

PUBLIC HEARING

before

ENVIRONMENTAL IMPAIRMENT LIABILITY INSURANCE STUDY COMMISSION

on

"Extent of Liability Insurance Crisis"

October 24, 1985
Room 438
State House Annex
Trenton, New Jersey

New Jersey State Library

MEMBERS OF COMMITTEE PRESENT:

Senator Raymond Lesniak, Chairman
Senator Lee B. Laskin
Senator Daniel J. Dalton
Senator S. Thomas Gagliano
Assemblyman Robert C. Shinn, Jr.
Assemblyman Robert J. Martin

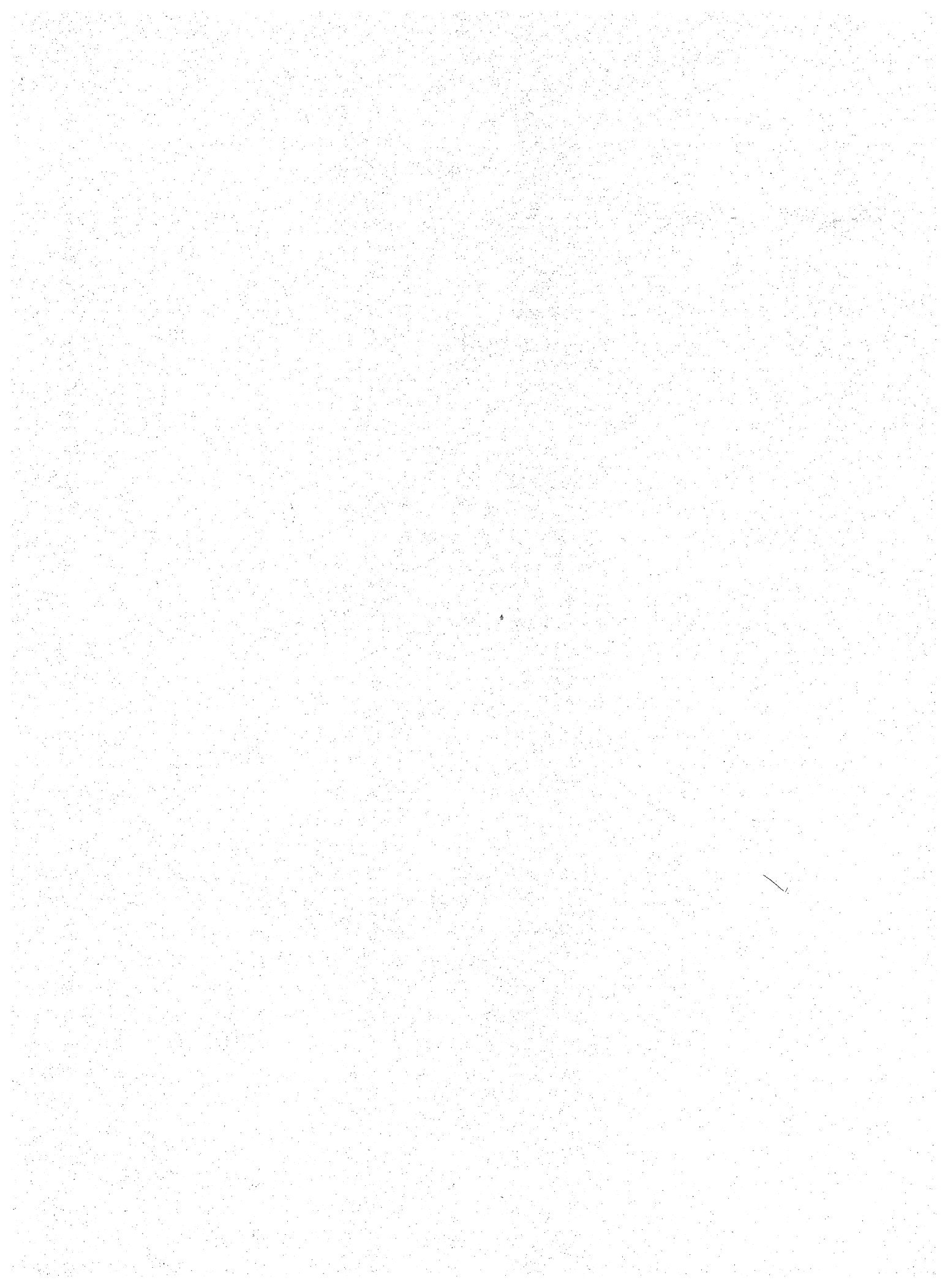
ALSO PRESENT:

Denise Drace
Office of Legislative Services
Aide, Environmental Impairment Liability Insurance Study Commission

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SENATOR RAYMOND LESNIAK (Chairman): Ready or not, here we come-- Let me first announce that the Commission will be meeting in executive session after today's testimony, to consider recommendations that we have been discussing during the week.

At this time, I would like to call up the first-- Oh, by the way, we had originally scheduled Alfred Slocum, Acting Public Advocate of the New Jersey Department of the Public Advocate, but he is unavailable at this time. He will be testifying a little later.

The first-- Oh, he's here. Oh, okay. Robert Mason, EPA Specialist for the Office of Waste Programs Enforcement, United States Environmental Protection Agency, Washington, D.C. Mr. Mason?

He's not here. Robert Mason? Okay, we will now call Drew Karpinski, Chairman of the New Jersey Insurance Task Force on Environmental Issues.

This is the testimony -- you are going to read this, Drew?
(laughter)

SENATOR GAGLIANO: Can you give me five minutes, Ray?
(laughter)

DREW KARPINSKI: That is just the overview; we have the total text here.

Senator Lesniak, members of the Commission, thank you for giving us the opportunity to be here this morning. My name is Drew Karpinski, and I am an insurance agent and broker; president of agencies in Parsippany and Morristown; and Immediate Past President of the Professional Insurance Agents of New Jersey. I am here this morning as Chairman of the New Jersey Insurance Task Force on Environmental Issues.

This group, the New Jersey Insurance Task Force on Environmental Issues, was formed not over the past few months, but back in February of this year. It was a result of a fragmentation within the insurance industry in which a lot of people were doing a lot of work in different quarters, and those efforts were not being coordinated. As a result, the industry felt that it would be helpful if a single group were formed, such as a task force which would serve to bring all of this information together and hopefully present a

broader, more comprehensive picture of the perception of the insurance industry and of the environmental liability problems that exist today.

So, back in February of 1985, this Task Force began to meet. The Task Force consists of several organizations: the AAI and the AIA, which are the two large company associations; the Professional Insurance Agents of New Jersey; the IIANJ, the independent agents' association; and representatives from four companies that are prominent in the State of New Jersey, in doing a substantial amount of business here, namely, CIGNA, Crum and Forster, Firemens Fund and Selected Risks.

The purpose of the group is to provide research and education and develop several comprehensive position papers regarding the problems that we face today. Working since February, we have most recently developed two statements. The first one is a 1985-86 survey of environmental pollution legislation and regulation, and I believe you all have a copy of that. In addition to that, we have a position statement dated October, 1985 concerning New Jersey Senate Bill 2545 and Assembly Bill 3073. That statement also concerns the Tort and Claims Act and the liability of public entities. You should also have a copy of that.

To get into more of the detail of what we are doing, I would like to now call on Jeff Klein, who is to my left and who will fill you in as to what the Task Force has been doing, and some of the information that we have for you this morning. Jeff?

JEFFREY KLEIN: Thanks, Drew.

We had to start someplace, and because the bill introduced by Senator Lynch and Assemblyman Foy was receiving so much attention, we decided to focus on that bill first, and to answer many questions that various groups like the League of Municipalities, the Department of Environmental Protection and the Governor's Office had concerning the insurance industry's position on that.

SENATOR LESNIAK: Excuse me, Jeff. For the record, you are with the American Insurance Association?

MR. KLEIN: That is correct. Associate Counsel.

The Task Force -- just to fill in something that Drew said -- is not a lobbying group, it is a research group. We decided to get what some people would say are the best minds -- but we may disagree amongst ourselves about that -- in the industry to sit down and look at the Tort Claims Act and the environmental statutes such as the Spill Fund Act, the Major Hazardous Waste Facilities Siting Act, and the other New Jersey statutes which are enumerated in the survey that we have before you, as an anthology of all the relevant statutes that we think must be examined and this Commission should take a look at.

But as I said, to start someplace, this bill was introduced in response to growing concerns about pollution availability for public entities in particular. We examined this bill over the course of the summer, and we have come up with some conclusions. I summarized them in a summary statement which is the second piece attached for you; I am not going to read from it here, I have asked that it be entered into the record. There is a much larger piece, approaching the size of a legal brief, if you will, which is attached as well.

Basically, the Lynch bill is composed of-- Senate 2545 is composed of three major components and attempts to make three major changes with respect to the tort standards for public entities. In section one, it attempts to create an express negligence standard by which a municipality's negligence could be governed in court actions. Number two, it attempts to create a state-of-the-art defense which would enable public entities to assert that they used the best available technology at the time, as an affirmative defense in any such action. And thirdly, it attempts to create a several and apportioned liability standard as opposed to what we view now as a joint and several standard applicable to public entities. I'll get on to a definition of each of those as we go through the three pieces.

