CAPITOL ANALYSTS NETWORK, INC.
Stuart J. Sweet, President March 19, 2003

OVERCOME YOUR ASBESTOPHOBIA

The words asbestos and optimism are rarely used in the same sentence – and for good reason. Just last week, on a 5-4 decision, the U.S. Supreme Court broke new legal ground by ruling that breathing impaired non-malignant asbestos victims could collect damages for "cancerophobia." Justices Ginsburg, Stevens, Souter, Scalia, and Thomas held that six former West Virginian railroad workers with asbestosis were entitled to $4.9 million in overall compensatory damages. These victims will be paid an average of $800,000, not only because they are short of breath, but because they now know there is a 10 percent chance their asbestosis will develop into fatal cancer. The Court's ruling will raise projected asbestos liabilities, which the RAND Institute recently forecast at $150 billion to $200 billion over the next twenty years. That is on top of the $54 billion that has already been paid out.

Conditioned to hearing only bad news, investors in companies drowning in asbestos lawsuits may be forgiven for missing an important turning point. Recently, three influential Senators, Orrin Hatch (R-UT), Pat Leahy (D-VT), and Chris Dodd (D-CT) announced their intentions to negotiate a resolution to the asbestos litigation crisis. They gave themselves one month to do so and have demanded that asbestos stakeholders – defendant corporations, insurance companies, labor leaders, and trial lawyers – meet with them to forge a solution. If they reach agreement, there is an excellent chance they will have the pull with their colleagues to muscle a settlement through the Senate later this year. Hatch probably can attract 49 Republican votes while Leahy and Dodd will need to generate only 11 Democrat supporters. Sixty votes shuts down a Senate filibuster. Leahy and Dodd are counting on Tom Carper (D-DE), Maria Cantwell (D-WA), Joe Lieberman (D-CT), Ben Nelson (D-NE) and Chuck Schumer (D-NY) to help put them over the top.

The House also is receptive to moving forward. A spokesman for Speaker Denny Hastert last week said he considers asbestos litigation reform legislation "incredibly important." While he is not wedded to a precise plan, the Speaker encouraged Rep. Mark Kirk (R-IL) to frame the House debate by introducing HR 1114 two weeks ago. If asbestos litigation reform legislation clears Congress, the bill should get a warm reception from the White House. Attorney General John Ashcroft, who championed reform as a Senator from Missouri with a seat on the Judiciary Committee, would happily offer his presidential boss a bill signing pen.

Should this Senate trio succeed, their initiative could lop off $100 billion in corporate liabilities. Taking into account the time value of money, the market capitalization of corporate America would rise by $50 billion, with the increase concentrated in firms that are most under assault, including many that have fled to the arms of bankruptcy courts. Anyone interested in possibly pocketing 20 percent to 200 percent short-term capital gains should start paying more attention to Orrin Hatch and Pat Leahy and less to Jacques Chirac and Tony Blair.

Burned by Asbestos

Between 1940 and 1979, the period when asbestos was widely used, up to 100 million American workers were exposed to the toxin on the job according to the Manville Trust. In 1982 when asbestos lawsuits drove Johns-Manville into bankruptcy, 21,000 suits were aimed at 300 companies. Today, litigation is almost 30 times bigger. Currently, over 600,000 plaintiffs have filed suit against more than 8,000 defendants. Analysts anticipate another 2.4 million will file before the largest mass tort in U.S. history concludes. The majority of these 600,000 suits sit on court dockets, and are very slowly moving through state courts. The backlog grows because more cases are added every year than are resolved.

In 1991, the Supreme Court first called upon Congress to enact a "national solution" that assured quick payment to victims and allowed companies to estimate their liabilities so they could make financial provision for them. Despite repeated urging from the Court, Congress let the problem fester, believing that the number of lawsuits had peaked and asbestos litigation would diminish over time. The reverse happened. More than 80,000 plaintiffs filed suit just in 2001. Litigation costs now exceed $5 billion a year, with at least half of the dollars going toward plaintiff and defendant legal expenses. The *Wall Street Journal* has commented that the $54 billion cost of asbestos litigation through 2000 is "more than the cost of 9/11, Enron and Worldcom put together."

Fixing a Broken System

If future cases parallel those of today, ten percent of successful plaintiffs will be found to have either mesothelioma, a fatal cancer of the lining around the lungs contracted solely from asbestos exposure, or other forms of lung and throat cancer. Another forty-five percent will be judged to have asbestosis, lung impairment ranging from negligible to requiring use of an iron lung. Finally, another forty-five percent of successful plaintiffs will be judged to have no measurable impairment today.

