Testimony of

Mr. Edmund F. Kelly

June 7, 2006

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Chairman, President& CEO
Liberty Mutual Group

Before the Senate Judiciary Committee Hearing on S.3274
"Fairness in Asbestos Injury Resolution Act of 2006"
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Mr. Chairman and Members of the Committee, I am Ted Kelly, Chairman, President and Chief Executive Officer of Liberty Mutual Group. Liberty Mutual is a leading global insurer and the sixth largest property and casualty insurer in the United States with headquarters located in Boston, Massachusetts and 900 offices worldwide. Our company is a member of PCI, the Property and Casualty Insurers Association of America, and a member of CAR, the Coalition for Asbestos Reform. Both organizations join in supporting my testimony today.

Thank you for the opportunity to testify and to work with you to address the asbestos litigation abuses that have resulted in denying sick claimants their just compensation, bankrupted approximately seventy companies and jeopardized a bedrock principle of American justice; namely, all parties involved in the tort system will be treated fairly and no one person, whether an individual or a corporation, will get special treatment. It is this fundamental principle that protects a corporation, whatever its size, and guarantees that it will have its "day in court" so that, when there is a valid claim, it will be judged on its own conduct and assessed its fair share of any wrong it caused.

At the outset, I, like many others, wish to acknowledge and praise the extraordinary commitment of the Chairman and the Ranking Member for their efforts to fix the asbestos litigation quagmire. Were Judge Becker still alive, I would also thank him, particularly because his tireless and selfless efforts are a very large part of the reason why we are all here today.

The question we have all wrestled with is would the Trust Fund as envisioned in the Fair Act work? To answer that question we need to look at four issues: (1) Is the Trust Fund fair and equitable? (2) Does it provide an exclusive remedy for all asbestos claims? (3) Is it viable and sustainable so that it provides "global peace" for asbestos victims, asbestos defendants and asbestos insurers at a known cost? (4) Is there a better alternative to the Trust Fund with a proven record of success? When originally proposed, the Trust Fund's purpose was to extinguish all asbestos-related tort system liability in exchange for a simple, no-fault administrative system at a single fixed price fair to all contributors. I will now address in turn each of these issues to determine if S.3274 meets these goals and, if not, what should be done in its place.

(1) Is the Trust Fund fair? As originally contemplated, each participant - whether a defendant or an insurer - would contribute to the Trust Fund based upon its relative share of liability in the tort system. No participant would receive special treatment to the disadvantage of another participant. This over-arching principle of fairness was absolutely fundamental to the integrity of the Trust Fund because the fault-based tort system was being replaced by the no-fault Trust Fund. That core principle of fairness, however, has now been violated. Rather than have the Trust Fund allocate payments to correspond to liability, the Trust Fund guarantees a complete windfall to certain Fortune 100 companies facing significant asbestos-related exposure. For example, one such company, whose own projections estimated its future asbestos liability at $1.6 - $2.2 billion for the next 15 years, will only pay $378.5 million for the next 30 years under S.3274. The recent settlements of Owens Corning and USG further prove the gross inequities embedded in this legislation. In January, USG settled its asbestos liability for $4 billion and, less than a month ago,

Owens Corning settled for $5.2 billion. Both of these settlements, which occurred in the context of a bankruptcy court, have FAIR Act "carve-outs" or exceptions which, in the event of enactment of the Trust Fund, extinguish billions of dollars of obligations and reduce their remaining payments to $378.5 million. While that is good news for these companies, it is grossly unfair to the rest of the defendants. Under this wealth transfer, companies with dramatically lower revenues and dramatically lower asbestos exposure will be called upon to pay not only their own share, but now be obligated to pay a much greater amount solely because of this multi-billion dollar windfall to a few Fortune 100 companies. A corporate bailout, to enrich a few companies at the expense of numerous other companies, is unacceptable as both a business proposition and a matter of public policy.

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his special treatment is not limited to defendant companies. S.3274 contains a provision whereby insurers, who have made asbestos-related payments as the result of a bankruptcy judicially confirmed after May 22, 2003 but before enactment, will get a dollar-for-dollar offset against their Trust Fund contribution. Again, while that is good news for those few insurers, it is completely unfair to the remaining insurers who will be responsible for the shortfall created by this special interest exception. While S.3274 now mandates a reserve-driven study for all insurers as a predicate to determining the amount of each insurer's contribution, S. 3274 continues to allow special treatment to a very small handful of insurers, an outcome that, as with the special treatment for a select few defendant companies, is unjustifiable as either a business practice or public policy.