Section one, in its attempt to create a negligence standard, uses the term "unreasonable" in its scope, and we have some concerns about that. At first glance, the industry's reaction to that bill was favorable because municipalities could otherwise be held to strict liability under some of the environmental statutes. On looking at it again and on further research, Title 59, the Tort Claims Act, and

Section 59:2-3(d), expressly provides that the standard for a public entity and discretionary actions are that they will not be held liable for those actions unless a court determines that they were palpably unreasonable.

Putting those pieces together, we feel that the bill as presently drafted may provide less protection for public entities in pollution cases than in other normal tort cases, such as those involving negligence developed as a result of actions by policemen or firemen.

And if we are talking about availability problems, and we are talking about strengthening-- If you go from the assumption that, in order to improve the insurance environment in this State, there have to be certain reforms of the tort standards -- and we will get back to that assumption later on -- we believe that this may be a step back, albeit unwittingly, and we suggest that section of the bill be exempt.

However, we don't believe that a switch back, on further research, to palpably unreasonable would be sufficient. The problem here is that although the Tort Claims Act says, by its own nature, that it governs actions against public entities, we have reviewed many of the environmental statutes including the Spill Fund Act, the Environmental Cleanup Responsibility Act and the like, and based both on cases which we have seen in New Jersey and trends we have seen in other states, we believe, if it hasn't happened already, that any day now, a court could determine that the liability standards under those environmental statutes would predominate over any standards in the Tort Claims Act. And as a result of that, public entities themselves, which are defined-- which are included in the definition of person or owner or operator in many of those statutes, by the way -- that public entities would be found to be strictly liable, that is, liable without having to have proof of fault or causation; and that they could be found joint and severally liable, meaning that any one defendant could be liable for the entire scope of the damages of another defendant who was unable to be reached because of bankruptcy or other purposes.

SENATOR LESNIAK: Jeff, let's correct the record. Strict liability is without regard to fault, but you still have to prove causation.

MR. KLEIN: Okay. You're correct.

SENATOR LESNIAK: I know it was a mistake; I just wanted to clarify it for the record.

MR. KLEIN: So, we have reviewed the bill and based on those concerns, we think the only way municipalities could be afforded greater protection than they have now, is a form of limited sovereign immunity, which was discussed and mentioned by representatives of many of the municipalities and others at the first hearing here, October 2. We have suggested language to that effect on page 5 of the executive summary; that is, a public entity or a public employee would not be held liable for any injury unless it was grossly negligent, or the pollution incident it was involved in resulted from grossly negligent noncompliance with any Federal, State or local law or regulation.

We know that many in the Legislature will have questions about that, but the whole approach we are trying to take in this Task Force is to present to you the optimum and the most necessary changes that you could make to improve the tort climate as it affects public entities.

I also want to say, before I go further, that we do not intend to stop with this bill, nor do we, as members of the Task Force, view this bill as an end-all solution. It is a piece of a larger puzzle; hopefully, in the context of these hearings, it will be addressed within the scope of a larger set of recommendations by this Commission. Any one bill or any one proposal by itself will not solve the problem. We have tried to make that clear to all we have spoken to down here, and in other places here in Trenton; and we hope that is recognized here today.

The second aspect of the bill which we address concerns a state-of-the-art defense. There was a case in New Jersey several years ago, know as the Beshada case, which was a State Supreme Court decision, I believe. Basically, what it said was that drug manufacturers would be unable to assert that they used the best

available knowledge or technology at the time, by virtue of the fact that they had put a product into the marketplaces and had to suffer the consequences for it. That decision was overruled, at least on its facts, by a later case which I cite, and will discuss later in my testimony for the AIA — Feldman v. Lederle Laboratories. For reasons I will express then, we think that case was very narrow, and that the original Beshada case will continue to be a precedent-setting case in this State. We don't know if it is going to be extended to public entities; it deals with drug manufacturers. But again, because of the uncertain judicial climate, we are suggesting that the Lynch bill, Senate 2545, goes a step in the right direction, in providing such a defense, with one change: public entities are not as sophisticated as Exxon, or other drug or chemical defendants. We don't know if a pure, technical, state-of-the-art defense would be either workable or helpful to them, so we are suggesting that the bill be amended to permit municipalities and other public entities only to assert that they did everything they could to comply with existing Federal, State and local requirements that were in effect at the time. So, if a public entity complies with State DEP requirements, with respect to generation or transportation of waste, and that it complied with the requirements fully at the time, it should be able to assert that in a subsequent court case.

SENATOR GAGLIANO: Is it all right to interrupt?

SENATOR LESNIAK: Oh, sure. Please.

MR. KLEIN: I'll go on forever, otherwise.

SENATOR GAGLIANO: Thank you, Mr. Chairman.

Let's say you are talking about-- I think you are talking about a parallel to the state-of-the-art defense, on a municipal, county or authority level, right?

MR. KLEIN: That's right.

SENATOR GAGLIANO: Some kind of governmental entity. How would you couch that? Would you say-- I think you explained it, but I would like a little more detail, because I think that is an interesting point. You are going to say that, if at the time-- Let's say, for example, the municipality allowed a certain type of construction

through their town. Let's say a school board. A school board provided a certain type of construction in a new school, which, 10 years later, was discovered was very hazardous, carcinogenic-- whatever you want to call it, especially to the children. You are saying that in that circumstance, if the school board had gone through all of the procedures in purchasing the equipment or whatever it was, checked it out carefully and found it met all the requirements -- they had done everything that they could do, so to speak, within the guidelines as they knew them -- and then, if a suit starts 10 years later, and this carcinogenic item was in the school all that time and was causing damage, that would be a defense? Now, would that be an absolute defense?

MR. KLEIN: I don't believe, under those circumstances, it should be an absolute defense just because there may have been circumstances which came to the attention of the entity, and if they did not take any corrective action--

SENATOR GAGLIANO: No, no, they removed it immediately, but during that 10 year period, allegedly, students, children, teachers or whatever were injured by this. How do you weave it into a defense? I mean, does it become an absolute defense? Does it become something you could not even testify to, at a subsequent hearing or trial?

MR. KLEIN: The way we envision it, Senator -- and there is an insurance perspective to this -- is that it would be a defense that is permitted to be asserted, that it not be an absolute defense but that it could be discussed during the course of the trial and asserted; and read into the record and be able to be contradicted by the opposing side. But not--

SENATOR GAGLIANO: Okay. All right, so not an absolute, but a separate defense which the municipality or school board or whoever, could raise during the course of the trial--

MR. KLEIN: That is correct. We are not totally clear on this, but I guess it would almost rise to the level of rebuttable presumption, if you will-- something to that effect, but something that could be rebutted, not an absolute.

SENATOR GAGLIANO: Would you recommend using something like that, a rebuttable presumption? Wouldn't that be more clear?

MR. KLEIN: From a court perspective, probably yes. I would like to check with our liability experts to determine whether that would be the better way to go. I am not too clear on what would be the best judicial interpretation.

SENATOR GAGLIANO: For example, I mean-- I have a situation, I keep going back to it because it just irks me. I had a building one time that I put insulation in. I pumped in the insulation, and there was advertising and everything that said, "Non-toxic; non-this and non-that." About four or five years later, I find out that I have to rip out the walls and take this stuff out. That is what I am saying. The company went bankrupt, so I can't even go after them, even if they were around. But, I am concerned that we make a clear statement, or try to make a clear statement, so that several years later, if an issue like this arises, that the legislative intent is clear -- what we intended to do. I am not sure we could do it, but I think it is important that we are clear on this statement. Maybe a rebuttable presumption is the best way to handle it. I don't know.

MR. KLEIN: Okay. We will try to get back to you on that.

SENATOR LESNIAK: Let me make something else-- another observation, Senator. It appears to me, what is being presented to us today is beyond a state-of-the-art defense. What I heard was that, as long as you comply with the State rules and regulations, even if there were better procedures out there, things that reasonable people would have done but the State did not require-- What you are saying is, that ought to be an affirmative defense as well.

MR. KLEIN: And the reason we are suggesting that, as I was starting to say before-- Public entities are not as sophisticated, and I don't mean that in a derogatory sense. I used to work for one -- the City of New York -- although some would disagree. They are not as sophisticated as other defendants. To hold them to a standard, assuming that they had techniques and technology available to them at the time, may just not be feasible in the real world.

But what we are suggesting is, if the State DEP had regulations in place in 1981 that school districts and public entities had to comply with, concerning both removal of asbestos, for example,

or dumping or transporting of waste in a publicly-owned landfill -- and if it fulfilled its requirements -- that it be permitted to assert that and be permitted to show that it did the best job it could at the time, and no more.

From an insurance perspective, both with respect to public entities and others, this is important, because when an insurance company is assessing a risk, there are certain parameters an underwriter has to go with, including, to a certain degree, the track record of a particular defendant, a record concerning other defendants around it, certainly-- But it is very important to note what that individual insured's responsibility was, and we think it makes eminent sense, and would help the insurance environment greatly, if an insurer were able to underwrite a policy, and knowing its insured took the best took the best precautions that it could take at the time of the action in question. That policy would be easier to write, and probably more affordable to write, without all of these other uncertainties coming into play, but I will discuss that later.

