Jerry Overton et al. vs. Consolidated Insurance Co. et al., Supreme Court of the State of Washington, No. 70562-3. Decided Jan. 17, 2002.

Errors & omissions

● A Jan. 21 story on a 2nd U.S. Circuit Court of Appeals ruling about benefit promises omitted a word from a sentence explaining a district court judge's decision. The sentence should have read: "Relying on a 1993 5th U.S. Circuit Court of Appeals ruling, the judge ruled that the absence of reservation clauses in pre-1987 plan documents does not require Empire to provide lifetime retiree benefits."

● The Jan. 21 Comings & Goings column misidentified the former employer of Dennis Slabaugh, senior risk management consultant for Gulfshore Insurance of Naples, Fla. Mr. Slabaugh previously was corporate risk manager for NCH Healthcare Systems in Naples.

BI adds to staff in Chicago

CHICAGO—*Business Insurance* has added to its editorial staff in Chicago.

Carrie Brittain, 23, has joined the newsmagazine as assistant directory editor. She replaces Michel Schwartz, who resigned.

Ms. Brittain's responsibilities will include assisting in the production of *BI*'s in-publication and online directories.

Prior to joining *Business Insurance*, Ms. Brittain was an editorial assistant at Telecom Business magazine in Chicago, where she was involved in proofreading, Web site administration and writing. Before that, she was an editorial assistant at Digital Chicago magazine.

Ms. Brittain has a bachelor's degree in journalism from Columbia College in Chicago.

She can be reached at 312-649-5313.

Comp: Talks exclude employers

Continued from page 1

creases statewide but also contains reforms that would shave $1.5 billion in costs, for a net cost increase of $1 billion, according to Assemblyman Thomas M. Calderon, D-Montebello, who co-sponsored the bill with Sen. Burton.

Because employers are the sole funding source for workers compensation benefits, they argue they should have participated in the negotiations.

"It's very irritating, very," Willie Washington, legislative director for the Sacramento-based California Manufacturers & Technology Assn., said of the negotiations that were held without employers present. "Nobody is happy about that."

For three consecutive years, the governor acceded to employer requests by vetoing legislation that employers said would have increased total benefits costs by about $3 billion.

Organized labor still has the necessary legislative support to pass a bill, and the governor is up for reelection in November, with labor as one of his major backers.

Additionally, Gov. Davis is under pressure because California faces a potential ballot fight over benefits if he fails to sign the current legislation, Sacramento observers say. Labor activists in November filed applications with the office of the state's attorney general for two ballot initiatives. The two initiative proposals contain similar wording to increase workers comp benefits, but one would change the state's labor code, while the other would amend the state's constitution.

Either of the initiatives, if adopted by voters, would increase benefits costs by 39.8%—or $6 billion—annually, according to the Workers' Compensation Insurance Rating Bureau. The WCIRB derived its estimate by projecting statewide benefits costs of $15.2 billion for 2003. That includes costs for self-insured employers.

With those pressures as a backdrop, the governor likely would attempt to convince labor and attorneys to pare down the benefits increases from the $3 billion proposal, said a spokeswoman for the California Chamber of Commerce. Still, the spokeswoman said, the Chamber is irked that employers have not participated in those discussions.

A spokesman for the governor said his office does not comment on ongoing negotiations.

As of late last week, employer groups remained on the sidelines, attempting to keep an eye on developments in the negotiations.

The last draft of legislation they saw was very similar to past benefits-increase legislation employers had asked the governor to veto, but employer groups had not had a chance late Friday to examine the most-recent wording.

The earlier measure, S.B. 1156, would have increased payments for permanent partial disability injuries, including soft-tissue injuries, which account for the greatest number of claims filed. But employers have argued that increases should mostly benefit workers who are more severely injured. Employers also want an objective rating standard adopted for permanent partial disabilities, as opposed to the current approach of relying on the subjective judgments of physicians.

A statement from Assemblyman Calderon says the new legislation would eliminate the presumption that a treating physician is correct and would mandate additional education for physicians.

For their part, labor representatives maintain that workers are due a benefits increase. They note that most injured workers with limited partial disability ratings lose 30% of their wages while benefits replace just 12% of wages.

Off-duty: Injury a comp matter

Continued from page 3

ployment."

The decision says that Ms. Wright "was not hurt while she was signing a condolence card or visiting with coworkers. She was hurt holding up a shelf in an effort to protect the property of her employer, an activity reasonably contemplated by her employment."

Ms. Wright's attorney—Gary S. Davis of Modesto, Calif.-based Curtis & Arata—said he plans to ask the court to reconsider its decision and will appeal if unsuccessful. Mr. Davis said the decision fails to adequately take into account that Ms. Wright had acted on instinct when she rushed to help.

"How does one go from a social visit to being an employee—with no thought process, in a split second?" asked Mr. Davis. He also noted that Ms. Wright had testified that she would have acted in the same way had the incident occurred at another company's store.

Defense attorney David S. Key of Sandall & Penrose in San Jose, Calif., said the decision is important because if it had it gone in Ms. Wright's favor, it would have forced employers to bar employees from the premises in their off hours, "and I don't think that's to anyone's advantage."

Another defense attorney on the case—James P. Wagoner of McCormick, Barstow, Sheppard, Wayte & Carruth in Fresno, Calif.—said appellate courts are traditionally very reluctant to reverse jury verdicts. "I think they really felt compelled by the law to do what they did," he said.

Paula Wright vs. Beverly Fabrics Inc., Court of Appeal of the State of California, 5th Appellate District, F035445.

Liability: States compared

Continued from page 3

Washington, Kansas and Iowa, in that order. Their next worst, after Mississippi, were West Virginia, Alabama, Louisiana and Texas.

The attorneys rated Delaware highest in each of 10 categories and Mississippi worst in eight of the 10 categories. West Virginia was ranked last in the other two categories.

Most of the nation's larger states fell in the lower half of the rankings, said Humphrey Taylor, chairman of the Harris Poll, which is part of Harris Interactive. California, for example, ranked only one slot above Texas.

In addition, Mr. Taylor noted that the surveys covered only states as a whole, with no differentiation between, for example, New York City and upstate New York, so there could be large variations within a state.

Nevertheless, "the differences between the states are substantial. These are not trivial differences," he said.

In addition, 43% of the respondents rated the nation's overall state court liability system as "only fair," with 14% calling it "poor." Although 37% of the respondents called the system "pretty good," only 2% called it "excellent," with the remainder responding "not sure."

Chamber President Thomas Donohue noted that 78% of the survey respondents said that the litigation environment could affect important business decisions, such as where to locate or where to conduct business.

The survey also asked its respondents to identify the most important issues that state policymakers concerned about economic development should focus on as they attempt to improve the litigation environment. The two most frequently cited were tort reform and punitive damages, mentioned by 18% and 17% of the respondents, respectively.

The Chamber plans to conduct similar surveys in the future, Mr. Donohue said.

Copies of the Chamber's report, "U.S. Chamber of Commerce State Liability Systems Ranking Study," are available online at www.litigationfairness.org.

Commentary

401(k) 'freedom' carries big price

It hasn't been hard to spot the most sympathetic victims of the Enron debacle: the company's employees. These are the 15,000 people who collectively saw $1.3 billion—or about 62%—of their year-end 2000 401(k) retirement savings vanish as Enron's stock cratered last fall.

It also hasn't taken long for free-market hard-liners to spot the threat these employees pose to the laissez-faire regulation of 401(k) plans. While expressing pity for Enron's workers, some conservatives are, in the same breath, attacking the idea of any new regulations that would limit employees' "freedom" to choose retirement plan investments. Enron workers had this freedom, the argument goes. They chose badly. Tough luck.

But shouldn't a retirement vehicle's main aim be security rather than freedom of choice? And don't current 401(k) regulations make this "freedom" illusory anyway?

Douglas McLeod

Enron employees, as everyone now knows, had far more money in company stock than is typical for such plans: 62% vs. the 28% to 43% that various consultants have found to be average. In many other ways, though, the Enron 401(k) was typical. The company allowed employees to defer up to 6% of salary into any of 20 investment options, with Enron matching 50% of employee contributions. As federal regulations permit, Enron used its own shares for the company match, and it prohibited employees from shifting the matching funds from Enron stock to other investments before reaching age 50.

Who could be surprised that the plan's holdings in Enron shares dwarfed the amounts in the other investment alternatives, or that employees were happy to have it that way? Enron stock climbed steadily from $20 per share in mid-1998 to more than $80 in early 2001 before beginning the slide that ended in the company's December bankruptcy filing. During its ascent, the stock's performance surely outpaced any other investment option, and the employees very likely believed Enron's self-aggrandizing bluster and Chairman Kenneth Lay's 11th-hour advice that the company stock was "cheap" at $30.

So can we say that employees in this situation made up their own minds and must live with the consequences? Not really.

Enron shows how far we've come from the days when defined benefit plans were the norm, when employers were committed to providing fixed benefits to their retirees. Defined contribution plans such as 401(k)s shifted some of the retirement savings burden to employees, who were "freed" to take on the risk of investing their retirement assets.

Yet 401(k) participants, unlike corporations, are not sophisticated investors: Look no further than the failure of many employees to rebalance their portfolios over periods of years. And even sophisticated investors such as public employee pension funds lost their shirts on Enron stock.

Congress must act to limit this risk to retirees. There's no good reason, for instance, not to limit employee investments in company stock to 10% or 20% of total assets. And if freedom of choice is really an issue, Congress should make sure that workers can shift company contributions of stock into other investments if they choose, halting companies' ability to lock employees into long-term stakes in company shares.

Deregulation proponents—who presumably would never put 62% of their own money into one stock—decry such proposals as encroachments of heavy-handed government into a free marketplace.

The fact is, though, that government has a role in reining in the free marketplace where necessary, and it does so every day in all sorts of ways.

State insurance laws, for example, bar insurance companies from putting more than 10% of their money into any single investment. Insurance company portfolio managers are not novices; they know how to diversify. But the law is there, just in case. Should we assume that the average 401(k) participant knows more about investing than an insurance company does?

Everyone involved in this debate ought to agree that the goal of a 401(k) should be to provide secure retirement income, not to give employees a free run at the stock market—or employers an expedient place to deposit company shares. Many retirees will need that income to supplement inadequate Social Security benefits.

And given the fate of Enron's employees, most would probably trade a little freedom of choice in investments for a little more of that security.

Senior Editor Douglas McLeod's commentary appears periodically and on www.businessinsurance.com. He can be reached by e-mail at dmcleod@crain.com.

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Editorial

Lloyd's stands to gain from reforms

PROPOSALS TO REFORM LLOYD'S OF LONDON would advance efforts, begun with the market's reconstruction and renewal plan more than five years ago, to modernize the insurance marketplace and to address the concerns of critics.