Collectively, these windfalls are the antithesis of fairness. As the CEO of a mutual company, I cannot support legislation that hurts our policyholders - many of whom are smaller companies who will be required to shoulder an unfair economic burden - and likewise demands that Liberty Mutual pay its policyholders' equity to their and Liberty Mutual's own disadvantage. For example, as David Lascell, principal owner of Hopeman Brothers, Inc., a small company which Liberty Mutual has insured for decades, has testified, Hopeman will be required to absorb a liability on its books for 30 years that is grossly disproportionate to its own liability in the tort system today. It simply is not fair to Hopeman or any other company to have to pay into the Trust Fund an amount of money that does not reflect that company's own liability while at the same time allowing other companies to pay materially less than their own fair share.

Equally unfair is a requirement that mandates that the insurers' aggregate contribution "shall be equal to" $46.025 billion whereas the defendants' aggregate contribution "shall not exceed" $90 billion. While both insurers and defendants may benefit from certain bankruptcy trust credits and funding holidays, there is no requirement that the defendants actually pay $90 billion - only that they not pay more than $90 billion. Insurers, however, must pay in every penny of our $46.025 billion contribution and on a schedule that dramatically accelerates our obligation ($20.63 billion in the first five years) exposing us disproportionately to the risk that the Trust Fund fails. Whether looked at alone or altogether, these provisions completely lack the hallmarks of fairness. Consequently, S.3274 fails the test of fairness.

(2) Does the Trust Fund provide an exclusive remedy for all asbestos claims? As is apparent throughout S. 3274, there are numerous exceptions that allow asbestos claims to continue outside the Trust Fund thereby violating the second cornerstone principle of the Trust Fund; namely, the Trust Fund would be the sole remedy for all claimants and the sole obligation for all participants.

In particular, S.3274 specifically entitles a claimant to recover both (i) an award from the Trust Fund and (ii) benefits under state workers' compensation programs. Consequently, as a result of this "double-dipping", workers' compensation insurers, such as Liberty Mutual, are required to pay twice - once for the Trust Fund awards and again for the workers' compensation benefits. Critically, S. 3274 eliminates the right to offset any workers' compensation benefits because of the Trust Fund awards, an outcome that not only violates and encroaches upon state workers' compensation laws but also will add tens of billions of dollars in costs to the state workers' compensation system. By preventing the operation of state workers' compensation lien laws, the National Council on Compensation Insurance, Inc. (NCCI), using CBO projections, has estimated the ultimate additional cost to state-based workers' compensation systems to be between $39 billion - $88 billion which implies an increase of 20% - 50% in total workers' compensation system reserves. The American Academy of Actuaries, in its September 8, 2005 letter to the Chairman and Ranking Member, predicted equally ominous results.

The Trust Fund was intended to "bring an end to asbestos litigation, as we know it." The public policy behind this straightforward maxim was obvious: if defendants are going to pay into the Trust Fund, and insurers in particular are going to pay in their statutorily-required asbestos reserves, they cannot also be called upon to pay costs for asbestos claims handled outside the Trust Fund. S.3274, however, requires just that result. First, where evidence has been

introduced, lawsuits are allowed to continue in the tort system even after S.3274 is enacted. Thus, participants will have to incur both transaction costs and make indemnity payments above and beyond their contributions to the Trust Fund. Second, for certain pre-Act settlements, those payments are also required to be made and likewise do not reduce the participants' Trust Fund contributions. Third, with the passage of tort reform in key states and the threat of federal asbestos legislation, we have all seen the burst of claiming activity for allegedly newly-found silica claims. Asbestos claims recycled as silica claims would have been prevented under prior iterations of S.3274. Now, however, with the "silica-mixed dust" loophole that allows asbestos claims to be retread as silica claims outside the Trust Fund, this carve-out equally undermines any argument that the Trust Fund is an exclusive remedy.
Fourth, in an effort to accommodate the needs of the terminally ill, a cumbersome "start-up" program has been designed whereby such victims are to be paid either before the Trust Fund has been "certified" by the Fund Administrator as operational or through the tort system. While payments to such claimants may result in an offset against a participant's Trust Fund obligation, the "start-up" program is riddled with critical flaws that undercut the Trust Fund's goal of being an exclusive remedy. For example, if the Trust Fund Administrator does not conclude that the Trust Fund is operational within certain time limits, the Trust Fund is shut down and all asbestos claims revert to the tort system. Under that scenario, the exclusive remedy promised by the Trust Fund has evaporated with the anomalous result that the participants will have paid billions into the Trust Fund only to face continuing exposure in the tort system. For Liberty Mutual this is a particularly acute issue, given the insurers' accelerated payment obligations and that, within the first 2-3 years of the Fund, insurers will have paid over $6 billion.