SENATOR LESNIAK: Would you then want a coverage -- an exclusion for those entities that did not comply with--

MR. KLEIN: That is a good question. Part of the function of insurance is to gauge a risk. If an insured is judged to be a bad risk and if its premium is at a skyrocketing rate, in many instances that is because the insurance company does not feel that it is a particularly good risk, and there is a reasonable likelihood there will be some liability arising there. The insurance mechanism is intended to weed out those who are not being responsible enough. Some of the problems we have with mandated markets or other suggestions that pop around the country is that if we are forced to write insurance for everybody, we are, in effect, underwriting either criminal behavior, or very, very reckless behavior.

SENATOR LESNIAK: Let me make one other comment at this time, since you mentioned the Beshada case and how it has been reversed, at least in a very limited sense, and how you feel that it may still be applicable and could be -- Although it is a drug case, it could very well be applicable to public entities, and you mentioned the

uncertainty of the judicial climate here in the State of New Jersey, and I am sure that applies elsewhere.

Would you say that if this Legislature could bring some certainty — even if it were not to limit liability, or reduce liability concepts, but at least bring certainty into what your risks are — that would at least be beneficial in terms of being able to assess those risks and price them, if you will?

MR. KLEIN: I don't want to get into this too much now. As a representative of the Task Force, I would rather— Clearly, both reinsurers and the primary insurance community are looking to see what is happening in each and every individual state with respect to their tort systems, and the big problem, in environmental and other long-tail lines, is the great degree of uncertainty. We suggest that if this State takes a close look at these types of issues— again, there are no promises that it is going to change the market overnight, but we believe it will be a step toward improving the insurance climate in the not-too-distant future.

There is a third piece to the Lynch bill that I just want to—

ASSEMBLYMAN MARTIN: Can I just interrupt? Just so I am clear. I understand the concept of rebuttable presumptions, but outside of the factual questions, let's say that you do establish that you have met State "regs" and so forth. If a municipality reaches that level, how would the rebuttable presumption be overcome? How would it really differ, in fact, from an absolute defense at that stage?

MR. KLEIN: The only way I envision that happening is if there was some evidence that subsequent to the time of the construction, or dumping, that the municipality knew that the problem was there or was festering, and that new technologies had become available and new regulations had come down the pike. And if that somehow has a bearing on the outcome of the trial in terms of whether damages have been worsened because of inaction over time, or something like that, then that should be permitted to be discussed during the course of the trial as a cause of action.

It could be, as I said, a scenario where there are changed circumstances, but the public entity by negligence or whatever, forgot to do anything about it, or didn't read the newsletter sent to them that month by the technical waste specialists in the division of waste management or whatever in EPA, and that if that somehow worsened the damages which were ultimately the subject of court action, that somehow, that should have to be addressed. Whether that is going to arise, and in what percentage of the cases, I don't know and I am not prepared to say.

ASSEMBLYMAN MARTIN: Thank you.

SENATOR LESNIAK: Senator Dalton?

SENATOR DALTON: I understand your point, and I guess the insurance industry's point, that the more predictable we can make this for the industry and the industry's underwriters, perhaps that will increase the likelihood of opening up the marketplace again. The concern I have is that when you have a public entity, that has a— is predictable as far as the risk, from even an environmental standpoint, where you have no landfills within the municipality, either presently operating or old landfills, and that municipality still can not obtain general liability insurance — I then wonder, well, you know— and listening to you, you are saying, "We want a predictable risk;" you have a predictable risk, for the most part, and yet there is no one writing it. How do you take a situation like that and correlate to your statement of predictability?

SENATOR GAGLIANO: It's called leverage.

SENATOR DALTON: Well—

MR. KLEIN: There are two aspects to that, and again, I would like to address that with my separate hat on, not representing these entities here because that has not been within the scope of our research.

But there are two items that are relevant to that, and one is that although pollution liability is a horror, underwriters are expressing a smaller degree of concern with respect to predictability of many public entities with respect to the general liability insurance. And that is for the reasons I will state later on: the

rising number of court judgments and court cases have made public entity insurance difficult, if not impossible, to write. In my experience in New York State, where I helped set up a market assistance program for municipal liabilities, four months after that was set up, there seemed to be more of an affordability problem than an availability problem. The coverage was available, not to everybody, but on a wider scale than we would otherwise have believed, based on reports we were hearing. But it was available at a much higher price than municipalities had been paying over the last several years.

The second thing, Senator Dalton, that we have to concede as an industry, which has been discussed by Congressman Florio and others, is that a portion of this problem is definitely due to the underwriting cycle, which I would like to get into a little later on, and business practices of insurers. We take a degree of responsibility for this problem which has come about now, and is, in part, a result of some of the things that have happened, and that there is a capacity and surplus problem out there right now. We conceded that and we do not intend to shove that under the rug. And that is, in part, why some of these coverages, particularly in commercial lines, are becoming difficult to find.

On the other hand, the underwriters have told us -- and the figures of the industry show -- that for 1984, the loss ratio was 152% for commercial lines, which means for every dollar taken in a premium, the loss has been \$1.52. Whether that is as a result of bad practices or bad court decisions -- I don't know where to split the line, but we think it is at least a good deal the result of huge damage awards and things like that which have been coming down the pike.

SENATOR DALTON: I am sure we will talk about this more--

MR. KLEIN: Yes.

SENATOR DALTON: --because I know you are going to get into it in your testimony. But to indicate that the problem is mainly one of affordability and not availability really contradicts what we have heard from the League of Municipalities, that we have approximately 50 municipalities in the State that are literally running bare as far as general liability. If you look at Newsweek and Time Magazine, you

hear-- the first paragraphs of those stories talk about "the naked city," on a national basis. And I know affordability is a concern, but availability is also a concern, and I don't understand that, to tell you the truth. I am an insurance agent, and if you are meeting an underwriter's criteria, that criteria being predictability -- being able to focus in on a risk, and then judge what sort of premium you are going to charge that risk -- I don't know why we are in the state we are in.

For instance, in a number of municipalities in my district, in the southern part of the State, a municipal entity or a State authority in our area, that doesn't even dump waste had over a 700 increase in their premium, and yet their coverage has dropped by 500%. These types of things, even for someone who has been in the industry 10 years, are very tough questions to grapple with, and tough to understand.

MR. KLEIN: It's very complex, too. We are only suggesting that it is a result of many causes, which I hope to delineate. There are no simple answers.

SENATOR LESNIAK: I would like to briefly comment on two, Senator.

It is complex. One of the problems is, again, that a lot of it relates to uncertainties. They write a general liability insurance policy, with certain exclusions that they believe are going to exclude a risk. And then when a court comes along and says, "well, you did not exclude that risk," and it is something that you did not cost in, you are going to be paying for it. I think that is a problem that we have to deal with, because that adds only uncertainty to the marketplace and is only an extra cost that ought not to be.

The other thing is, again, in our tort liability system, even if a municipality, for instance, does not operate a landfill, but their garbage goes somewhere, they could be brought into a suit and held completely or partially liable for damages under certain circumstances, regardless of whether they operated that landfill or not. So, it is--

SENATOR DALTON: What I think I am hearing is, you are talking about the marketplace like it is some homogeneous type of

entity. And yet, we have over 500 municipalities being able to obtain insurance, and approximately 50 unable to do so. That is the thing that I can not square in my own mind. Is there a market out there, or isn't there a market out there? Is there unpredictability out there for some, and not for others?

SENATOR LESNIAK: That is an interesting question.

SENATOR GAGLIANO: If I may, I think it is a matter of the companies. Because I think— One company that I know of decided to pull insurance from a fairly large area, a city, and then they pulled the insurance from a fairly small town — that just happened to be the same company — and to the best of anybody's knowledge, there was no risk whatsoever in the small town. There were a small number of people, no industry, no dumping; they never had even a garbage pit, let alone a landfill, but I think the company made that decision and left this municipality naked, without coverage, just because that is their current policy. I guess, really, the bottom line is that the insurance companies wanted to get our attention, and that was one way of doing it. It is a graphic illustration of how to do it — just raise the rates like crazy, then take the insurance away from a lot of people, and say, "Next year, when your renewal is up, you are not going to have insurance, either." That got our attention. And I think that is one of the things they really wanted to do.

SENATOR DALTON: Well, right or wrong, one of the things that we have to do to get the insurance industry's attention, I think, is to insure that whatever we fashion, or whatever recommendations this Commission makes, there is going to have to be some give and take on all sides. And I think the insurance industry is going to have to give something, too, in at least providing a marketplace if, in fact, we can reach some general agreement. It is very difficult to sit up here and say, for instance, as one possibility, limiting a litigant's ability to sue, and then to go back to your district and still find people unable to obtain insurance. I wish— One of the things about the legislative process, and in dealing with something as huge as the insurance industry, is, I wish they all talked with one voice, but they don't. And the problem, however, is that we are here to make sure the industry

as a whole is out there providing insurance to the people that we represent.