Lloyd's, which is more than 300 years old, in the last century became a leading insurance marketplace for coverage in the United States and around the world. With that prominence came unprecedented losses—fueled, in part, by bad underwriting and greed—that nearly broke the market. Yet, beginning with the R&R plan, in recent years Lloyd's has made strides to put the mistakes of the past behind it and remain competitive in the global marketplace. In spite of these efforts, though, further change is needed to unshackle Lloyd's from problems created by systems that are historic but flawed, and to transform Lloyd's into a competitor for the 21st century.

Adherents of Lloyd's tradition and uniqueness no doubt will deplore the proposed reforms as an unfortunate transformation into an insurance market that has more in common with today's multinational insurance corporations than with Edward Lloyd's coffeehouse. Also opposed are likely to be many individual names who have put their wealth at risk and have profited from sound underwriting or, in some cases, hefty tax breaks.

Although some of Lloyd's singularity and mystery would be lost under the proposals, many other elements would be left intact and would ensure that Lloyd's remains distinctive in the world of insurance. These include its international reach, the specialization and expertise within the market and, indeed, the fact that it will remain a marketplace and not become a single corporate entity like its competitors.

For the sake of policyholders that depend on the market to pay claims and to provide coverage against future risks, we hope the proposed reforms are approved. For the underwriters, brokers and others whose livelihood is tied to Lloyd's, these changes are essential if the market is to continue to attract policyholders and new capital.

The proposed reforms were drawn up by a task force appointed by Chairman Sax Riley and submitted to Lloyd's ruling council earlier this month. The proposals call for:

- Abandoning the market's three-year accounting system in favor of generally accepted accounting principles.
- Abolishing unlimited liability underwriting by names. Lloyd's would not accept any new names, and existing names would have to convert to limited liability status by 2005.
- Ending the annual venture system, in which the market had to renew its capital base each year.
- Replacing the dual Market Board and Regulatory Board with a single governance body for the market.

Mr. Riley succinctly summed up the reasons behind the proposed reforms: "Our aims are profitability, modernity and transparency."

We believe these changes would help achieve those aims. Deciphering results under the three-year accounting system, for example, was often a murky effort for all but Lloyd's insiders. That system also stymied attempts by investors, policyholders and regulators to compare Lloyd's underwriting performance and potential with that of other sources of coverage.

The move away from individual unlimited liability names is also overdue. It can be argued that Lloyd's traditional capital base—wealthy individual names—was also largely naive capital. This gave underwriters greater latitude to make poorer decisions on risks and pricing than might a corporate investor with insurance expertise.

For those individuals who want to remain with Lloyd's as an investment, there will still be many ways in which to do so, albeit without some of the lucrative tax breaks afforded unlimited liability names.

Given all of these considerations, we believe that the proposed changes will help transform Lloyd's from an anachronism to a modern insurance market poised to meet buyers' needs for a long time to come.

Pilots set example worthy of emulation

IT IS HEARTENING to see that many of the men and women who are pilots for the nation's airlines are doing their part to ease the pain of their fellow pilots who have been laid off because of the slowdown in air traffic.

As we report on page 3, pilots of several major airlines, who are represented by the Air Line Pilots Assn., have agreed to reimburse furloughed pilots for their COBRA health care continuation premiums.

Although pilots are among the most highly paid employees in the country, even this organized elite can feel the bite of COBRA premiums—which can be more than $10,000 a year for family coverage—at a time when the chances of returning to work soon aren't very high.

The airline pilots who were fortunate enough to keep their jobs are not standing idly by. Although the amounts vary from airline to airline, individual pilots have agreed to pay anywhere from $40 to nearly $100 per month for one year, to ensure continued COBRA medical coverage for their laid-off colleagues.

It is an incredibly kind gesture, and the pilots should be commended for their generosity. Indeed, as one ALPA representative said, "We are gratified and proud that our pilots recognize the needs of their fellow pilots in times of hardship."

With their quick response, the pilots stand in stark contrast to Congress and the Bush administration, which have wrangled for months—and continue to wrangle—over what kind of health care premium subsidies, if any, the federal government should provide employees laid off since the Sept. 11 terrorist attacks.

We doubt that politicians will reach agreement on the matter any time soon. Fortunately, pilots, who are known for quick thinking under pressure, were able to act with the needed speed to come to the aid of their colleagues.

Schillerstrom

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Employment Risk Management

[Spotlight Editor: Sally Roberts]

Brands used to bargain in EPL suits

Companies may settle to avoid bad publicity

By ROBERTO CENICEROS

Brand protection and employment practices liability have become entwined as plaintiffs attorneys target image-conscious large corporations that are eager to avoid negative publicity.

More than in the past—before brand image became a bargaining chip held by plaintiffs in employment disputes—major corporations now want quick out-of-court settlements. They seek to avoid drawn-out legal fights that land their corporate names in the media, say attorneys, brokers and insurers.

Several Fortune 100 companies recently have paid tens of millions of dollars each to settle demands before they reached court, the sources say. Once in court, records are opened to the public and the media.

Some insurers worry about a rush to settle demands before they can ascertain the viability of claims. Reducing losses, meanwhile, requires employee recruitment, retention and promotion practices that foster workforce diversity, observers say.

"The battlefield has shifted," said Gerald L. Maatman Jr., a partner at the law firm of Baker & McKenzie in Chicago.

The problem first surfaces for an employer when a formidable law firm threatens multiparty, or "mass-action," litigation because of a company's employment practices toward a protected class of employees. But the plaintiffs' real leverage point—one that some observers liken to blackmail—is the defendant's brand reputation. The attorneys usually advise their targets that they want to settle a case rather than file a lawsuit that will pique media attention.

"It's becoming a huge issue," said Gina Higgins, managing director and employment practices liability leader for Marsh's FINPRO group in New York. "All the financial institutions and all the publicity-savvy corporations—like soft drink companies, oil and gas companies that have a good public relations image—are very concerned about this."

Retail industry companies also are favorite targets, said Michael J. Maloney, employment practices liability group manager and vp in Simsbury, Conn., for Chubb Specialty Insurance, a division of Chubb Corp.

Several risk managers say, though, that brand protection has yet to become a concern for them, especially in relation to employment liability. But as high-profile business debacles grab media attention, corporate officers could start demanding that risk managers address brand protection, said David L. Mair,

See BRAND /page 14

Likelihood of less cover for more money seen in D&O renewals

By DAVE LENCKUS

The likelihood of receiving nonrenewal notices for directors and officers liability insurance puts the prospect of higher costs, less coverage and tougher terms and conditions at renewals into a new perspective for risk managers.

While the collapse of energy trader Enron Corp. may be too recent to influence D&O policy terms and conditions, it has strengthened many insurers' resolve to underwrite accounts more meticulously, broker and insurer executives say.

Many market executives estimate that 50% to 80% of risk managers should expect nonrenewal notices on D&O coverage this year. But that does not automatically mean that insurers are unwilling to renew. State regulations, adopted after the hard market of the mid-1980s, require insurers to issue the notices if premiums rise or coverage deteriorates beyond certain thresholds—even if the insurers fully intend to renew.

"Very few accounts are exempt from rate movement" and some other coverage changes, explained Tony Galban, vp and worldwide underwriting manager for Chubb Corp. subsidiary Chubb Specialty Insurance in Simsbury, Conn.

Risk managers should not be alarmed, though, because the notices do not mean underwriters will walk away, Mr. Galban said.

Still, market executives say that insurers will abandon policyholders that do not agree to certain changes in their D&O policies.

Most significantly, risk managers should expect to pay 20% to 50% more for less primary D&O coverage.

Only the biggest publicly traded companies and small privately held companies are likely to be able to negotiate better deals—with their premiums increasing by 10%—but only if they have sparkling loss histories.

Market executives cite far more examples of companies that should expect their D&O premiums to be double, triple or, in extreme cases, spike by 1,000% over their expiring premium. Those include risks with recent losses, those with anything but pristine balance sheets and those that have gone through initial public offerings in recent years. In addition, health care, telecommunications, financial institution and technology companies should expect above-average increases in their premiums.

For excess D&O coverage, the cost problem

See D&O /page 16

Fiduciary liability market constricting

By JOANNE WOJCIK

The bear market for securities, which is triggering an increasing number of fiduciary liability suits against employers, is providing a bullish opportunity for insurers.

Underwriters assert they must increase premiums and reduce capacity because fiduciary liability insurance is underpriced relative to its exposure. They say that liabilities under the federal Employee Retirement Income Security Act today have the potential to rival directors and officers losses, which, in the past, had been many companies' biggest exposure.

Recognizing the increased risk, coverage experts are advising risk managers to switch from blended programs—with their aggregate limits for D&O, fiduciary liability, employment practices and other types of professional liability coverage—to stand-alone fiduciary liability policies.

They also recommend buying higher limits—if employers can get them.

Several high-profile lawsuits, such as that those by 401(k) participants at the failed Enron Corp. (*BI*, Dec. 10, 2001), have drawn growing attention to the risk of fiduciary liability suits against employers.

"We've seen the market constricting even before Enron," said Ann M. Longmore, senior vp and fiduciary practice leader at Willis Ltd. in New York, pointing to suits filed by 401(k) plan participants against Lucent Technologies Inc., First Union Corp., IKON Office Solutions Inc. and the Bank of New York. "There have been a number of eight-figure cases."

Because many of these cases involve 401(k) plans whose value plummeted when the price of company stock fell, "some underwriters want to know what percentage of company stock is in the 401(k) plan. A $1 billion plan with 20% or 25% invested in company stock will attract attention," Ms. Longmore said.

Companies with employee stock ownership plans also will find themselves under tougher scrutiny, said Cary Meiners, underwriting director in the financial and professional services unit of The St. Paul Cos. Inc. in St. Paul, Minn.

"The underwriters will ask questions about the company's philosophy about investing in company stock," Mr. Meiners said. For example, "many companies, including dotcom companies, were really encouraging employees to invest in their own company's stock."

Such tougher underwriting is necessary because the nature of fiduciary liability has changed, Mr. Meiners said. "In the past, a lot of the focus was on prohibited transactions," such as conflicts of interest in selecting investment managers. "Lately, it's shifted to suitability," he said.

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■ Virtual workplace training Page 14

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Fiduciary: Bear market provides opportunity

Continued from page 10

Today, employers must determine whether the investments offered in 401(k) plans and other defined contribution plans are suitable and whether there is sufficient opportunity for diversification, Mr. Meiners said.

Mr. Meiners said he has seen claims filed by disgruntled retirees following a merger or acquisition if the share price of the tender offer exceeded the per-share price that workers were paid when they cashed out of company stock at retirement. "Downsizing and layoffs also can trigger claims," he said.

Financial institutions that use their own funds also have been "a cause for concern" for insurers that write this line of coverage, said Rhonda Prussack, vp and fiduciary liability product manager at National Union Insurance Co. in New York, a unit of American International Group Inc. "It's important that they use third-party investment managers and third-party administrators," Ms. Prussack said.