Thus, far from channeling all asbestos claims into the Trust Fund as the exclusive remedy, S.3274 actually creates, in addition to the Trust Fund itself, at least three overlapping pathways for the handling and payment of asbestos claims: (1) the tort system for cases where evidence has started, for certain settlements and for terminally ill claimants who opt out of the early "start-up" program, (2) the workers' compensation system and (3) the tort system for asbestos claims masquerading as silica claims.

(3) Is the Trust Fund sustainable and viable? Given that insurers will have paid in their asbestos reserves, it is critical that the Trust Fund be able to sustain itself. Solvency is threatened in two basic and obvious ways: too many dollars paid out or too few dollars paid in. As to the former, diluted medical and exposure criteria, with ineffective efforts to eliminate the very doctors and screening companies who have provided invalid diagnoses in the tort system, serve no legitimate public policy purpose and can only result in the payment of claims that should never be allowed, thereby rewarding vast numbers of unimpaired claimants and dissipating the assets of the Fund.
Consequently, instead of weeding out the unimpaireds and the attorney's fees they generate, the Trust Fund creates a defined benefit at the expense of the truly sick and the participants funding those payments. More importantly, however, with a Trust Fund "welcome mat," the solvency of the Fund is placed at risk, all the more so by the efforts throughout the legislation to placate special interest groups by expanding the pool of Fund claimants. Clearly anyone knowledgeable about asbestos litigation feels a special concern for the residents of Libby, Montana. The exception created for the residents of Libby, Montana, however, creates the potential for other Libby-like exceptions. This expanding pool of claimants now includes the victims of the September 11, 2001 attack on the World Trade Center and Hurricanes Katrina and Rita. While all of our sympathies lie with those victims, it is difficult to see how this expansion of the Fund-claiming population and its elimination of any occupational exposure criteria will not be yet another threat to the solvency of the Fund. Inclusion of these sympathetic groups demonstrates one of the fundamental weaknesses of the Trust Fund approach. To state the obvious, exponential growth of the claimant pool, where such members were not even factored into the claimant forecasts made years ago, dangerously imperils the solvency of the Trust Fund

The Fund's viability is further called into question by the start-up program discussed earlier. Under this protocol, neither Liberty Mutual nor anyone else has any assurance whatsoever that the Fund Administrator will find the Fund operational and thereby guarantee the viability of the Fund. Whether looking at the CBO analysis, the Bates White study or the testimony of numerous witnesses before this Committee, the only certainty is that there is enormous uncertainty about the number of claims that will be made and the amount of dollars paid out.

With respect to certainty about the amount of dollars paid into the Fund, again, there is none. First, notwithstanding repeated requests for public transparency of the funding process and particularly with respect to which defendant is in which tier and subtier, no such information has been forthcoming. It is inconceivable that the funding for at least $90 billion of a $140 billion government-created Trust Fund is a virtual mystery. Without identification of which companies are in which tier and subtier there is no opportunity to challenge the economic forecasts, no basis to believe that such funding exists and no basis to believe that the Trust Fund has any real chance to sustain itself for a few, let alone, 30

years. Second, this violation of the core principle of viability is exacerbated further by the looming constitutional challenges to the Act, the assumption that all defendants will be in business for the next 30 years and able to make their payments for all 30 years - an assumption that ignores the business reality in the global economy - and that the payment obligations of insurers and reinsurers beyond the jurisdiction of United States courts can be enforced. Well-managed and well-reserved companies simply cannot trade their future - and their policyholders' future - for the uncertainty of S.3274.

In the end, the Trust Fund lacks fundamental fairness, no longer provides an exclusive remedy and is not economically sustainable and viable. Because S.3274 fails to meet these three basic tests, Liberty Mutual, the members of PCI and the members of CAR do not support S.3274 - particularly when there are viable alternatives that have been tested and proven to work, alternatives that Liberty Mutual, PCI and CAR very much do support.