SENATOR LESNIAK: I would say, though, Senator, that there is a danger if they talk with one voice, and that danger is obviously the conspiracy type of issue that Senator Gagliano alluded to. I think one of the things we have to look at is, are we creating the right climate? We have to make the right judgment. And if we do create the right climate, and the insurance companies are not writing insurance when we can show that the risks are definable, and that we have taken care of the the uncertainties that they talk about that do exist-- If that does not solve the problem, then we are going to have to look at some very serious measures to take with regard to the industry.

SENATOR GAGLIANO: What is your next-- Excuse me, I thought you were going on to your next point.

SENATOR LESNIAK: Yes-- Assemblyman Shinn?

ASSEMBLYMAN SHINN: I've reached the point where I think the only thing I am sure of is that I am not sure of anything. We had a situation in Burlington County, with both a hazardous waste and a solid waste incinerator. We were in the position to do a plan amendment either including or excluding this facility in our solid waste plan. We set out a list of things that this particular applicant would be required to do to operate this facility within our county, including protocols of waste types that he intended to burn, a demand escrow account he set up so that our consultant could review his protocols that were submitted, fire alarms at our central communication, hydrocarbon emissions ongoing analysis, et cetera. The last item was environmental liability insurance, and if he met those criteria, basically, he would come into our plan; if he did not, then he would not. He was successful in obtaining a claims-made, \$3 million environmental impairment liability coverage for that operation, which totally surprised me. I felt that was the area that we were really going to have problems with putting this on-line. I sat in a hearing a couple of weeks ago and heard that the State was in a situation where it really did not have its normal \$100 million impairment coverage. I think we were somewhere in the \$2.5 million area at that time, and

someone was attempting to rectify that. I think somebody is looking at a potential risk pretty carefully, and making a judgment -- Individual companies who are not hearing one voice, as Senator Gagliano pointed out.

But I think the window that we have to create is the window for the judges, because I think, for you to assess the liability, there has to be an upper and lower limit, and probability of risk, I guess. But that window we have to look through has to be one so the judges see where they can go with their decisions. To follow that up, is there another state that has been in a similar situation and has addressed this problem? Do you have any experience in that, since you have more of a national experience?

MR. KLEIN: With respect to environmental liability?

ASSEMBLYMAN SHINN: Yes, with respect to environmental liability.

MR. KLEIN: I have Patricia Casey, our counsel for environmental matters and liability matters in general, and she will be able to give everybody an idea as to what is happening in California and other states, and what we are doing on the Federal level. But clearly, and in response to some statements made earlier in the hearing, we can say that the pollution liability problem is not confined to the State of New Jersey. It is happening all over the country, to a different degree in some states than others, but the problem is occurring around the country and again for the same reasons. As of now, underwriters don't believe it is insurable because it does not have any of the normal characteristics of insurance, since there are absolutely no walls -- as I like to put it -- to the room. It is an open-ended thing, and there is no way to determine a premium or in any way, with any certainty, to know that the premium which has been collected will ultimately pay for the losses which are paid out, with any reasonable degree of comparison or certainty. So, this is not a New Jersey problem. It may be exacerbated in this State because of cases like Jackson Township, which we have all beaten to death during the course of these hearings, but it is an important case in terms of how insurance companies are looking at the market.

There have been comments made by some municipalities that they had perfectly good track records, never had a major loss, and yet their insurance was either increased or cancelled, and that is a legitimate concern. I am only suggesting to you -- although I am not an underwriter, unfortunately; I am a lawyer -- that part of the factors that go into assessing a risk are not simply the existing track record, but what may be coming down the pike within the very near future, because of changing environmental and judicial situations in the State, with respect to that risk. So that is a piece of it -- that is in response to a very likely concern. We are sympathetic, and I am not trying to downplay the concerns of the mayor of Park Ridge or anybody else, especially if you have had a clean record, but the insurance mechanism is a little more complex than just looking at what your experience was for the past two years.

ASSEMBLYMAN SHINN: One quick follow-up-- Two things I think this Commission is after is availability and affordability. The reason for my question about other states and their experience is that if there is some positive experience out there, and if you could supply us with some of that legislation or some of your comments on it, that may aid in our review and progress.

MR. KLEIN: One thing we will talk about, for example, is an arbitration system that is being set up in the State of California, pursuant to a July 1984 statute which provides for some out-of-court apportionment, both in damages and cleanup costs. And that is the type of thing that would be helpful for this Commission to consider in this State.

SENATOR LESNIAK: You are going to address that issue later?

MR. KLEIN: Yes.

SENATOR LESNIAK: Okay.

SENATOR GAGLIANO: What is your third point?

MR. KLEIN: Very quickly, the third portion of the Lynch bill attempts to provide specifically, in the Tort Claims Act, for a several and apportioned standard of liability for public entities. The language seems good on its face already; we don't have any suggestions for improvement other than to state our support for it. Again, because

there are instances where there may be several public entities which have all used the same county landfill, and, under the hypothetical example that I like to use -- which has happened and is very likely, in many states -- if one particular municipality contributed, somehow, five or 10% of the ultimate waste that was put into this landfill, it could ultimately get hooked into paying the entire judgment or a far greater share than it was negligent for. We are not talking about a drug company or private enterprise here, we are talking about taxpayers. The well goes someplace. There is no such thing as a free lunch, and all the other scenarios and things we have heard over the last few years are true. Somebody ends up paying for it, and the taxpayers, through the municipalities, are paying for it through higher insurance rates.

So we think it is not only better from an insurance perspective, but very logical that some degree of certainty, some logic be put in this, and some barriers be placed on a particular public entity being liable beyond the scope of its own negligent actions. There is no incentive under the current system, and we will talk about this later. If you are going to be liable for someone else's negligence, whether you did everything you could or not, what incentive is there for any defendant -- whether they are a public entity or anybody else -- to act as responsibly as they should have? And an insurance company, in assessing a risk, wants to examine how a particular future defendant, or I should say, insured, is acting, one of the things they look at is how responsible that particular defendant has been in doing what it has done. And if ultimately, that individual or that entity will be held liable for things beyond its control, it is unfair to it and it is impossible to write, from an insurance perspective.

SENATOR GAGLIANO: Mr. Chairman?

Two things. I would like to know your position on the statute of limitations that might be cranked into any legislation we propose, and the second thing is, the limitation of liability in terms of dollars, either by way of a deductible amount or a high-ended amount in terms of the dollars that would go to each person. One of the

things that I thought about, even coming down here, was this Exxon problem in the last couple of days. If they had not just sent out something that smelled like rotten eggs and gotten a few people nauseous, but instead, had pumped out something that was lethal, a good part of your district, I guess, and Staten Island and New York would have been severely affected. So, I-- That is a very current issue, but I am concerned about whether or not what we do with respect to the statute of limitations on the old stuff, and what, if anything, we try to do with respect to limitation on dollars.

MR. KLEIN: Again, Senator, I can't speak with my Task Force hat on because we have not addressed this, but certainly, as a trade association, we traditionally advocated fair statutes of limitation. I don't know what the current statute is in New Jersey; forgive me, but if it was a discovery statute, and it was from a perspective only in the sense that you did not consider cases for which insurance was already written, and for which the time has already run, but if you have some degree of certainty -- like three years from the date you knew or should have known that you suffered a particular injury -- that is something the insurance industry can assess very well.

With respect to caps on dollars, as an industry, I suppose we would certainly favor that. I guess it is a question as to where you draw the line and how helpful it would be. Do you draw the line at \$100,000; \$500,000? Who are you precluding by arbitrarily drawing the line where you are? And certain people are going to get hurt no matter where you do it, as you know better than I. But certainly that also brings in a certain degree of certainty. Caps for pain and suffering, for example, are something that we have been looking at, for those damages that are not economic and which are speculative in nature.

SENATOR GAGLIANO: The issue of the statute of limitations-- I think this Lone Pine suit that is now pending -- I have been to the Lone Pine Landfill, I think most of us probably have. It is a huge landfill. They say that there are barrels 40, 50 feet deep under the garbage. It is traversed by brooks which go to the Manasquan River, so there is a question there of whether or not the toxicity is carried down through the leachate; but when you take municipalities, for

example, that may have dumped there 15 years ago, through a contract, and say that that municipality may be liable for 5%, or 8% or 10%, it is totally speculative, the way I see it. The drums that were put there are probably all rotted out, and it is very difficult to determine. It would cost millions of dollars, really, to figure out whose they were unless a chemical company name was right on the drum, and then that still might have been somebody else who filled someone else's drum.

So, I just wonder, actually, whether or not we should try to deal with that, and whether or not that would help the underwriters determine what their liabilities might be. I know that probably sounds a little far out, but I think the courts would have to at least deal with the statute of limitations issue. When we get to the point of being totally speculative with respect to someone's liability for something that happened 10 or 12 years ago, I just wonder if we can say that the insurance companies, or the municipalities, have to respond in those circumstances. I am just putting it on the table, I don't know.

SENATOR LESNIAK: I don't have an answer for that. That is something we will certainly discuss during our deliberations.

SENATOR LASKIN: May I ask a question?