The fees that financial institutions charge their employees for investing in proprietary funds also will be reviewed, she said, citing as an example one case in which a firm was charging its employees investment management fees but not its clients.

Such plan sponsors also will be asked whether they periodically investigate other, comparable, funds to make sure the sponsors are providing an adequate number of the best options to their employees, said Rich Koski, a principal in Buck Consultants Inc.'s New York office. "Make sure you do due diligence (and) periodically review plan offerings. Go to market every now and then," Mr. Koski said.

In addition to tightening up its fiduciary liability underwriting practices, National Union is requiring higher retentions and sublimits for claims involving company securities, Ms. Prussack said. National Union also is raising premiums anywhere from 20% to 30% for "small, clean stuff," to 200% to 300% "on some tough risks," she said.

And "there are no multiyear policies any more," Ms. Prussack said.

In fact, few, if any, multiyear fiduciary liability policies are available anywhere in the market, sources say.

Michael D. Phillipus, manager of risk management at Pennzoil-Quaker State Co. in Houston and vp-external affairs for the Risk & Insurance Management Society Inc., said he has heard from his colleagues that "the primary players have been unwilling to roll the coverage to more than one year."

Another common practice—combining fiduciary liability coverage with other so-called "executive protection" coverage, such as D&O and employment practices liability—also is being reconsidered, not only by insurers but by buyers.

"A lot of companies have chosen to write blended products" that include "professional liability, D&O, employment practices, fiduciary liability and some E&O," St. Paul's Mr. Meiners said. But blended programs generally have a single aggregate limit for all of these exposures, and that limit may not be sufficient to cover both a fiduciary liability and a D&O lawsuit, he said.

Such combinations of suits are becoming increasingly common, Mr. Meiners said. "There have been a number of follow-on suits, fiduciary liability suits brought after a D&O or shareholder action has been settled," he said.

Now that either of these exposures individually has the potential to exhaust the aggregate limits, Mr. Meiners said, risk managers may want to rethink buying blended programs.

"If there's a risk, directors and officers may not be able to utilize the full limits; they may not be comfortable with package policies," Mr. Phillipus said.

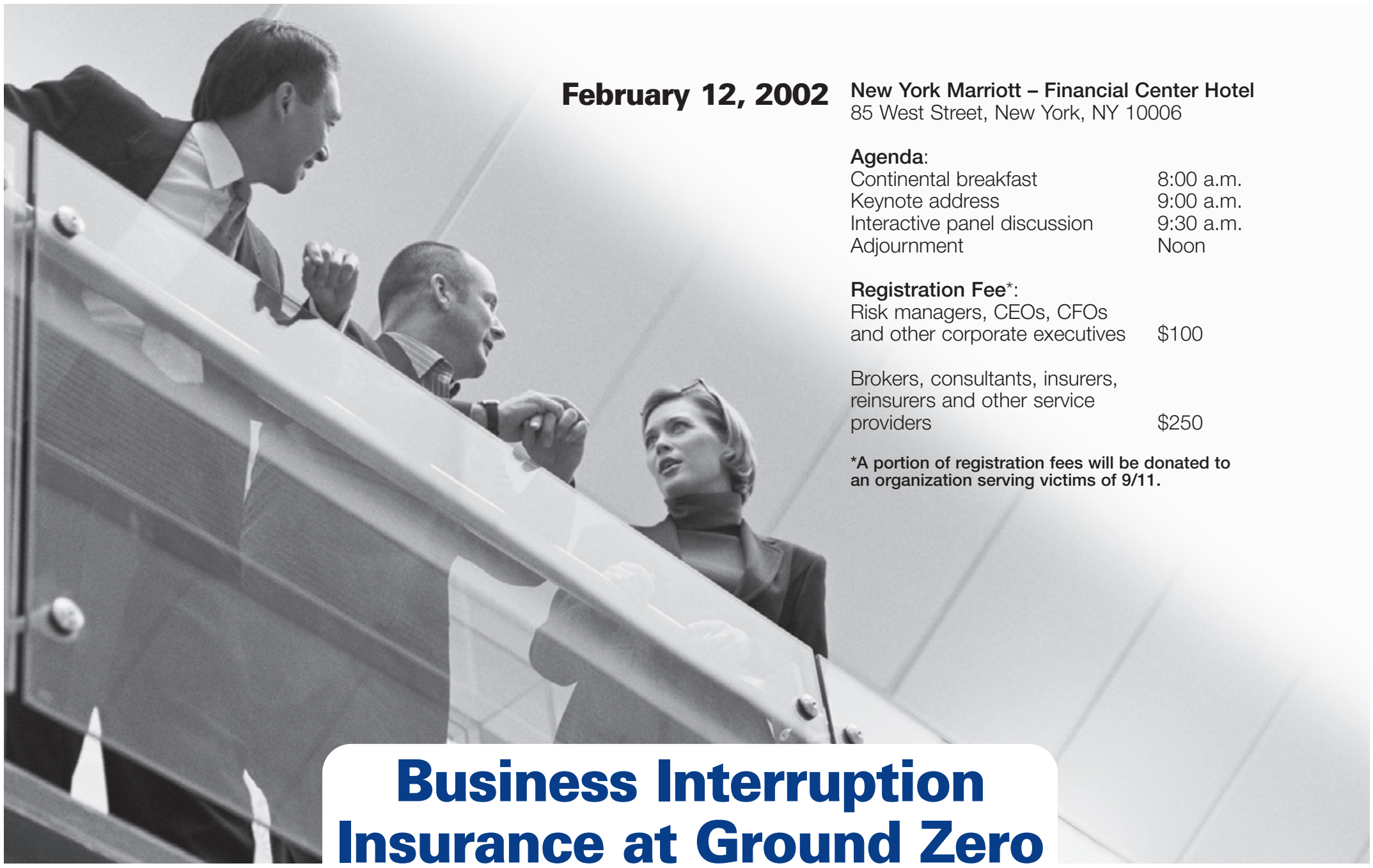
Finding adequate limits even separately may not be an easy task, though, said Willis' Ms. Longmore. "This time last year, you could get $50 million from a single carrier. Now, you may get only $10 million or $15 million or $20 million," she said.

That makes it difficult to assemble the sizable limits that companies with large pension funds need, she said.

For example, Ms. Longmore recommends that companies with pension funds valued at $1 billion or more buy limits anywhere from 5% to 15% of total plan assets, or $50 million to $150 million. "You may need 10 carriers" to get this amount of coverage, she said.

Assembling a large program is even more difficult if an insurer institutes sublimits, as National Union is doing, Ms. Longmore said. "Say you have a $15 million primary policy with a $10 million sublimit. The excess carrier won't drop down, so the policyholder has to pay the difference. And if the excess carriers followed form, there would be a gap in every layer," she said.

But even if a company can find adequate coverage limits, "they're going to pay through the teeth," Ms. Longmore said. Renewals this year for fiduciary liability coverage "are going to be very, very shocking" for insurance buyers, she warned.



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Agenda:

Continental breakfast	8:00 a.m.
Keynote address	9:00 a.m.
Interactive panel discussion	9:30 a.m.
Adjournment	Noon

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Online tools aiding harassment-prevention efforts

High-tech approach cost-effective for reaching broad audience

By MICHAEL PRINCE

Because of the high cost of in-person employment practices training, some employers have turned to online systems as a way to educate employees about the prevention of workplace harassment and discrimination.

And, experts say, three recent Supreme Court decisions have made the potential cost of not providing such training very high.

Traditionally, formal employment practices training has been provided by attorneys or other professionals during live presentations. Although such talks allow presenters to address employers' specific concerns and can lead to wide-ranging discussions, they can be very costly, particularly for employers with multiple locations. In addition, gathering all of a firm's employees at one location can be difficult, and many people never attend the training.

With online training, though, employees undergo training on their home or work computers, allowing them to complete the program at their convenience. In addition, a single training program can be used to educate all of an employer's workers, making the online approach, in many cases, more cost effective than relying on in-person seminars.

Online training is easier to "spread throughout the whole organization," said Michael Maloney, vp-employment practices liability products group manager for Chubb Corp. in Simsbury, Conn. Last September, Chubb launched a free online training program for its policyholders.

Lexington Insurance Co. in Boston, another large underwriter of employment practices liability coverage, offers its own online training program. And a program jointly developed by Corporate Matters Ltd. in Montclair, N.J., and Rutgers University became available online this month.

The move toward online training is part of a broader push to educate employees about workplace harassment in order to reduce or eliminate sexual harassment lawsuits.

Training has become much more important for employers since 1998, when the U.S. Supreme Court handed down two key decisions—*Burlington Industries vs. Ellerth* and *Beth Ann Faragher vs. City of Boca Raton*—said Gerald L. Maatman Jr., partner and chair of global employment law practice at Baker & McKenzie in Chicago. These rulings held that, in many cases, an employee that fails to follow an employer's procedures for lodging a harassment complaint cannot prevail, provided the employer exercises reasonable care in promptly correcting any harassment (*BI*, June 29, 1998).

And in 1999, the Supreme Court ruled in *Kolstad vs. The American Dental Assn.* (*BI,* June 28, 1999) that an employer that undertakes reasonable steps to train managers in preventing discrimination won't be liable for punitive damages in suits filed under federal anti-discrimination laws, Mr. Maatman said.

Providing training on harassment prevention "enables a defendant to more readily defend itself," he said.

Indeed, that trio of Supreme Court decisions has boosted employers' demand for training, according to companies providing the services. The Lexington program "was created directly in response to those three cases," said Lisa Bee, director of risk management services at Lexington in Boston.

Lexington, which is a unit of American International Group Inc., offers the training program to its policyholders at no charge. The program consists of comprehensive training for managers and an abridged version for nonmanagers, Ms. Bee said.

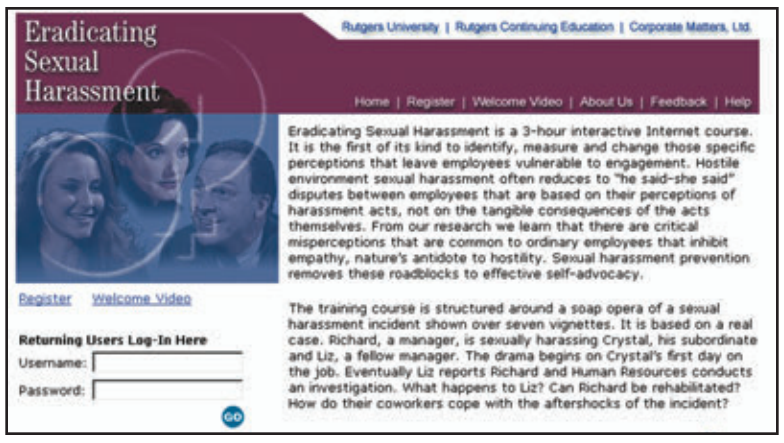
Like many online training programs, Lexington's tracks each employee's progress through the materials. After reading each section, the employee answers several multiple-choice questions. If an incorrect response is given, the employee must re-read the appropriate section and answer the question again until he or she gives the right answer. The system then captures the test results, demonstrating that the employee has completed the training.