In 2003, in the absence of reforms in key states, the seminal silica MDL decision issued by Judge Janis Jack in Texas and the willingness of judges to reject manufactured claims, the Trust Fund was a creative concept that showed great potential. But, we are in 2006. Over the last three years, no doubt motivated by the hard work of this very Committee, there has been a sea change in asbestos litigation which has begun to yield profound results. It is because of (i) the successes at the state level, (ii) the influx of case management orders and inactive dockets in countless jurisdictions, (iii) the changes in case law in, for example, Mississippi and (iv) the impact of Judge Jack's ruling that we have concluded that, while the Trust Fund is now the wrong fix at the wrong time, medical criteria, coupled with venue and case-consolidation reform, are the right fix in the current litigation environment.
(4) Is there a viable alternative to S.3274 with a proven track of success? Liberty Mutual's goal is not to make light or dismiss the efforts that lead to S.3274. Indeed, for some time Liberty Mutual supported the efforts to develop a viable trust fund. Rather, Liberty Mutual's goal is to identify what will work and to collaborate in the efforts to pass such legislation so that all asbestos claimants and participants are treated fairly, in whatever forum the claim is pursued---state, federal or bankruptcy court. Tremendous progress has been made at the state level and should not be ignored, particularly where there is abundant information to show that the impact of state medical criteria, venue and case-consolidation reform has been dramatic. For example, the Texas medical criteria legislation, S.B. 15 (effective September 1, 2005), contains medical criteria such that each plaintiff with a non-malignant claim must provide a qualifying medical report in order to activate his or her case. According to the judge overseeing the S.B. 15 cases, his docket contains approximately 30,000 plaintiffs who allege a non-malignant claim. To date, no non-malignancy claimant has filed a medical report qualified by the Court as meeting the requirements of S.B. 15. To date, only six claimants have even attempted to file reports to qualify under S.B. 15's medical criteria.

Texas is not an isolated situation. To the contrary, no less than 16 states have tackled asbestos litigation abuses, many through legislation, many through inactive dockets and yet others through case law. In addition to Texas, Georgia, Ohio, Florida, Kansas and South Carolina have each passed legislation that imposes medical criteria to guarantee that physical impairment is a predicate to filing an asbestos claim. The following state courts have also reached the same result through either inactive dockets or case management orders that preclude prosecution of a claim without physical impairment: Syracuse, NY; New York City, NY; Baltimore City, MD; Chicago, IL; Boston, MA; St. Clair County, IL; Portsmouth, VA.; King County (Seattle), WA; Madison County, IL; Cuyahoga County (Cleveland) OH; Minnesota (coordinated litigation). The states of Pennsylvania, Maine, Maryland and Mississippi have each resolved the abuses associated with forum shopping or unimpaired claimants through case law.

The beneficial impact of these efforts cannot be overstated. Historically Texas, Ohio and Mississippi have been the leading states to generate claims filed against Liberty Mutual's policyholders, collectively accounting for approximately 80% of the asbestos claims filed against Liberty Mutual's insureds. Since the statutory and judicial reforms in those three key states, the decrease in the volume of claims has been truly remarkable. In Mississippi, the decrease has been 90%, in Texas nearly 65% and, in Ohio, approximately 35%. Across all states, from 2004 to 2005 we have seen over a 50% decrease in the number of new claims filed, a trend that has continued in 2006. These numbers are the best evidence that state-driven initiatives are working and should not be negated by the passage of S. 3274. To the contrary, these efforts should be replicated at the federal level. Rep. Cannon's pending legislation, H.R. 1957: Asbestos Compensation Fairness Act of 2005, with over sixty sponsors, is the model that should be followed. Forum-shopping, case consolidation and ineffective medical criteria cannot be tolerated, especially at the expense of the truly sick. Federal legislation that mirrors these successful models, with conforming changes to the Bankruptcy Code, would eliminate once and for all the historic abuses that have plagued the truly sick, the courts and the global business community.

In conclusion, Liberty Mutual very much supports asbestos litigation reform. However, we believe the Trust Fund embodied in S.3274 is not the solution, as it fails to meet the tests of fairness, exclusive remedy, and sustainability. There is a better solution, one that is proving itself in numerous states - medical criteria and venue and case consolidation reform.