I have heard this concept of caps on awards about 73 times, and I am not saying this to be smart. I don't understand why insurance companies care at all about caps, because you cap when you sell an insurance policy. You say, "We will sell you \$5 million worth of insurance," or \$10 million, or whatever it is. You have capped by contract. Now, you are going to pay some additional expenses for fees and costs, but you know what I am talking about. You are capping by contract, so I don't understand why insurance companies care at all about this concept of capping liability awards of damage awards.

MR. KLEIN: Senator, let me give you one scenario that I read about that might have been in the auto area, or whatever. They are worried about it because courts have, in some instances, determined that the aggregate liability under an insurance policy per year can somehow be stacked; in other words, where there is a need to find a deep pocket, that--

SENATOR LASKIN: That is fine, except that that could be handled by good writing and good draftsmanship. The insurance contract is the cap. Now, if there had been improper interpretations on ambiguous language, or even if the language was not ambiguous, if there had been improper interpretations, contracts cap. And if they are written well, that is the end of that subject matter. I just don't understand why insurance companies are concerned about caps. That is just an aside; it has nothing to do with what this Commission is ultimately going to do. I just can't understand why insurance companies talk about the cap issue when they cap by contract.

SENATOR GAGLIANO: Well, I brought it up.

SENATOR LASKIN: I don't mean this time, I mean generally. At all the meetings we have had, I keep hearing this.

SENATOR LESNIAK: As well, by the way-- I am not that sure that good draftsmanship does work. I think we have seen some pretty plain language interpreted by the courts as other than plain language. And I think again, that may be one of the responsibilities that we can get into, because we can state things as public policy that the courts still can fool around with. But they are going to have a harder time fooling around with what we do as a public policy than with what the industry does in terms of contracts. So, it is not always as simple as writing a contract, Senator.

SENATOR LASKIN: I know it is not that simple, but I learned long ago that you write it right -- w-r-i-t-e, and then r-i-g-h-t. And I think that that goes a long way.

SENATOR LESNIAK: It certainly helps.

MR. KLEIN: I just want to note for your information that the paper we have here deals substantially with the first issue, the negligence issue. There are written papers which are being finally drafted by two other members of the Task Force on the state of the art and on the negligence standard. I will make them available with enough copies to Miss Drace. I expect them in very shortly.

We intend, as a Task Force, to continue to meet throughout the fall as fast as we can to examine whether we can come up with any other recommendations for your use and for the Legislature's use in

terms of what should or should not be done with respect to the other environmental statutes. We do not intend to stop here, but I understand time is of the essence. We have been operating under that principle since we first met in May.

SENATOR LESNIAK: Let me ask you another threshold questions. The reason you focused on the Lynch bill was not because you looked at this whole problem and said, "We need to do this, this, this and this." Rather, you said you saw the Lynch bill going to the Legislature and you said, "Well, let's look at this and see if this is going to do it"?

MR. KLEIN: That is correct. And we were asked by many in and out of government what our position was on that bill, and we found that it was not a simple answer that we could give over the telephone, and that is one of the reasons Drew was good enough to help convene this group, and help us bang heads together and come up with some answers.

SENATOR LESNIAK: And you know my opinion. My opinion is that this problem is much more complex than this bill, and even the Lynch bill, would create other problems and other difficulties.

Any other questions? Are you finished, by the way?

MR. KLEIN: That's it.

MR. KARPINSKI: Can I add just one statement, Senator? I would like to mention that there are many insurance companies out there that, in these very difficult times, as the person in the middle such as yourself-- You have contact with the citizens of the State, as I do, as an agent, and I represent many clients including public entities. In the discussions that are going on right now concerning the current state of the insurance industry, but one thing that I see, and I think it is worth mentioning here, is that while the problem is an enormous one, there is an attempt -- and I can tell you this being in the middle and having to negotiate with our companies and talk to our insureds -- by many of the players to work with the accounts that they now write, and to provide an insurance product. It is difficult, not easy, and most municipalities are not happy with the results, but I think one of the results that is encouraging is action in the State of

New Jersey. And I think the industry is very pleased to see this Commission in existence, and very, very anxious to cooperate to the extent that we can, which is part of the purpose of this Task Force. A comment that was made earlier that the industry is, in many instances, splintered -- coming from many different directions -- here you see the industry together, many companies, producers, organizations. I would just like to close by saying that we would like to work with you as closely as we possibly can, and be of whatever help we can.

SENATOR LESNIAK: I am glad you said that, because I would like to ask Senator Dalton and Senator Gagliano to meet with a representative of the industry and the League of Municipalities to respond to the question that Senator Dalton raised as to why some municipalities don't have the problem, and why others do. That may help us clarify some of the things that we have to answer.

Thank you very much.

MR. KARPINSKI: Thank you.

MR. KLEIN: Thank you.

SENATOR LESNIAK: The Public Advocate has not arrived yet, is that correct? How about Robert Mason? Is he gone forever-- Ah, he is here. Please come forward.

Robert Mason, EPA Specialist, Office of Waste Programs Enforcement, United States Environmental Protection Agency.

Mr. Robert Mason, please? Mr. Mason, do you have a prepared statement?

ROBERT MASON: Yes, I do.

SENATOR LESNIAK: I think I have seen your testimony. You testified before a Congressional Committee, didn't you?

MR. MASON: Are you talking about the Federal level?

SENATOR LESNIAK: Yes.

MR. MASON: Both House and Senate.

SENATOR LESNIAK: Right.

MR. MASON: The testimony is relatively consistent throughout.

SENATOR LESNIAK: Do you want to read directly from your testimony or would you just like to highlight it?

MR. MASON: I would like to highlight it, if I may.

SENATOR LESNIAK: Okay. We are ready when you are.

MR. MASON: Okay, very good. My name is Bob Mason. I work for the Environmental Protection Agency in Washington, D.C. I am here to speak on behalf of the Agency on the subject of pollution liability insurance, relative to the specific aspects of our program, the research efforts we have been involved in, and the negotiations we have been involved in over the past year, with a primary focus on Superfund reauthorization, liability provisions -- by trying to create incentives for the insurance industry to participate, in offering coverage in our field -- and also to make sure that the hazardous waste management industry, as well as response-action contractors working under the Superfund Program are faced with an environment in which there is adequate incentives in offsetting of risk for them to participate in our program.

Briefly, what I would like to do is to basically give you some indication regarding what we have been doing over the past several months on this subject, what our view of the current insurance environment is, what we see as the causes of the shortages -- you are well aware that we see the solutions to be both at the legislative level and within the insurance industry -- and what we project our ongoing efforts to be on this subject.

We have been spending a good deal of time working on this issue within EPA. In order to get a handle on this and assess it properly, we have tried to view it from the standpoint of the need to discuss this with as many affected parties -- insurers, reinsurers, hazardous waste management industry participants, etc. -- in order to ascertain what the causes of the problem are in order to craft reasonable solutions.

We spent time in Europe meeting with reinsurers. We met with reinsurers here in the United States. We have had hearings on the subject on both the House and Senate side, and on numerous cases over the past six months we have participated in a variety of public hearings on the subject.

In our program, we have two specific needs for pollution liability insurance. Number one is under our RCRA -- Resource Conservation Recovery Act -- where we have requirements for both sudden and non-sudden insurance to be maintained by people who are in the business of hazardous waste management: waste transporters, haulers, treaters, disposers, etc.

We also have, under the Superfund program, a body which we paraphrase as "response-action contractors," who participate in the various aspects of cleaning up Superfund sites. That would be from initial investigations all the way through evaluation of alternatives, to design and ultimate construction.

We feel insurance is necessary for those particular activities for two reasons. Number one, traditionally insurance is designed to offset risk, not to assume all risk but to offset a significant portion, or a portion to a level where industries and companies, etc. are willing to participate in given markets.

Number two, we feel it is important because it does serve the role of helping to improve management practices within a given industry, ideally under the premise that insurers underwrite on a facility's specific basis, using sound underwriting practices. Consequently, and as an example, in order to place the coverage an insured party would need to have demonstrated reasonable waste management practices.

Rather than get into the distinctions regarding the current environment in discussions of comprehensive general liability and environmental impairment liability, which, based on the brief time I have been here, it seems you folks are well aware of, what I would like to do is to briefly summarize the insurance shortage as we see it, and what we think the causes of the problem are. From there, I will delve right into the solutions, if I may.

What we are facing in our program right now is a severe shortage, if not total lack in certain cases, of the availability of insurance to address both sudden and non-sudden releases for both our RCRA facilities and for response-action contractors. If coverage is available, we are basically seeing that it is either inadequate in that

pollution rate of incidents are endorsed out of the coverage, or premiums are so high one might as well self-insure. We are also seeing situations -- as I am sure you are well aware -- where in early 1986, it is probable that the availability of pollution liability insurance, specifically to address both sudden and non-sudden releases, is going to be so severely constricted that it may be considered non-existent in many respects.

SENATOR GAGLIANO: Mr. Mason?

MR. MASON: Yes?

SENATOR GAGLIANO: Isn't it a fact that it has pretty much brought the Superfund program to a point where very little is happening?

MR. MASON: No, not at all.

SENATOR GAGLIANO: I mean in terms of construction.