Reformers, which include all stakeholders except for most trial attorneys, have two major cost savings ideas in mind. The first idea is to tell the "worried well" to sue at a later date, if they become impaired. Approximately 260,000 plaintiffs have filed suit although they have no symptoms because they are concerned that their rights to sue could expire under the statute of limitations. Asbestos-related illnesses such as mesothelioma or asbestosis can have a latency period of as long as forty years. If plaintiffs don't sue now, they risk being shut out of court if they do become ill ten years from now. Consequently, the worried well join up in class action suits. When their cases are likely settled en masse on the courthouse steps, they typically receive $10,000 to $15,000, and hand over thirty-three to forty percent of this amount to their attorneys, and can even be taxed on the balance. For this small compensation, they forever waive their claims.

This is a triple injustice. First, many corporations settle class action lawsuits involving the worried well because to do otherwise would be to "bet the company" on what an unfriendly

judge and jury decide. Class action attorneys make a point of filing actions in venues most hospitable to their plaintiffs, increasing the corporate dangers of playing legal Russian roulette. Second, the vast majority of the worried well will never become sick, but they happily split the largesse with their attorneys anyway. Third, a small percentage of those who are now asymptomatic tragically will come down with asbestosis, or worse, years in the future. Having settled for pennies on the dollar, some will die penniless; in an irony not lost on observers, a few are now suing their former trial attorneys!

All reformers believe that the correct way to prevent these injustices is to require the worried well to wait to sue until they have become sick, and know how serious their conditions are. There is a consensus that the statute of limitations should not apply to asbestos victims. No consensus exists yet on how "sick" someone must be to sue now, however, and who must wait. At one end, the National Association of Manufacturers (NAM) supports medical standards based on those proposed by the American Medical Association, which would certify asbestos-related impairments from mesothelioma, certain lung cancers, and asbestosis that affects breathing so severely that plaintiffs are unable to work. At the other end are trial attorneys who represent the worried well. They think everything is fine, as is. In a surprising announcement, the American Bar Association recently shocked their trial attorney colleagues by coming out in favor of the medical standards that NAM is backing. RAND researchers estimate that the worried well and their attorneys now receive approximately twenty percent of total asbestos dollar awards. If the reformers prevail, this twenty percent will disappear and be replaced by total awards of a smaller amount many years in the future. Trial attorneys with seriously ill clients also favor medical criteria to qualify for court; their cases would then move forward more rapidly if the asbestos docket almost were cut in half.

The medical criteria lawsuit eligibility concept has most aggressive support from the "Asbestos Alliance," an advocacy group formed by companies with dangerously high asbestos exposure, insurance firms, trial lawyers who represent the sickest asbestos plaintiffs, and the American Bar Association. Two trade associations dominate the Alliance, the National Association of Manufacturers and the American Insurance Association. Both are well organized and know how to lobby. Sen. Don Nickles (R-OK), Chairman of the Senate Budget Committee, has introduced the Alliance plan as S 413. The Alliance also is making hard pitches to staff members for Hatch, Leahy, and Dodd.

"The First Thing We Do is Fire the Lawyers"

The second major source of savings favored by reformers is to lower transaction costs – a polite way of saying that defendants and plaintiffs should minimize their use of the 700 expensive trial lawyers who now handle asbestos litigation. In a typical $100 million class action settlement, the defendant also pays $20 million in defense expenses. Meanwhile, the plaintiffs receive $60 million and their trial lawyers collect $40 million. As a result, only 50 percent of the amount paid by defendants, $60 million out of $120 million in total defendant costs, actually reaches plaintiffs. One way to cut transaction costs is to establish, by statute or regulation, the monetary value of given levels of impairment, taking into account the ages of

victims. Thus, a ninety year old man who comes down with mild asbestosis would receive a small settlement while a forty year old with mesothelioma would receive $2 million. Both defendants and plaintiffs would be better off. In the example above, if transactions fees were zero and the savings split between the parties, the defendant would pay $90 million while plaintiffs received that amount. Both parties would be $30 million ahead.