Maintaining such records is crucial, because they can serve as evidence in court that an employee has completed training, Mr. Maatman said.

Although the off-the-shelf programs are well suited to the needs of small employers, larger companies should use a customized program, said Margaret Rueda, the president of Human Performance Technologies Corp. Farmington, Conn.-based Human Performance Technologies develops custom-made training programs.

Customized programs are more expensive but can directly address the specific issues the company executives deem important, she said.

Indeed, many large employers need customized programs that incorporate their own policies into their training, said Chubb's Mr. Maloney.



An online program developed by Corporate Matters Ltd. and Rutgers University aims to shape the ways employees think about harassment.

An entirely different approach to training is advocated by Steven Dranoff and Wanda Dobrich, the two psychologists behind the online program offered by Corporate Matters. Rather than reciting the laws and the dos and don'ts, the Corporate Matters approach seeks to make employees think more critically about their own perceptions and responses to harassment. The program's goal is to align the "public voice"—the right thing to do—with an individual's "private voice," or his or her own feelings.

"It's the private voice that often drives behavior," Mr. Dranoff said.

This approach, the two psychologists contend, distinguishes their program from all others. By getting a person to see how his or her own views differ from ethical norms, the program aims to change how the individual will react when confronted with an actual harassment scenario.

"If you don't see your behavior, you can't do anything about it," Mr. Dranoff said.

During the training, viewers record into the computer their impressions of a sexual harassment scenario played out by actors. The computer provides immediate feedback comparing the individual's views with those of other individuals who have seen the scenario, as well as with what the law would require.

"Every step of the way, they get to monitor what they think and feel," Ms. Dobrich said.

Despite the growing popularity of online training, not everyone believes the old ways are gone forever.

For sexual harassment training, a live interactive discussion is superior to online or video-based training, said Karen Ludington, the president of The Ludington Co. Inc., a human resources consulting and training company that is based in Holden, Mass.

"Live training by a decent trainer is so far and away better than canned training, whether it's computer or videotape," Ms. Ludington said. The subtleties of sexual harassment "make a customized and interactive approach far more effective than a package approach," she said.

Brand: Reputation used as lever to force settlements

Continued from page 10

risk manager with the U.S. Olympic Committee in Colorado Springs, Colo. The damage sustained by the brand image of the Chicago-based accounting firm of Arthur Andersen following its audit of the Houston-based energy firm Enron Corp. is one such example, Mr. Mair said.

"If I'm a director of a major corporation today, one of the questions I want to ask is whether our risk management is looking at the brand risks we face as a result of the business we are in or the business practices we employ," Mr. Mair said.

In cases where plaintiffs attorneys seek to use brand as a lever in employment disputes, they typically employ statisticians to help select their targets. The statisticians review corporate hiring, retention and promotion patterns, Mr. Maatman said. The attorneys then advise the company that they likely can prove a disparate-impact discrimination case on the bases of race, gender or other factors. In addition to making demands for large monetary settlements, they usually invite the company to mediate the dispute before a class-action lawsuit is filed.

But a quick settlement, agreed to before a lawsuit is filed, can deprive a company's insurer of information normally obtained when a company is sued, Mr. Maloney said. An insurer typically relies on depositions to help it determine the strength of a defendant's case. Without a lawsuit, though, there are no depositions.

That leaves the insurer wondering whether a settlement was warranted and whether the settlement amount was appropriate. Once a policyholder settles, the insurer may not know whether the plaintiffs really had the evidence to file a single class-action lawsuit or whether the facts supported only the filing of several individual lawsuits. In the latter situation, the policyholder might have been responsible for meeting several deductibles, Mr. Maloney said.

The plaintiffs claim to represent many employees or former employees, yet class-action lawsuits—or, for that matter, lawsuits of any kind—are never filed; observers, consequently, have dubbed the maneuver "mass action."

"There is a real aggressive push on behalf of the employer because of the desire to stay away from publicity, to immediately run away and settle," Mr. Maloney said.

'There is a real aggressive push on behalf of the employer because of the desire to stay away from publicity, to immediately run away and settle.'

Michael J. Maloney
Chubb Specialty Insurance

As the trend continues, insurers and policyholders are likely to end up disputing whether employment practice liability policies were meant to cover brand protection, Mr. Maloney said. Already, one policyholder agreed to contribute to a settlement and not hold its insurer responsible for the entire amount. The policyholder recognized that brand protection was its real concern, Mr. Maloney said.

The mass actions are driving up coverage pricing and reducing the capacity that insurers will provide each policyholder, Mr. Maloney said.

And with employment-related claims losses growing overall, insurers increasingly see policyholders tapping excess coverage, said Paul Cunningham, vp of casualty for Lexington Insurance Co. in Boston.

Huge companies face problems even when implementing workplace policies and audits aimed at preventing employment discrimination, said Ann M. Longmore, senior vp and EPL practice leader for Willis North America Inc. in New York. The sheer size of these companies makes it harder for them to enforce their policies, particularly if they have many subsidiaries at home or abroad or several different departments in charge of overseeing them, Ms. Long said.

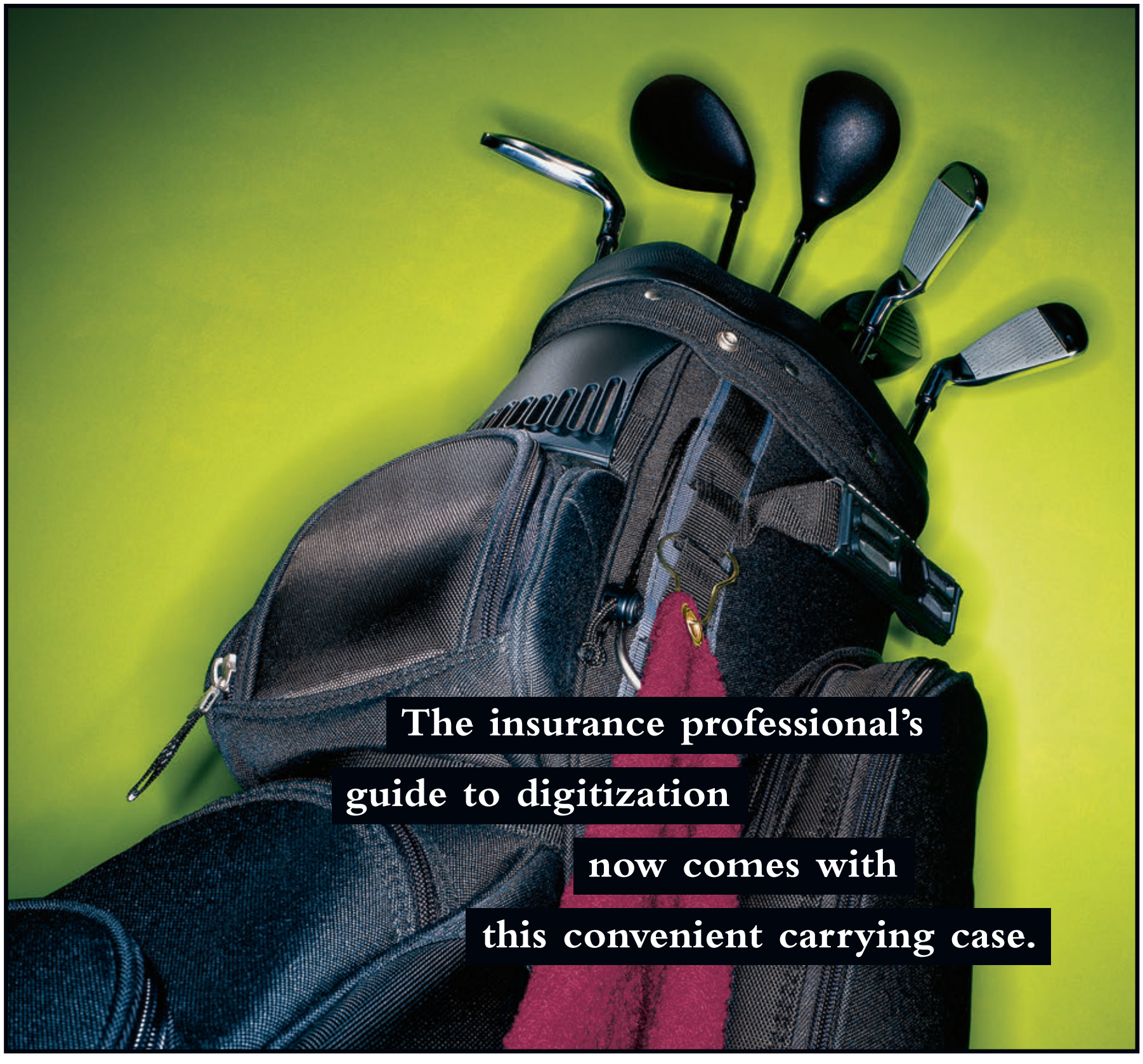
Yet those practices can prevent lawsuits and help a company defend itself if a lawsuit is filed, Ms. Longmore said.

But warding off plaintiffs attorneys who are armed with statistical findings and are threatening adverse media attention calls for more than just adopting loss prevention practices such as employment audits and the distribution of policy manuals, experts say.

"You can audit and get state-of-the-art written procedures, but if there isn't a will or the spirit in the company to recruit and promote minorities and women, then it's just going to be window dressing," Mr. Cunningham said.

Because the cases turn on statistical evidence, companies need to address pay equity, workforce diversity and the ratio of minority and female managers to all workers, other observers add. Doing so helps discourage plaintiffs; and if a suit is filed, employers are able to argue their case in the media as well as in court.

"If you think you are vulnerable in terms of your sex, race or national origin, you need to look at your hiring and promotion practices," Mr. Maatman said.



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ERC Clubhouse

D&O: Likelihood of less cover for more money seen

Continued from page 10

is worse, market executives say.

Excess insurers are demanding a significantly larger percentage of the primary rate—a move that began last year, when their percentage of the rate charged jumped to 60%. Now, excess insurers typically are getting 70% to 90%, market executives say.

And for low excess layers that complete a policyholder's first $10 million of coverage, insurers likely will seek 90% to 100% of the underlying rate or possibly more, said Fred T. Podolsky, the New York-based chief executive officer for Willis Global Financial & Executive Risk, a division of Willis Group Holdings Ltd.

When considering D&O coverage reductions and far less attractive terms and conditions, the cost issue is even worse than the cost hikes would suggest.