MR. MASON: Not in terms of construction, no sir. The reason why there may not be as much activity right now as we would hope is we are running out of money related to Superfund reauthorization. But we have not seen, at the Federal level, any reduction in competition amongst qualified response-action contractors to date as a result of the insurance problem. To date, that has now slowed our program down. I might add though that--

SENATOR GAGLIANO: Are you familiar with the Burnt Fly Bog situation here in New Jersey?

MR. MASON: No, sir.

SENATOR GAGLIANO: Well, it is my understanding that one of the major problems there -- it is a Superfund site -- was that the contractor could not get the required insurance. I think it started out at \$10 million then the thing kind of fell apart like a deck of cards that was not built on a solid footing.

I think it has been a severe problem for cleanup in New Jersey, and the reason why I am saying that is I wonder if the Feds will acknowledge that?

MR. MASON: We do acknowledge that it is a clear problem. Let me create a distinction here, if I may. Under the Federal program -- and by that I mean Federal lead, without states taking the lead

under cooperative agreement -- we have authority to indemnify our response-action contractors. We require a minimum amount of insurance over and above that. We do offer indemnification. That authority is not passed through to states working under a cooperative agreement at present.

SENATOR GAGLIANO: Why not?

MR. MASON: We don't have the statutory authority to do so at present.

SENATOR GAGLIANO: Are you trying to get it?

MR. MASON: Yes, we are.

SENATOR GAGLIANO: Oh, you are?

MR. MASON: Yes.

SENATOR GAGLIANO: In other words, that would be part of the Superfund II, so to speak?

MR. MASON: That's right.

SENATOR GAGLIANO: Would that be part of the new Superfund?

MR. MASON: That's right. What I was about to say was, as a result, we are not seeing problems to date at the Federal level. We clearly acknowledge there is the probability there are going to be problems because there are certain inefficiencies or inequities regarding our indemnification agreements. But at the state level, there are clearly problems.

What I presume is happening at Burnt Fly is that it is a state lead cooperative agreement, and if the states don't have the authority to pass through indemnification, there are situations we are becoming more and more aware of where qualified action contractors are unwilling to take on the risk.

SENATOR GAGLIANO: Basically, the contractors could not get-- I don't know whether this can be confirmed, Senator Dalton; I think it can be. They have not been able to get the \$10 million liability insurance required, and not being able to do that, and not knowing they were going to be indemnified by the government for claims, the system is just falling apart.

MR. MASON: Again, at the state level we would agree; there are severe problems because of the lack of indemnification authority

regarding Superfund sites where the states have the lead on the cooperative agreement.

We see two alternatives to that. The first alternative is for states to provide authority at the state level, to offer indemnification, or for the Federal government -- as we are proposing in Superfund reauthorization -- to have the ability to pass through indemnification authority to states working under cooperative agreements.

SENATOR GAGLIANO: Will the new Superfund provide for any limitation of liability, or any statute of limitations in terms of years?

MR. MASON: For response-action contractors?

SENATOR GAGLIANO: With respect to your indemnification. All right, you would indemnify a contractor if the contractor was sued when digging out a huge toxic waste site, or whatever.

MR. MASON: That's correct.

SENATOR GAGLIANO: Is there any indemnification-- For example, if a claim was made that whatever happened was caused 12 years ago, is there anything in the proposed statutes which would limit the liability of whomever is dealing with this stuff, once they take it out of the ground, or for something that might have happened 10 years ago? Is there anything like that?

MR. MASON: Related to a response-action contractor, or to anyone in general, sir?

SENATOR GAGLIANO: Anyone in general.

MR. MASON: No.

SENATOR LESNIAK: Isn't it a fact that the thrust of your testimony is that liability ought not to be limited?

MR. MASON: I'm sorry?

SENATOR LESNIAK: Isn't the thrust of your-- I have had the fortune to read your testimony before you put a different cover on it. (laughter)

SENATOR LASKIN: The primary part of his testimony is what you say, they do not like to lessen the liability.

MR. MASON: That's correct.

SENATOR GAGLIANO: Okay.

ASSEMBLYMAN SHINN: I-- Go ahead, Senator.

SENATOR GAGLIANO: Go ahead. I just wanted to know that. I hadn't read the testimony.

ASSEMBLYMAN SHINN: You mentioned your two-tier liability requirement with contractors: You require a contractor to acquire insurance at a lower level. Can you give me an example of some conceptual limits you require of the contractor?

MR. MASON: Quite frankly, what we require now is outdated. Let me explain that. When we originally developed our indemnification agreement, we developed it thinking that it would save the government money; it was not related to the risks. Right now, we require \$1 million of comprehensive general liability coverage. Over and above that, we offer indemnification at the Federal level.

Given the fact that it is probable that as of early 1986 it is going to endorse out of the coverage any pollution related releases, that kind of coverage is worthless coverage. So what is the purpose for the requirement?

We intend to recraft-- As part of the indemnification authority we expect to obtain, via Superfund reauthorization, the use of that authority to reflect the types of insurance required with are directly related to pollution releases. I can discuss in detail, if you would like, how we intend to use the indemnification authority to create adequate incentives for response-action contractors to continue to work in this line of business.

ASSEMBLYMAN SHINN: You used the terms sudden and non-sudden relative to releases, and I am interested in your tier concept. What would your new requirements be in limits of liability on the contractor level? Are you still looking at the \$1 million upper limit, or are you--

MR. MASON: No, sir.

ASSEMBLYMAN SHINN: Okay.

MR. MASON: It is a bit premature to discuss exactly how the authority will be used. We are a bit uncertain at this time, regarding what Congress is going to specifically say by statute, as to how they intend us to use that authority.

I will lay out for you what our approach is, and how we have indicated to Congress, on both sides of the Hill, that we do intend to use the authority, and we feel it has been one of the reasons why we have been successful to do in seeing indemnification provisions become part of the Superfund legislation.

What we are proposing through the use of our indemnification authority is-- We are well aware of the problems in the insurance industry and the inability of the insurance industry for a period of time -- at least until they right themselves financially -- to be able to offer coverage. Regardless of what is done at the statutory level, unless you order them to offer the coverage, we are in a position where the insurance industry is incurring broad losses across their entire property and casualty lines.

You are well aware that this is part of the cyclical nature of the insurance industry. When the industry is in this position, they do two things. They withdraw from high-risk oriented length of coverage: Medical malpractice, product liability, or pollution liability; and, they restrict lines of coverage.

What we want to do is to use indemnification authority to put us in a position where we can keep our Superfund going through the use of qualified response-action contractors, but not replace on a permanent basis the role of the insurance industry.

So, what we intend to do is to craft our indemnification authority to be an interim replacement to supplement insurance. It will offer indemnification to cover negligence, it will include litigation costs, it will allow the authority to be passed through--

SENATOR LESNIAK: You are going to offer indemnification to cover negligence?

MR. MASON: That's correct.

SENATOR LESNIAK: What type of incentive, or inducement, does someone have to not operate responsibly?

MR. MASON: The reason for doing this is that is what insurance offers in their contracts. Insurers insure for negligence.

SENATOR GAGLIANO: They are not offering it anymore. That is why I was asking you if you were familiar with what was happening in

the states. The insurance companies don't want to offer that anymore, and unless Superfund II ties in with the state problems, we are not going to be anywhere.

MR. MASON: In the short term, I agree.

SENATOR LESNIAK: The problem is that the liability standard in the Superfund is strict liability, not negligence.

MR. MASON: That's correct.

SENATOR LESNIAK: Congressman Florio testified at our last public hearing, and he said that they never really intended for those people who did the actual cleanup work to be held to the same standard as the people who did the pollution.

MR. MASON: That's correct, and the EPA supports that.

SENATOR LESNIAK: But you want to go even further than that and indemnify not only for strict liability actions but for negligence actions as well?

MR. MASON: That's correct.

ASSEMBLYMAN SHINN: But with a layer?

MR. MASON: With a layer. Let me explain how we intend to do it.

SENATOR LESNIAK: I don't want to tell you how to do business but--

MR. MASON: We are trying to create a substitute for insurance in the absence of insurance. Once a number of things take place, which I can discuss later, we believe that there will be an insurance market at some time in the future.

At this point the position of the Agency is, in order to maintain our Superfund Program and keep response-action contractors involved in the Program, we have to offer them a similar substitute for insurance. Insurance covers negligence, so we have to make that parallel. In addition--

SENATOR LESNIAK: Insurance covers strict liability as well.

MR. MASON: That's right, but from the standpoint of a response-action contractor looking to offset risk, the traditional vehicle they have used has been insurance. That traditional vehicle covered negligent activities.

ASSEMBLYMAN MARTIN: I think what Senator Lesniak is driving at is, aren't you making an assumption? We don't know. If you were to indemnify just on the basis of strict liability, wouldn't that be enough? Private contractors could then obtain insurance for negligent acts, and wouldn't that be a better policy since they would not be responsible for trying to prevent their own carelessness?

SENATOR LESNIAK: Exactly.

MR. MASON: That is a very good point. We don't believe there is going to be an adequate insurance market out there for some time to come, based on the constraints of the insurance industry and because of their own internal capacity restraints to offer the coverage.