This insight provides the justification for the "Trust Fund" concept championed by the "Asbestos Study Group," which has nine known members: General Electric (GE), Honeywell (HON), Dow (DOW), Halliburton (HAL), Pfizer (PFE), 3M (MMM) , Viacom (VIAb), General Motors (GM), and Ford (F). Assuming the fund is large enough, the AFL-CIO says it will back the plan. The Group is pushing for a version of a no-fault settlement system. Under this approach, corporations historically involved in the production, use, or sale of asbestos products would be assessed specific dollar amounts by statute and required to placed their assessments into a national asbestos trust fund. Plaintiffs would receive compensation from the Trust Fund administrator, again on the basis of standard medical criteria.

Critics of the Trust Fund proposal question its political practicality, not its theoretical efficiency. They believe 8,000 corporate defendants will never accept the individually assigned required payment allotments needed to create a $150 billion to $300 billion fund, even though this is the same group who will most benefit from the transactional savings of a "no-fault" system.

A related plan sidesteps the political problems confronting Trust Fund advocates, relying on mediation to slash legal costs. Instead of suing , asbestos victims would voluntarily report to medical professionals certified by the Justice Department who would establish their levels of impairment through standardized testing, and consequently, the amount of monetary damages they were entitled to in compensation. The Justice Department would interview claimants to determine the amounts that defendant corporations should pay, then send culpable corporations their cost allocations. Whenever both plaintiffs and defendants were satisfied, then legal fees would be small. The champion of this approach is Representative Mark Kirk (R-IL) whose HR 114 has attracted thirty-seven House Republican cosponsors to date. The Congressional Budget Office estimates that forty percent of mesothelioma and asbestosis cases would be settled, with only minimal legal costs, if such a system were created. Under this plan, asbestos litigation costs would fall by about 28 percent.

Where Things Stand

At a Senate Judiciary hearing on March 5, Chairman Hatch gave feuding defendant business groups, insurers, the AFL-CIO, and trial lawyers two weeks to come up with a consensus bill. Today is the deadline. He made this announcement with Senator Pat Leahy looking on, the Democrats' leader on the Judiciary Committee. Leahy is a Vermont liberal who enjoyed wearing tie-dyed tee shirts when he went to Grateful Dead concerts while Jerry Garcia was alive. Nevertheless, he and the conservative Senator from Utah get along well, and they both feel that the time has come to adopt a consensus solution to the asbestos litigation problem.

At Hatch's hearing, Leahy described the status quo as a "lose-lose situation," with companies declaring bankruptcy while the truly sick are not compensated. According to the *Washington Post*, Leahy recently also said, "I am convinced we can get a fair solution – fair for companies and fair for victims. Just the sheer weight of all this coming down will force Congress to play a role." While Hatch's target date will come and go, the pressure is on all parties to come to agreement quickly or miss a golden opportunity. This deadline puts pressure on investors to pay attention now, too.

Asbestos and Insurers

To their dismay, many property and casualty insurance companies provided product liability or "premises and operations" coverage to asbestos defendants. Recently, two consulting actuaries for Milliman USA studied this issue. They predict that insurance companies will pick up $100 billion of an $275 billion American asbestos tab – or 36 percent of the total. Of this $100 billion, the authors believe American insurance companies are on the hook for $70 billion; the report can be found at:
http://www.millimanglobal.com/publications/mg_insurance/MG_Insurance_November2002.pdf
This explains why the American Insurance Association is an active member of the Asbestos Alliance, and why Aetna, Allstate, AIG, Farmers Insurance, Gray Insurance, Hartford Insurance, State Farm, and Travelers Property are closely watching developments.

What if Asbestos Stocks had a Rally, and Nobody Came?

For years, asbestos-impaired stocks have driven portfolio returns down. Investors were rewarded for staying away. Having watched the death spirals of numerous otherwise healthy corporations, it is hard for investors to be optimistic that bipartisan congressional intervention will reward them this year for being brave. So far, the market is unimpressed. It yawned on March 5 when Hatch and Leahy exchanged vows to act. Still, the sleepy will get left behind if this unlikely pair of friends get to "yes." With expectations so low and settlement talks underway, for the first time it may be risky *not* to own asbestos damaged goods. If you do not have your own casualty list that could spring back to life with federal help, a partial list of manufacturing or retailing candidates to choose from can be found at
http://robleslawcenter.com/Asbestos%20Products.htm .

For further analysis or information, contact Capitol Analysts Network, Inc. at:

4405 Bradley Lane
Chevy Chase, Maryland 20815
website: www.capitolanalysts.com

Phone: 301-951-9161
Fax: 301-652-5831
Email: capnet@xecu.net