The overall D&O market capacity is at a record $1 billion or more, said Don Bailey, a managing director with Aon Financial Services Group of Chicago, a unit of Aon Corp.

But the capacity that any single insurer is willing to write is shrinking. At year-end 2000, a single insurer would provide $50 million to $100 million of limits, market executives said. As of last summer, most insurers offered up to $25 million of limits.

Insurers today typically will write only $5 million to $15 million of D&O limits, though some will offer $25 million of limits to risks without losses, market executives say.

Because of insurers' reinsurance treaties, buying additional limits from a single insurer would be "very expensive," explained Eric Joost, another managing director with Aon Financial Services.

And "exceptionally poor risks" likely will find that insurers are willing to offer only $1 million to $2.5 million of primary limits, which means those risks would have to line up at least four insurers to fill out their first $10 million of coverage, Willis' Mr. Podolsky said.

Another underwriting change that will exert added cost pressure on risk managers is that D&O insurers no longer offer multiyear programs. Insurers do not want to give up an opportunity to generate more premium over the next few years by writing multiyear policies.

For securities claims, D&O insurers also are pushing policyholders to accept 20% to 25% co-insurance agreements. Those agreements dilute the full-entity coverage that insurers began offering in the mid-1990s after suffering several court defeats over the percentage of losses they could allocate to then-uninsured corporate entities.

D&O insurer executives say that co-insurance is necessary to make policyholders less willing to settle claims quickly for policy limits.

In exchange, risk managers can get some price breaks. In some cases, insurers offer 33% to 75% reductions in quoted premiums, market executives say. In many other cases, though, insurers are offering just 8% to 10% discounts off the quoted premium, they note.

Many policyholders "balk at that" level of discount as an uncompelling incentive and instead accept the full increase for 100% coverage after their deductibles, said Steven Anderson, vice chairman of the FINPRO division at New York-based Marsh Inc.

Unlike with a deductible, a D&O policyholder with a co-insurance requirement has money at stake 'every step of the way.'

Tony Galban
Chubb Specialty Insurance

While some market executives said insurers eventually might attempt to make co-insurance a routine D&O policy condition, David McElroy of Hartford Financial Services Group Inc. said he was "not sure we need to."

Hartford policyholders that do not accept co-insurance face a 100% increase in their premiums, noted Mr. McElroy, a senior vp in New York.

He also noted that Hartford has been most successful at obtaining co-insurance agreements from small- and mid-cap companies. Small- and mid-caps traditionally have more-volatile stock than do large-cap companies and, therefore, have a greater D&O exposure.

Insurers also want policyholders to increase their deductibles and self-insured retentions by a few hundred thousand dollars, but insurers are not pushing that as hard as they are co-insurance, market executives agree.

Unlike with a deductible, a D&O policyholder with a co-insurance requirement has money at stake "every step of the way," Chubb's Mr. Galban explained.

But FINPRO's Mr. Anderson noted that insurers are "aggressively moving" to boost financial institutions' deductibles and SIRs to between $25 million and $50 million from between $5 million and $10 million, in part because of poor loss experience.

In addition, programs for those risks typically include employer practices liability and bond coverages, and insurers want policyholders to retain more losses from all of those risks, Mr. Anderson said.

In another premium-generating move, insurers are slashing the thresholds at which they will charge additional premiums after policyholders make midterm acquisitions. Insurers now want additional premium when acquisitions are valued at more than 10% or 15% of the parent company's asset base. Previous thresholds ranged between 20% and 25%.

Even if risk mangers shop around and find D&O deals that are more reasonable than those their current insurers have offered, the current insurers may make the planned coverage move expensive or even cost-prohibitive.

To avoid losing business and the associated premium, some insurers are charging risk managers threefold increases of 75% to 150% of the expiring premium for the right to extend the claims reporting period of their claims-made policies. Insurers also are cutting back reporting period durations to state-mandated minimums of 30 to 90 days from previous durations of one year, market executives say.

In some cases, depending on the relevant state law, a D&O insurer might not offer any extended reporting period if the insurer offered to underwrite the risk. Such a move likely would drive up a competitor's premium quote, because an account would have to bring its loss history with it when it moved to another insurer.

If risk managers still decide to move their organizations' coverage, they likely will have to provide warranty statements and accept exclusions barring coverage for pending and prior litigation, said Jack Juhn, president of Berkeley Heights, N.J.-based Kemper Financial Insurance Solutions, a division of Kemper Insurance Cos.

Buyers see advantages to reforms, but names voice objections

Lloyd's plans draw mixed response

By SARAH VEYSEY

LONDON—Proposals to modernize the way Lloyd's of London operates have drawn a mixed response from participants in the 314-year-old market.

The proposals, developed by the Lloyd's chairman's strategy group, were presented to the market's ruling body, the Council of Lloyd's, on Jan. 17 (*BI*, Jan. 21).

The recommendations, which include the abolition of unlimited liability underwriting and the introduction of accounting changes, will now be reviewed by members of the market and voted on at an extraordinary general meeting of Lloyd's 12,000 members later in the year.

"Our aims are profitability, modernity and transparency," said Lloyd's Chairman Sax Riley. "Investors and policyholders have a choice of where they go, and we want them to be able to compare us easily, and favorably, with our competitors."

In an attempt to enable buyers and investors to better compare the market's performance, the strategy group has recommended that Lloyd's exchange its traditional three-year accounting system for generally accepted accounting principles.

David Gamble, the executive director of the London-based Assn. of Insurance & Risk Managers, welcomed the efforts to modernize Lloyd's. "Anything that makes Lloyd's more efficient and more attractive as a market to put capital in and extends Lloyd's franchise has to be welcomed by AIRMIC," he said.

Mr. Gamble pointed out that it would be a loss to risk managers and insurance buyers if Lloyd's were to cease to operate or become a secondary market. "We are in favor of a dynamic London market," he said, adding that a simplification of the Lloyd's market is needed to make it more attractive to buyers.

Luc Laurens, the head of insurance at Paris-based La Poste, the French postal service, and the vice chairman of the Assn. pour le Management des Risques et des Assurances de L'Entreprise, agreed that Lloyd's must be simplified. A couple of years ago, La Poste ceased placing some coverages at Lloyd's because it became easier to use the French market, he said.

He also cited another difficulty. "The French market thinks there is a problem of transparency" at Lloyd's, he said. He noted that risk managers, when dealing with individual insurers, are well aware of the ratings of those insurers, but the complexity of Lloyd's makes comparisons difficult. "With Lloyd's syndicates, it is not that easy. When you are dealing with Lloyd's, you have to look at all the certificates. That is not so easy, because we are far away," he said.

One of the main advantages for buyers, if the proposals are enacted, is the potential reduction in price, said one Lloyd's insider who asked not to be named. That individual said the abolition of the annual venture—the system whereby syndicates disband and reform every year and capital is raised annually—

See LLOYD'S/next page

PHOTO: JAMES MANFIELD

Lloyd's participants are reviewing plans to modernize the market.

PHOTO: AP/ WIDE WORLD

Two Swedish firms failed to pay fines in England stemming from the collapse of this walkway at the port of Ramsgate.

E.U.-wide penalties proposal advances

BRUSSELS, Belgium—The European Parliament has approved draft legislation that would allow mutual recognition of penalties levied for safety violations through the European Union.

The measure, jointly proposed by France, the United Kingdom and Sweden, would prevent E.U. companies found guilty of breaking health and safety laws in one country from avoiding fines by virtue of being based in another country. The three E.U. member states see the draft as important for the enforcement of health and safety laws in all E.U. countries.

The legislation will now go before the European Council for final approval.

The U.K. government, in particular, was incensed by two incidents that cost it more than £1.5 million ($2.2 million) in lost fines and legal expenses. In the first case, a U.K. court fined two Swedish construction firms a total of £1 million ($1.4 million), plus costs of £251,500 ($361,028), after a walkway they had built at the port of Ramsgate collapsed in 1994, killing six people. In the same year, a tunnel being built at London's Heathrow Airport collapsed. The Austrian construction company building the tunnel was fined £500,000 ($717,500) and ordered to pay legal costs of £100,000 ($143,550). But the fines and costs were not paid in either case because the United Kingdom lacked the authority to enforce penalties against non-U.K. companies.

—By Edwin Unsworth

U.K. government to end program for airline cover

By EDWIN UNSWORTH

LONDON—London insurance market participants say that private insurers will be able to provide sufficient terrorism coverage for airlines when the U.K. government's program ends in March.

Still uncertain, though, is the price airlines will have to pay for that coverage.

The U.K. Treasury last week said that it would extend until March 20 its short-term excess coverage for airlines. The program, which already had been renewed twice, was due to expire on Jan. 22. The latest extension will be the last, the Treasury said, as the European Union has said that all such coverage programs for airlines must end by March 31.

The U.K. government began offering the coverage after commercial insurers largely canceled their war risk liability coverage for airlines following the Sept. 11 terrorist attacks. The government program, provided through a company set up by leading brokers in the London market, currently offers limits of up to $2 billion for terrorism liability above an attachment point of $50 million.

Rod Dampier, aviation underwriter for Amlin Underwriting Ltd. syndicate 824 at Lloyd's of London, said he is confident that the commercial market will be able to provide adequate airline terrorism coverage when the government's program expires.

Mr. Dampier noted that the London market started offering coverage of up to $1 billion shortly after the Sept. 11 attacks. "The market already provides cover for those airlines where their governments don't pick up the tab," he said.

While he acknowledged that the main question will be one of pricing, he stressed that terrorism cover will be "affordable" for the airlines, in that it is essential. "In the end, it will be the consumers who will pay."

A leading London market broker agreed that pricing is the key question. Speaking on the condition of anonymity, the broker said it is impossible to guess what insurers will charge for terrorism coverage in two months' time. Capacity for terrorism coverage has contracted considerably since Sept. 11, while at the same time, the risk has increased.

Insurers "always manage at a price," but terms could be tough for airlines, he noted.

The government-backed insurance is provided for a "commercial charge," a Treasury statement said. Currently, for coverage between $50 million and $150 million, a premium of not less that $0.35 per passenger is charged; for between $150 million and $1 billion, not less than $0.30 per passenger; and for coverage above $1 billion, not less than $0.25 per passenger.

World Updates

Asthma prevention lacking in Britain: TUC

The respiratory disorder asthma is needlessly costing U.K. employers billions of pounds in reduced productivity and in compensation payments, according to Britain's biggest labor organization. The Trades Union Congress says in a new report that more than 150,000 people in the United Kingdom have occupational asthma and that 1,500 to 7,000 people develop asthma each year because of their work. The TUC says the problem—and the cost to employers—could be reduced significantly if more employers used alternatives to asthma-causing substances in the workplace. A survey of nearly 1,000 union safety representatives conducted by the TUC and the Health and Safety Executive found that only 8% of employers substitute asthma-causing substances with alternatives. The HSE is examining the issue, and a code of practice on occupational asthma is scheduled to be introduced this summer.