So, we see that for a period of time we need the authority -- and I should say the authority is discretionary; it is not mandatory -- to offer equivalent insurance based on what is happening in the insurance market. That is how we intend to use the authority. If the insurance is not available, or if insurance is inadequate to a certain degree, we will supplement to the appropriate in order to ensure that response-action contractors are obtaining equivalent levels of coverage, as they would in a healthy insurance market.

SENATOR GAGLIANO: My bottom line question to you, sir, is where does this leave the State, not just the State of New Jersey but every state that has certain responsibilities with respect to cleanup? They cannot get insurance if it is designated a Superfund site. It could be a site next door or up the street. Contractors have no concern, they are going to be indemnified. They have no concern for neighbors -- indemnification. But if the State is responsible, for whatever reason, Superfund says, "We are not going to take that site. You do it." There is no insurance and no indemnification unless the State lays out a tremendous amount of money, and it might not have anywhere near the resources you have. Do you follow what I am saying?

I think you are creating a bad situation for the states. I think almost every state that has had any kind of a chemical industry, or a petrochemical industry, has problems that are not necessarily elevated to the so-called Superfund site designation. Or, it may be a

site where a state feels it should be cleaned up and you haven't gotten around to it because you have so many hundreds of sites. The states will be in a position where they will not be able to cover those sites without putting out a hell of a lot of money in terms of indemnification for insurance, or whatever. Do you know what I am saying?

You are writing a blank check on somebody else's checkbook. I see it with this type of legislation on the Federal level because we have sites that we have to address on the state level, and we are going to have to I guess, essentially, adopt your standards with an entirely different tax base. Am I wrong?

MR. MASON: If the authority is passed as currently crafted in Superfund legislation, for states working under cooperative agreement with EPA—

SENATOR LESNIAK: On Superfund sites?

MR. MASON: On Superfund sites, you would have the authority to indemnify response-action contractors under our indemnification authority and Superfund reauthorization.

SENATOR LESNIAK: What about liability standards established under Federal law at non-Superfund sites?

MR. MASON: The other thing we are supporting for response-action contractors is a standard of negligence for that industry. Okay? We are doing that on a preemptive basis. H.R. 2817 contains a provision at present which does a lot for a uniform standard of negligence for response-action contractors.

SENATOR LASKIN: Where do you say that in your prepared remarks?

SENATOR GAGLIANO: That's my point.

SENATOR LASKIN: Where is there anything about this new standard of negligence in these prepared remarks? I didn't see it.

MR. MASON: That we support it?

SENATOR LASKIN: Yes.

MR. MASON: I am not certain that it is in there, sir.

SENATOR LESNIAK: No, it is not.

ASSEMBLYMAN SHINN: I think my questioning led to a conceptual, non-enacted provision, how they are going to deal with it conceptually on an interim basis, and the layer concept. I don't know whether you completed—

MR. MASON: I wasn't finished.

ASSEMBLYMAN SHINN: Okay. You are going to continue with that. I would just like to get to the end of that so I can get an idea of what you are looking at on the Federal level and if it is compatible or incompatible with the state level.

MR. MASON: What we intend to do for Superfund sites — and, again, this would be with EPA lead and other federal agency or states working under cooperative agreement -- is to craft the authority as a supplement, or substitute, for insurance in the absence of insurance. We would require our response-action contractors to obtain adequate levels as opposed to minimum levels of coverage. We would reimburse them for that cost, so we would review the policies to determine whether or not we considered the coverage to be adequate or inadequate, both in relation to what it would cover and what it would cost. We would use our indemnification authority to supplement it, as appropriate.

We are not intending to use the authority to offer indemnification on a blank check basis; rather, it is our believe that response-action contractors should maintain liability at both the low ends of insurance — in relation to insurance -- and at the high ends, as they currently do. So, we are not supporting the use of our authority to simply offset all of their risk.

SENATOR LESNIAK: Okay. I think we can make it easier for all of us. In other words, you are writing umbrella policies in effect. I think that is what you are saying in Federal language, which is very confusing.

MR. MASON: There will be equivalent levels of deductibles and premium caps.

SENATOR LESNIAK: You are talking about an umbrella over basic coverage?

SENATOR GAGLIANO: Or excess.

SENATOR LASKIN: Or excess. You are not writing basic coverage. You are not giving basic indemnification. You are saying that they have to come in with a basic policy, and above that you are going to go into the indemnification business.

MR. MASON: Unless the basic policy is inadequate.

SENATOR LASKIN: I have already said that. You are going to require some basics, and then above that you will be the umbrella, in effect.

MR. MASON: To a certain point.

ASSEMBLYMAN SHINN: How do you make the decision as to whether the contractor does or does not, in fact, have the ability to secure the insurance? How do you decide whether to reimburse him for his coverage? What is the incentive for him to really search out that lower level coverage rather than just say, "I can't get it; reimburse me"?

MR. MASON: The incentive is crafted into our contract agreement, in our termination clauses. There are several incentives, aside from the traditional market force incentives, to want to maintain the business. The way we offer our contracts agreements-- They are on large contract procurements. We will offer a \$250 million contract for five years to cover a broad range of services related to this field. So, there is strong incentive for a response-action contractor to perform all his business properly initially. That is the first incentive.

Second, we have the provision within our contract to terminate for default in the absence of an adequate demonstration on their part they have gone out and obtained adequate levels of coverage.

Third, the way the indemnification agreement is to be crafted-- Let me give you an example. If they can go out and get \$1 million worth of coverage, and that is all they can get, that is considered adequate. We would foresee our indemnification authority to basically craft a \$100 thousand deductible, as an example, with a \$50 million -- not to give any validity to that number -- cap on the indemnification coverage we would offer for that \$250 million contract.

At the low end, they assume that \$100 thousand deductible, and at the high end, either insurance coverage up to the \$50 million or indemnification. We would require them to go out and try to obtain the \$50 million. If they can't get it, or if they can get a lesser amount, we will supplement accordingly. But, over and above that \$50 million -- or whatever number is determined to be the appropriate number -- the liability falls back to the response-action contractor, which is basically the environment they work under in absence of Federal indemnification.

ASSEMBLYMAN SHINN: How do you deal with the tail? In other words, is it a claims made policy?

MR. MASON: It would be the equivalent of a current space coverage.

ASSEMBLYMAN LESNIAK: It would have to be.

MR. MASON: In order for it to be adequate it would have to be.

ASSEMBLYMAN SHINN: So, for my edification, it is a claims made type of coverage? In other words, what is your limit of liability if a contractor goes in and does a job? How long after he completes a job are you exposed to liability?

MR. MASON: In perpetuity.

SENATOR GAGLIANO: How does that affect New Jersey in a non-Superfund situation?

SENATOR LESNIAK: It doesn't. We are stuck until they change the Federal law.

MR. MASON: I am strictly tying it to Superfund; that's correct.

SENATOR LESNIAK: Can I ask you a philosophical question? Do you believe that strict liability is essential to maintain proper waste management practices, is that correct?

MR. MASON: Absolutely.

SENATOR LESNIAK: Okay. You also believe that joint and several liability is essential in order to encourage private party cleanup.

MR. MASON: That's correct.

SENATOR LESNIAK: Okay. That is basically the substance of your arguments for those two liability concepts, is that correct? (no response) Okay, I am simplifying it.

Would those two arguments apply as well to public entities? One would think that strict liability in terms of waste management practices as applied to public entities is still essential to encourage proper waste management practices.

MR. MASON: Frankly, sir, I have not been involved in any of the negotiations regarding the Agency's positions which are specifically tied to public entities.

However, let me say that our position has been that strict, joint, and several liability, prospectively and across the board, is good public policy.

SENATOR LESNIAK: Okay. The point I am trying to make is, does joint and several liability make the same sense-- I can see that in terms of waste management, a public entity and private business would be the same. But, in terms of joint and several liability for public entities, if the underpinning, the reason, the main crux of that concept is to encourage private party cleanups, would that apply equally to public entities as well? (no response) You are not in a position to answer that?

MR. MASON: I am not in a position to answer, but joint and several liability serves two incentives. Number one it promotes private party cleanup, and, number two, it serves a clear signal to the private sector that in the absence of a massive Federal oversight regulatory program, they are responsible for their waste management practices in the future, and that shifting waste from one site to another doesn't matter in that regard. In ultimate liability -- regarding the process of waste management -- strict joint and several improves waste management practices.

I will give you an example. We met with numerous representatives of the chemical industry on this subject, and I asked a gentleman in a particular forum what he would do if strict, joint, and several liability were to be maintained. His answer was, "I would reduce waste streams; I would incinerate; I would recycle, etc."

Prospectively, those are exactly the types of incentives strict, joint, and several liabilities are intended to create.

SENATOR LESNIAK: Do those same arguments -- insofar as joint and several liability is concerned -- apply equally, or with the same amount of weight, to public entities?

MR. MASON: I can't speak for the Agency on that. I have not been involved in that particular discussion.

SENATOR DALTON: You have a policy presently within Superfund with regard to municipally owned sites, correct?

MR. MASON: Yes.

SENATOR DALTON: Okay. Your policy is one where perhaps a municipality owns but perhaps did not operate land on which a Superfund site is located, and they are strictly liable on a 90-10 basis. Is that correct?

MR. MASON: That's basically correct.