BP Amoco fined for safety violations

Oil and chemicals giant BP Amoco P.L.C. has been fined a total £1 million ($1.4 million) for breaches of safety law last year at its Grangemouth, Scotland, refinery. The Procurator Fiscal William Gallacher said that two incidents at the plant in 2001 could have caused multiple deaths and serious environmental damage. On June 7, 2001, a steam pipe at the plant operating at more than three times the normal pressure broke, injuring one woman. BP Chemicals Ltd., a division of BP Amoco, was fined £250,000 ($351,250) for the accident. Three days later, a large fire occurred at the plant when pipework in the refinery broke. BP Oil Grangemouth Refinery Ltd. was fined £750,000.

U.K. temps may get better pension access

The U.K. government has drawn up draft regulations that would, among other things, give temporary employees wider access to occupational pension plans. Currently, many occupational pension plans do not permit temporary employees to participate. The draft regulations are part of the U.K. Employment Bill, which is likely to be voted on later this year. The regulations are part of the U.K government's efforts to comply with the European Union's Fixed-Term Workers Directive, which must be implemented by July 10, 2002.

Lloyd's: Buyers see advantages in proposed reforms

Continued from previous page
would eliminate a great deal of cost for managing agents. This cost is reflected in the price of doing business at Lloyd's, the source said.

Insurance buyers would benefit from increased continuity in their dealings with syndicates because the syndicates would behave more like companies, if Lloyd's approves the reforms, the source said.

But traditional investors at Lloyd's have been less enthusiastic about the proposals. The London-based Assn. of Lloyd's Members said it welcomed the proposed replacement of the market's existing regulatory and market boards and committees with a single franchise board. This proposal, it said, would impose the best underwriting practices on all syndicates.

But the ALM expressed its opposition to abolishing the annual venture and unlimited liability—the traditional practice of individual underwriting at Lloyd's whereby names are said to be liable to "down to their cufflinks." Under the reform proposals, both of these traditional mechanisms would be phased out by 2005.

Anthony Young, the chief executive of the ALM, explained that unlimited liability underwriting gives names a tax advantage that makes it attractive for them to underwrite. Under unlimited liability, names are able to "roll over" losses from recent years and offset them against future profits. He said the ALM opposes any move to abandon unlimited liability underwriting.

"Unlimited liability names have suffered massive losses as a result of the World Trade Center disaster. The abolition of unlimited liability would make it impossible for them

'Lloyd's problems have not been caused by the annual venture.'

Michael Deeny
Assn. of Lloyd's Members

to recover the losses they have suffered, since (the U.K. tax office) will not permit these to be carried forward against limited liability underwriting," ALM Chairman Michael Deeny said in a statement. "There is absolutely no evidence that unlimited liability has reduced the profitability of Lloyd's in recent years."

The ALM also slammed the proposed abolition of the annual venture. "Lloyd's problems have not been caused by the annual venture but by the inability of some managing agents to make profits in other than the most favorable underwriting conditions," Mr. Deeny said.

Lloyd's annual venture and three-year accounting system allow new businesses to join Lloyd's "knowing that they will not have to bear any (direct) losses resulting from underwriting prior to their membership," the ALM said in a statement.

The association added that the annual venture allows capital providers to move their capital according to trading conditions and provides a way of checking managing agent and underwriter performance. The ALM also said the annual venture and three-year accounting system "fits naturally" with the annual nature of most insurance and reinsurance policies.

Christopher Stockwell, the chairman of the Lloyd's Names Assn. and a longtime critic of Lloyd's leadership, said the proposals "seem aimed at soothing the ruffled feelings of corporate capital providers rather than dealing with Lloyd's fundamental problems."

"Corporate capital has proved itself fickle and has no fundamental need for Lloyd's. If Lloyd's is only corporate capital providers, it becomes totally expendable," he said. "These proposals seem to remove the reason for Lloyd's existence and do not address names' main concerns."

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Enron: Company's insurers face claims, lawsuits

Continued from page 1

that Mahonia then planned to resell.

Insurers charge that the Mahonia companies never actually intended to take delivery of any oil or gas, though, and that their contracts were a ruse meant to disguise hundreds of millions of dollars of loans to Enron as supply contracts. Insurers claim that Mahonia's "materially false" descriptions of the deals should void the surety bonds.

The bond deals have already triggered a reaction at one of the insurers: Dean O'Hare, chairman and chief executive officer of Chubb Corp., which faces $183.6 million in claims, blasted his company's involvement as a "gross embarrassment" in a holiday memo to employees (see related story)

Enron's public disintegration began last October, when it stunned investors by reporting a $638 million third-quarter loss and a $1.2 billion writedown of shareholders' equity. The loss and writedown stemmed partly from Enron's unwinding of deals with LJM Cayman L.P. and LJM2 Co-Investment L.P., limited partnerships run by former Enron Chief Financial Officer Andrew Fastow that had the effect of keeping large debts off Enron's balance sheet.

The Securities and Exchange Commission launched a formal investigation of the partnership dealings, and Enron surprised investors again in November, when it disclosed that it was trying to restructure a $690 million debt due at the end of that month. By then, the company's stock price had plummeted to only a few dollars a share from a high of $83 a share in early 2001 and about $30 in August, when Chairman Kenneth Lay had touted Enron's strength to investors and employees. The company filed for bankruptcy reorganization in early December.

Shareholder lawsuits have followed, charging that Enron officers and directors pocketed $1.1 billion selling their own Enron shares between 1998 and 2001 while they covered up the company's dire financial condition with fraudulent accounting gimmicks.

Dozens more suits have been filed by angry ex-employees who saw about $1.3 billion, or 62%, of their 401(k) retirement money invested in Enron stock evaporate.

The suits, along with federal investigations of the collapse, will hand already-beleaguered D&O insurers more huge claims.

Enron lawyers earlier this month asked U.S. Bankruptcy Court Judge Arthur J. Gonzalez to approve interim defense cost payments of $20 million from the company's D&O policy and $10 million from its fiduciary liability policy.

AEGIS, the Bermuda mutual insurer of which Enron was a member, wrote a $35 million primary layer on both programs. The D&O program provides an additional $315 million in excess limits, with $65 million written by Energy Insurance Mutual and the remainder divided among Chubb's Federal Insurance Co. unit, the Twin City Fire Insurance Co. unit of Hartford Financial Services Group Inc. and others (see chart).

In addition to its $35 million primary fiduciary liability policy, AEGIS provided Enron with an added $10 million limit for defense costs. Federal Insurance wrote a $50 million layer excess of $35 million. AEGIS has agreed to advance the defense costs while reserving its rights to deny coverage, according to Enron court filings. AEGIS is also requiring Enron officials to agree to repay the advances under certain circumstances, including if they are found to have committed "dishonest, fraudulent, criminal or malicious" acts.

The AEGIS D&O liability policy covers not only Enron's directors and officers but also Enron officials serving at the company's request as managers of other "for-profit organizations" named in the policy. One of the organizations named is "LJM Limited Partnership," a copy of the policy shows. Enron's D&O coverage would be excess, attaching above any coverage already in place for the outside for-profit organizations, according to the AEGIS policy.

An AEGIS official declined to comment on Enron.

Meanwhile, several insurers are asking a New York federal judge to rescind a series of six surety bonds that they allege Enron, Chase and the Mahonia companies obtained under false pretenses. The $2 billion in bonds, written between 1997 and 2000, ranged in amount from $250 million to $500 million and guaranteed Enron's future deliveries of oil and gas to Mahonia over periods of up to five years.

Insurers participating on various bonds were Liberty Mutual Insurance Co., two units of Travelers Property Casualty Corp., St. Paul Fire & Marine Insurance Co., two units of CNA Financial Corp., Fireman's Fund Insurance Co., SAFECO Insurance Co. of America, Federal Insurance, Hartford Fire Insurance Co. and Lumbermens Mutual Casualty Co.

Chase—which has a security interest in the bond proceeds and is acting as agent for Mahonia—notified insurers of bond claims totaling $1.36 billion on Dec. 7, shortly after Enron's bankruptcy filing, according to Chase court papers. Insurers responded by demanding documents related to Mahonia's dealings with Enron and Chase. They have also asked about the ultimate ownership of Mahonia, who's direct shareholders are two other corporations, Lively Ltd. and Jurist Ltd.

In subsequent complaints demanding rescission of the bonds, insurers charge that Enron never intended to deliver oil or gas to Mahonia and that Mahonia had no ability to take delivery and had no contracts to sell the oil and gas to others. Instead, insurers allege, the supply deals were intended to disguise loans from Mahonia to Enron while allowing Mahonia to secure the loans with surety bonds.

Jeffrey Dellapina, a Chase managing director, denied these charges in an affidavit, saying that Enron, in fact, delivered oil and gas to Mahonia until last November, and he offered oil and gas pipeline records as evidence of the deliveries.

Chase contends the terms of the bonds do not require it to produce any of the documents insurers have demanded and that its claim notices are "conclusive evidence" of the facts surrounding the losses under the bonds' terms.

Mr. Dellapina also noted that the insurers are sophisticated companies and that the bonds' original terms were hammered out in extensive negotiations that included Chase officials.

Chase has filed a motion for summary judgment against the insurers.

SURETY CLAIMS

JP Morgan Chase Bank surety claims on Enron deals, in millions of dollars

Surety underwriter	Amount of claim
Travelers	$266.0
Federal Insurance	183.6
Lumbermens Mutual	156.2
Fireman's Fund	153.9
St. Paul	134.0
CNA	77.9
SAFECO	55.4
Hartford Fire	40.8
Liberty Mutual	25.5
Total	$1,359.1

Source: JP Morgan Chase Bank court filings

CEO rips Chubb underwriters over Enron surety bonds

By DAVE LENCKUS

Enron Corp.'s collapse has triggered repercussions for at least one of its insurers beyond potential losses from surety bond and other insurance claims the bankruptcy has spawned.

Especially galling to the insurer's top official is that the surety losses resulted from underwriting he considers a "gross embarrassment" to the insurer, Warren, N.J.-based Chubb Corp.

The Chubb official, Chairman and Chief Executive Officer Dean O'Hare, explained the underwriting miscues in a 2001 holiday memo in which he informed Chubb employees that the losses had wiped out their annual cash bonuses.

Mr. O'Hare

Chubb now is countersuing the agent for the surety bondholder in an effort to avoid paying $183.6 million of losses. Chubb claims in its suit that the contracts underlying the surety bonds were part of a scam designed to disguise loans that the bondholder made to Enron. Chubb alleges that Enron never intended nor was expected to honor its contractual commitments to deliver energy to the bondholder (see story, page 1).

Chubb's full exposure under the two surety bonds was $220 million, the insurer noted in December.

Mr. O'Hare refers to that figure in his memo, in which he explains how the cash bonuses first were threatened by the Sept. 11 terrorist attacks.

After Chubb's World Trade Center loss of $645 million net of reinsurance jeopardized employees' bonuses, Mr. O'Hare persuaded the insurer's board to save the bonuses by making "an adjustment" in calculating them, he noted in the memo.

"While no one could have foreseen the WTC attack, the Enron loss is another matter; it resulted from both poor decisions and the violation of company oversight policies which might have reversed those decisions," Mr. O'Hare wrote.

He continued: "When I say poor decisions, I do not mean it in the sense of underwriting risks, which didn't work out. After all, we're in the insurance business; if we take no risk, we sell no business, and we are in the game to grow our business. What happened with Enron is that our folks who wrote it didn't know what they were writing; they thought they wrote a performance bond, which is what we were paid for and should have contained some protection for us in the event of a bankruptcy. Instead, it was a financial guarantee, with no protection and for which we did not receive anywhere near an adequate premium."

According to sources, the bonds amounted to financial guarantees because either the bonds or the underlying contracts compelled Chubb to financially compensate the bondholder if Enron failed. Typically, surety underwriters have the right to decide whether to make arrangements to fulfill the terms of a bondholder's contract—in this case, delivering the contracted energy—or to financially indemnify the bondholder.

"Frankly, it was a gross embarrassment for a company which prides itself on underwriting savvy," Mr. O'Hare wrote. "To make matters worse, before being written in that magnitude, the deal should have been brought before one of our oversight committees, and it was not."

In consoling remarks about the loss of the bonuses, Mr. O'Hare wrote: "I can understand the anger some of you might feel that the mistakes of a few people could wipe out all the good work you did in 2001."

Those mistakes cost the involved underwriters their jobs, which were terminated in a phone conversation when the underwriters were playing a round of golf, according to sources.

See CHUBB/page 22

ENRON'S D&O LIABILITY PROGRAM

Total limit $350 million

Company	Limit
Associated Electric & Gas Insurance Services	$35 million primary
Energy Insurance Mutual	$65 million excess of $35 million
Federal Insurance Co.	$25 million excess of $100 million
Twin City Fire Insurance Co.	$25 million excess of $125 million
Executive Liability Underwriters	$25 million excess of $150 million
Lloyd's of London	$25 million excess of $175 million
St. Paul Fire & Marine Insurance Co.	$25 million excess of $200 million
Federal Insurance Co.	$25 million excess of $225 million
Royal & SunAlliance P.L.C.	$25 million excess of $250 million
ACE	$25 million excess of $275 million
	$50 million excess of $300 million written on a quota share basis
Federal Insurance Co.	50%
Kemper Insurance Cos.	20%
Energy Insurance Mutual	15%
Associated Electric & Gas Insurance Services	10%
Executive Liability Underwriters	5%

Source: Enron court filings

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New Orleans: Security stressed

Continued from page 3

40,000 people to the area around the Louisiana Superdome. In December, the Federal Emergency Management Agency involved city, state and federal agencies in disaster drills at the Superdome, staging a variety of emergency scenarios.

New Orleans officials began fencing off streets surrounding the Superdome last Thursday and plan to close them to traffic beginning Wednesday. And some parking areas near the Superdome will be closed for the game.

Access to the various events leading up to the game also will be tightly controlled.

The state of Louisiana carries insurance coverage on the publicly owned Superdome. The coverage renews on July 1, so it does not include the terrorism exclusions that have been incorporated into many property/casualty renewed since the Sept. 11 terrorist attacks.

Primary blanket property is through the Louisiana Self-Insurance Fund, with a $500 million excess of $1 million policy from Clarendon National Insurance Co.

The state's primary commercial general liability coverage for the Superdome is $2 million per occurrence, with American Alternative Insurance Corp. A $48 million excess of $2 million layer is written by Lumbermens Mutual Casualty Co. and a $50 million excess of $50 million layer is written by National Union Fire Insurance Co. of Louisiana, a unit of American International Group Inc. All those policies also renew July 1.

Workers comp for the Superdome is with the Louisiana Workers Compensation Corp., for $1 million per accident and disease.

The National Football League's coverage for the Super Bowl is placed by Marsh Inc. through Fort Wayne, Ind.-based K&K Insurance Group Inc.

Marsh and K&K would not disclose details of the coverage.

Meanwhile, syndicates at Lloyd's of London write between $5 million and $10 million in per-player disability limits for many of the teams in the playoffs. The policies do not exclude terrorism, sources say.

In addition, cancellation coverage for the Super Bowl has also been placed in London, sources say.

The Feb. 3 Super Bowl prompted the rescheduling of a number of Mardi Gras parades that were originally set to take place around New Orleans the weekend of the game.

"We did move some parades," the city spokeswoman said. "We would have had 11 parades the weekend of the Super Bowl."

Instead, the krewes, or private clubs, that sponsor the parades agreed to hold them this past weekend, according to Frank Arceri, the president of Arceri & Associates in New Orleans, which places coverages for 256 Mardi Gras parades in Louisiana, Mississippi and Alabama. The coverage, placed with TIG Insurance Co. through K&K, is primarily liability, with each krewe purchasing its own policy.

"The policy is unique in design around the needs of Mardi Gras," Mr. Arceri said. "It's essentially a manuscripted general liability policy."

Premiums for the coverage average $7,000 per krewe, though this year premiums were up 22%, Mr. Arceri said. "The rates went up and the coverage was lessened," he said.

The impact was felt primarily in the lack of availability of excess liability coverage, Mr. Arceri said.

"They cut back on the amount of excess we could get," he said. "We had one club that had $1 million in liability with $6 million excess, and TIG couldn't provide the excess. We've been looking at other markets."

Mardi Gras likely will draw about 1 million people to New Orleans, with the largest crowds hitting the streets on Fat Tuesday, Feb. 12.

The New Orleans Police Department is taking extra steps with Mardi Gras security this year, the city spokeswoman said. "The NOPD will operate at full staff, no vacations. Everybody will be operating at full staff for Mardi Gras," she said. "They're looking at things they didn't used to think of."

Mr. Arceri noted that, in the past, Mardi Gras parade float sponsors would advertise for people to ride on their floats and toss trinkets to parade-goers. This year, such advertising was banned, though, and float sponsors were told to know everyone on their floats and be aware of everything brought aboard.

Carolyn Aldred contributed to this story.

Chubb: Enron losses rued

Continued from page 20

Not all Chubb employees lost their entire bonuses, though. Mr. O'Hare explained in the memo that he had made special arrangements with a Chubb board committee to award smaller bonuses—one-fifth of the amount of the lost bonuses—to the highest performers in Chubb's lower pay grades.

Another, more-serious problem could develop for Chubb and the other surety underwriters that participated on the bonds if New York insurance regulators decide to investigate the underwriting transaction, market sources said. New York-licensed insurers must write financial guarantees through monoline financial guarantee companies. Chubb did not write the surety bonds through such a facility.

The New York Insurance Department neither confirms nor denies the targets or existence of investigations, a spokeswoman said.

A Chubb spokesman said that no investigation is warranted. "We're not aware of any New York Insurance Department inquiry into our surety bonds for Enron, nor would one be appropriate, since Mr. O'Hare's memo's reference to financial guarantee was not meant in the statutory sense," the spokesman said.

"Our surety underwriters thought they were writing a conventional performance bond for the delivery of gas. Such bonds always include some assumption of financial risk, but our underwriters underestimated the extent of financial risk that they assumed," he said.

Self-funding: Interest on the rise

Continued from page 1

crease in costs and the increased pressure on HMOs and commercial carriers to make profits, that's pushed more margin and more risk charges onto their insurance rates," said Mr. Stover. "So there aren't as many deals out there for employers to take advantage of in the insured marketplace."

Over the past year, in particular, insurers have been introducing normal margin and risk charges, plus building in additional margin "on top of that," said Mr. Stover. As a result, he said, "even the larger employers we're dealing with have moved more and more decisively toward self-funding their HMO offerings."

Employers are saying, "If insurers don't want to take on the risk, we might as well take on the risk ourselves and save on the margins," said John Povinelli, vp and benefits consultant for The Segal Co. in Phoenix.

"Costs in general are going up like crazy," said John Ungvary, human resources director for the Roman Catholic Diocese of Phoenix, which anticipates it would save several hundred thousand dollars by becoming self-insured.

The diocese now has fully insured HMO and PPO plans with Blue Cross & Blue Shield of Arizona for its 3,200 employees and dependents. If it becomes self-insured, it would lease the Blue Cross network and do the administrative work itself, said Mr. Ungvary. A decision will be made next month, he said.

Nicole Cox, compensation and benefits manager for Amarillo, Texas-based Hastings Entertainment, a self-insured media entertainment retailer, also cited the ERISA exemption as a factor that enhances the appeal of self-insurance. Self-insurance relieves Hastings of the burden of complying with the various laws in the 24 states in which it operates, said Ms. Cox. "Otherwise, it's difficult to keep a handle on all the different laws," she said.

Blaine Bos, a principal in Mercer's Chicago office, said he expects that, by the end of this year, close to 20% of large employers will self-fund their HMOs. Mr. Bos said the impetus to self-insure comes from both the employers and the HMOs. In addition to rate hikes serving as a driving factor, large employers' employee pools, in particular, have fairly stable overall claims costs, he said.

As a result, Mr. Bos said, by self-insuring, "they're cutting out the margin costs and the insurance premium tax costs in a lot of states. So I would expect that self-insurance of HMOs for that particular group would increase."

Furthermore, Mr. Bos said, "a lot of HMOs have abandoned capitation as the preferred method of reimbursing physicians and hospitals. The HMOs have been taking on more and more of the risk."

As a result, he said, "many of them have started going to smaller and midsized clients and tried to convince them to go to self-insurance because they don't like being in the business of taking a substantial amount of risk, particularly unintended risks" as they move to other forms of reimbursement besides capitation, he said.

Mr. Bos noted that there has been a parallel increase in the percentage of employers that self-insure the coverage of their POS plans. That's because HMOs typically serve as the basic platform for the coverage, with employees paying more if they use health care providers that are outside the HMO network, he said.

Meanwhile, in response to the hard market, a growing number of midsize employers that have never self-funded at all previously are beginning to do so.

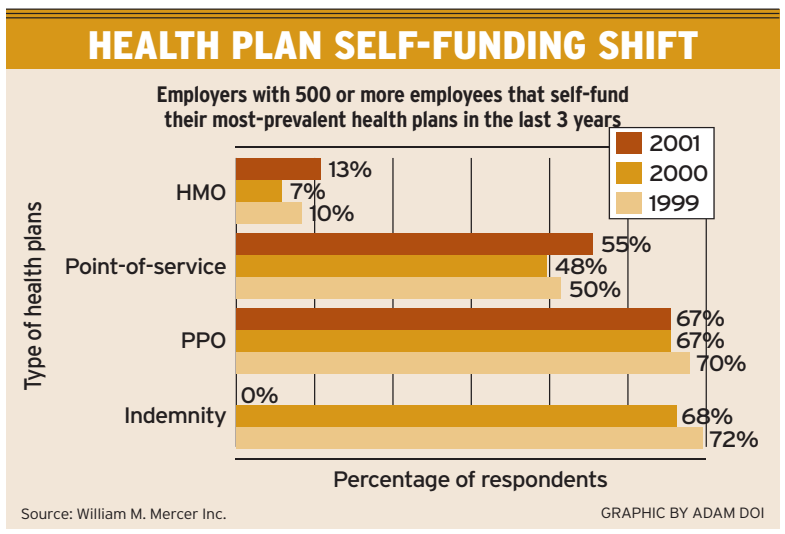
Rich Ostuw, senior consultant in the Stamford, Conn., office of Towers Perrin, said, "As a general rule, I'd say that as health care costs have increased, the crossover point declines in how large a group for which self-insurance is justified." As a result, he said, "the issue is more and more what midsized companies would find it attractive."

Brokerage Concepts' Mr. Katz said he expects to see growth among employers with 100 to 650 employees and those with 50 to 100 employees, but not among companies with fewer than 50 employees. In the smaller companies, he said, "it doesn't generally pay."

Roger Edgren, managing director and national practice leader of employee benefits for Marsh USA Inc. in Grand Rapids, Mich., noted that smaller employers are "more likely to go back and forth than larger employers" between fully insured and self-insured plans because of greater volatility in the pricing of their fully insured programs or in their claims experience.

But even some large employers will begin to drift back to fully insured arrangements for their HMO coverage in another three to five years, predicted Jim Winkler, a Norwalk, Conn.-based senior consultant with Hewitt Associates L.L.C. Mr. Winkler explained that many small local HMOs may not make enough profit on administrative fees and consequently fail.

When that happens, the surviving national and regional HMOs will get a larger pool of people in their books of business, which will make them more comfortable with large employers' claims costs. That "makes (HMOs) price more conservatively and allows them to go back to employers and transfer the risk back to the health plan in a fully insured manner," said Mr. Winkler.



ADVERTISER INDEX

Issue of January 28

FTR

This roundup of news from the previous week is generated by *BI*'s daily news reporting. To get breaking news as it occurs, log on to *www.businessinsurance.com*, or sign up online for free *BI* Daily News by e-mail.

Two more reinsurers form in Bermuda

Two new reinsurers have set up shop in Bermuda. Olympus Reinsurance Ltd. and Queens Island Reinsurance Ltd. were licensed last month, according to the office of Bermuda's Registrar of Companies. Regulators would not release details about the new entities' capitalization or ownership. The companies are among eight insurers and reinsurers that have formed in Bermuda since the Sept. 11 terrorist attacks in the United States. Bermuda startups so far have raised more than $9 billion in capital.

Hewitt, Willis partner for online outsourcing

Hewitt Associates L.L.C. will offer its online benefits outsourcing services to the middle market under a new partnership with Willis Group Inc. Lincolnshire, Ill.-based Hewitt's online outsourcing system, Sageo, allows employers to enroll employees into health plans and to perform most of their benefits administration online. Since its introduction in 2000, Sageo has been used almost exclusively by large employers. By partnering with London-based Willis, whose primary U.S. client base is midsize employers, Hewitt hopes to attract more middle-market outsourcing clients.

Reding leaves ACE for Aon unit

Dennis B. Reding, formerly the president of ACE INA Holdings Inc. and president and chief executive officer of ACE USA, has been named CEO of Aon Corp.'s Combined Specialty Corp. Mr. Reding, 53, will be responsible for leading Aon's insurance and reinsurance underwriting operations and completing the spinoff of Chicago-based Combined Specialty, planned for this spring. The former CEO of Combined Specialty, Kenneth J. LeStrange, left in November to head Bermuda startup Endurance Specialty Insurance. Mr. Reding joined ACE in January 1998, when the company acquired Westchester Specialty Group Inc. in Atlanta and renamed it ACE USA. In 1999, he moved to Philadelphia, where he oversaw ACE's U.S. property/casualty operations.

Mr. Reding

Empire covering new diagnostic procedure

Empire Blue Cross & Blue Shield is providing coverage for a new diagnostic procedure designed to aid in the early detection of breast cancer among high-risk women. The procedure, called ductal lavage, finds changes in cells lining the milk ducts, where an estimated 95% of all breast cancers originate, according to Cytyc Health Corp., the Boxborough, Mass.-based firm that developed the technology. Clinical trials have found that ductal lavage significantly aids in the assessment of a woman's risk of developing breast cancer, according to a study published recently in the Journal of the National Cancer Institute. In recognition of its effectiveness, clinical practice guidelines for the procedure were published in Cancer, the journal of the American Cancer Society.

St. Paul posts $1.09 billion net loss

The St. Paul Cos. Inc. recorded a net loss of $1.09 billion for 2001, compared with profits of $993.5 million in 2000. St. Paul's revenues, however, rose 12.2% in 2001, to $8.94 billion. Contributing to the loss for 2001 was a fourth-quarter operating loss of $646.7 million, according to the St. Paul, Minn.-based insurer. The fourth-quarter loss stemmed largely from $612 million in reserve strengthening, restructuring charges and goodwill writedowns, St. Paul said in a statement. In December, St. Paul announced that it would exit its worldwide health care business as well as several primary insurance markets outside the United States, and that it would significantly reposition the company's reinsurance and Lloyd's of London operations, resulting in various fourth-quarter charges.

Gallagher sees revenue growth

Rate increases throughout 2001 helped boost revenues at Arthur J. Gallagher & Co. by 14.4%, to $910 million last year, the Itasca, Ill.-based insurance brokerage reported last week. Net income rose to $125.3 million in 2001, a 34.7% increase over the prior year. Insurance coverage renewed by the brokerage saw price increases throughout 2001, Executive Vp Michael J. Cloherty said in a statement. Policyholders have reacted to the hardening market with a coverage reviews, self-insurance and alternative risk transfer, Mr. Cloherty said.

Briefly noted

The Surety Assn. of America and INROADS Inc. agreed last week to form a partnership to increase **diversity in the surety industry**. INROADS is a St. Louis-based nonprofit organization that promotes internships for minority college students....London-based **Cox Insurance Holdings P.L.C.** said its losses arising from the Sept. 11 terrorist attacks could total as much as £125 million ($179.8 million). Cox, which earlier estimated its losses at about £67 million ($96.3 million), said it has so far received insurance and reinsurance claims of about £85 million ($122.2 million) for property near the World Trade Center....Stuart Grayston has joined **USA Risk Group** as president of Bermuda-based USA Offshore Management Ltd. In his new position, Mr. Grayston will be responsible for USA Risk Group's captive management and alternative risk market operations in Bermuda and the British Virgin Islands.... **WellPoint Health Networks Inc.** is buying MethodistCare, the managed care subsidiary of Methodist Health Care system in Houston. MethodistCare has about 78,000 members in the Houston area.

BI Online Poll [1/21 - 1/25]

What is your prognosis for the current hard property/casualty market?

Has already peaked	Has not yet peaked	Too soon to say
12.2%	71.4%	16.4%

Take part in our weekly poll at *www.businessinsurance.com*

BI Stock Index [1/21 - 1/25]

Up-to-the-minute data for all 87 companies that make up the *BI* Stock Index can be found at *www.businessinsurance.com*

Percentage change of *BI* Stock Index vs. key indicators

BI Stock Index	Dow Jones	S&P 500
-0.40	0.70	0.51
2337.73	9840.08	1133.28

Largest gains

Meadowbrook Ins. Group	55.50
Hilb, Rogal & Hamilton	11.91
Sierra Health Services	10.53
St. Paul Cos.	8.53
Brown & Brown	6.82

Largest losses

ESG Re Ltd.	-15.00
Tokio Marine & Fire	-7.84
Selective Insurance Group	-5.89
Fremont General Corp.	-5.25
SCOR	-5.12

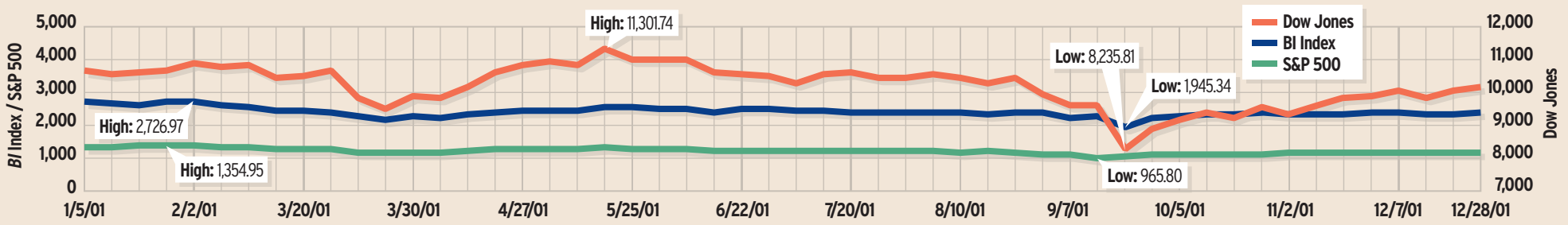
Weekly change by market segment

Brokers	2.11
Insurers/Reinsurers	1.43
Managed Care Organizations	2.83

Source: CNET Investor (investor.cnet.com)

2001 stocks in review

***Business Insurance* Index, Standard & Poor's 500 Index and Dow Jones Industrial Average**



Source: Nordby International Inc.

GRAPHIC BY JOHN HALL

The terrorist attacks of Sept. 11, 2001, threw stock markets into upheaval, sending the Dow Jones Industrial Average, the Standard & Poor's 500 and the *Business Insurance* Index to their low points of the year. When trading resumed after the markets' halt from the attacks, the *BI* Index of insurance industry stocks dropped 28.7% to 1,945.34 from its high for the year. After Sept. 11, the DJIA and S&P 500 fell 27.1% and 28.7%, respectively, from their highs in 2001. The *BI* Index started the year at 2,721.54 and rose to 2,726.97 on Feb. 2, its high for the year. The *BI* Index ended the year at 2,382.46, down 12.4% from the beginning of 2001. The Dow began the year at 10,662.01 and rose 6.0% to a high of 11,301.74 on May 18. The Dow reached its low, 8,235.81, after Sept. 11 and ended the year at 10,136.99, only 4.9% lower than its Jan. 5 close. The S&P 500 started 2001 at 1,298.35 and quickly hit its high point on Jan. 26, when it closed at 1,354.95, a rise of 4.4%. The stock closed at 965.80 after the terrorist attacks but rose to 1,161.02 at year end, down 10.6% overall for the year.