SENATOR DALTON: For instance, the number five site in this State is a site in Camden County, and it is a site owned by a municipality, okay? The land was leased to a private operator and it became a Superfund site. What is the agency's position in this new Superfund bill insofar as that municipality's liability is concerned?

MR. MASON: Our current position is that the municipality's liability would be subject to the same standard of liability.

SENATOR DALTON: Strictly liable?

MR. MASON: That's correct. However, let me say that there are a series of negotiations taking place at the present time on that subject which I have not been involved in. I think it would be premature for me to speak regarding the Agency's position with relation to those negotiations. I simply have not been involved, and I would not want to do that.

SENATOR DALTON: So, at present your strict liability position is not only a prospective position, but it is also a retroactive position as well?

MR. MASON: That's correct.

ASSEMBLYMAN SHINN: I would like to make one comment on something I feel very strongly about. The Federal government took some

initiatives to make State government an arm of the Federal government, and State government took an initiative to make county government an arm of State government on the Environmental Health Act, with a whole host of chores to do and very little funds to do them with. You have prioritized counties as the most critical sections to look at. I see some incentive from what I am hearing for, "If the State can't secure proper insurability, it is going to stop being a lead agency for EPA." I see some of that on the horizon, and maybe very quickly.

If we don't help to indemnify counties in some fashion, I see counties with Environmental Health Act responsibilities -- which are very broad in the area of solid waste -- saying, "Wait a minute. We want to go on that site and expose our environmental liability with 10% of the revenue we need to do the job," and expose the assets of the county.

I think if we end up both with a situation where we have the counties retreating, both from technologies and siting facilities, and the Environmental Health Act requirements, and if we have the State retreating under lead agencies for cleanup, we haven't done our job. I think there has to be a separation in the way we treat a private contractor -- a for-profit contractor -- and a governmental entity which has flow-through responsibilities from the Federal and State level to the county and, in some cases, municipal level under the Health Act requirements.

I just think there is a separation. We can't just put them all together and say, "Well, this is the way we are going to treat this group," because I think the residual effects are going to be negative from the public perspective in the long-term.

SENATOR DALTON: Through you, Mr. Chairman, in order to put the EPA's position in context, on how many sites is the EPA lead agency on in New Jersey? We have 97 sites. Are you aware of how many you are lead agency on?

MR. MASON: I don't know what the particulars are but, again, it wouldn't matter whether EPA is the lead agency or the State is the lead agency. Under the anticipated indemnification authority, indemnification would be allowed in either case.

SENATOR DALTON: Okay.

MR. MASON: Okay?

SENATOR LESNIAK: But not on the other 300, 400, or 500 sites that aren't Superfund sites because you wouldn't be involved in that.

MR. MASON: That's correct.

SENATOR LESNIAK: But liability standards are established under Federal law.

MR. MASON: And, for response-action contractors, it could change to negligence; that's correct.

ASSEMBLYMAN SHINN: But from today until the day that act passes, we are in sort of a crisis situation, aren't we?

MR. MASON: Yes, we are. I mentioned some inequities with our indemnification authority. It is an administrative indemnification authority. It is not tied to clear statutory authority, which is why we are trying to obtain it. There is concern that it is violation as a result of the Anti-Deficiency Act, which means, basically, that if a contractor were to make a claim against the Federal government, we would say that the agreement we entered into with them -- we may say, and the General Accounting Office supports that opinion -- is invalid. So, we are trying to respond to the needs of the contractor and the community in that regard.

SENATOR LESNIAK: One last question. What timetable do you foresee for Congressional action?

MR. MASON: Regarding Superfund reauthorization?

SENATOR LESNIAK: Well, I am presuming Superfund reauthorization would be the changing of the liability standards we talked about vis-a-vis contractors.

MR. MASON: As soon as we get a bill. My guess is-- We are working for a November time frame.

SENATOR LESNIAK: In other words, his guess is as good as yours. (laughter)

SENATOR LESNIAK: Assemblyman Martin?

ASSEMBLYMAN MARTIN: I have one question. When you talk about this coverage, you indicated-- I guess the language used here was "umbrella coverage," but it has a maximum limit. We talked about \$50 million as a hypothetical figure under certain circumstances.

My question is, given the fact that there is strict liability, and joint liability, to what extent would a contractor who is going to be exposed to risk above your willingness to provide indemnification be discouraged, if at all? I am thinking about responsible contractors saying, "I don't want to be part of this because the indemnification is not complete." With joint exposure — other people's negligence, so to speak — and an unlimited dollar figure at the top, do you see that as discouraging responsible contractors from choosing to continue in this line?

MR. MASON: The response-action contractors would obviously like an unlimited cap on liability. If they could get it, it would be preferable from their perspective.

Our position is that response-action contractors' risks related to this field are not as great as they are perceived to be at present. A great deal of what we are addressing here is meant to solve issues related to perception.

We have been working with this program, if you tie it back to our Spills Program, for 15 years; we have yet to have a single claim brought against a response-action contractor. We do not accept the clamoring that response-action contractors are going to be put in a position where they are going to be put out of business as a result of claims in the future, etc. We think this is an insurable risk.

SENATOR LESNIAK: How many years was asbestos used before the first claim was made?

MR. MASON: I can accept the analogy, but we are talking about a whole different type of line with a different type of waste management practices. The lines of authority are clearly defined, relative to the response-action contractors in our program. They don't make decisions, we do.

ASSEMBLYMAN MARTIN: I guess what I am driving at is— I don't pretend to have any expertise, other than what I am becoming familiar with. However, it seems to me -- going to back to what was said before -- that as opposed to the indemnification process you have outlined, with an upward cap, there is risk above and beyond that. It seems to me it would better to draw the lines of indemnification on

strict liability and have that strict liability indemnification go to ultimate, without the cap, and still allow the contractors to be responsible for their negligent acts, leaving that alone. Obviously, there wouldn't be any cap there. Maybe your claim that there has been no courses of action brought to bear at this point in time is just hypothetical.

I just wonder, given the marketplace, what this is going to do to insurance and what it is going to do to contractors who are just going to say, "I don't want to play the game"?

MR. MASON: The contractors have responded very negatively to being liable for negligible activities; that's what insurance covers them for. In the absence of insurance or indemnification, they have made it quite clear that they will not participate in our program.

In concept at least, what they appear to have agreed to in negotiations with EPA and Congress is to accept the fact that we can offer an equivalent substitute for insurance. We have touted the use of that authority so that the levels of coverage will be adequate from the standpoint of incentive or offsetting of risk, so that qualified response-action contractors will participate in our program.

But, if we were to simply indemnify for strict liability and leave them exposed to their own risk in the absence of insurance -- which we do not feel is going to be available for some time -- for negligent activities, which insurance covers, they have made it very clear they are not going to participate in our program. We have heard that from virtually every qualified response-action contractor, either currently working for a program or who has interest in doing so.

SENATOR LESNIAK: Okay. Are there any other questions? (no response) Thank you very much.

SENATOR LESNIAK: Jack Heher, Alliance of American Insurers. Jack, what is the proper pronunciation of your last name?

JOHN HEHER: As in H-E-R-E, here.

SENATOR LESNIAK: Oh, "here." Okay.

SENATOR LASKIN: It is like a former Supreme Court Justice. Didn't we have a Harry Heher?

MR. HEHER: That was my father.

SENATOR LASKIN: He was a very famous Justice too.

MR. HEHER: Thank you very much, Senator Lesniak and members of the Committee, for your very generous person awards and also for the opportunity to appear before you today.

My name is John Heher. I am New Jersey Counsel for the Alliance of American Insurers, which is an association of over 175 property and casualty insurance companies doing business in the United States and in New Jersey. Among them are Liberty Mutual and Sentry, and we represent domestic insurers as well.

You do have our nine-page statement, so perhaps it would be a waste of time to read from that. I will attempt to highlight it and also to avoid repetition.

The Alliance, not through myself, has been represented regularly on the Task Force, and we agree with much of what Mr. Klein has already stated. I know after my testimony, Mr. Klein and Ms. Casey will be giving you a lot of technical detail far better than I would be able to do personally.

I will attempt to highlight it. Our statement basically addresses system reform. We have heard much today about Federal Superfund experience, and we are concerned locally in New Jersey about, if I may refer to, the de-pocket syndrome. There are two cases which I would be happy to leave with you if you wish -- I don't have that many copies; I have just one which I can leave -- which give the Alliance great concern.

One is styled Jackson Township Municipal Utilities Authority v. Hartford Accident and Indemnity Company. That is a 1982 case in the Superior Court Law Division. There is then an Appellate Division ruling in 1985 -- last June -- styled Ayers v. Township of Jackson. Those cases reflect the concerns we have for the concepts of strict liability, and the concepts of joint and several liability. We feel it seems clear that both our courts and courts in other states are beginning to assess liability for both past and present damages caused by hazardous waste contamination based on current technology.

Companies and their insurers must also pay for the failures of yesterday's technology in the context of today's standards.

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The two cases which I mentioned to you do not, in a broad sense, address the extent of indemnity, but they do, in a very broad sense, address the extent of the obligation of companies to defend. I know I may be carrying coals to Newcastle, but as an attorney of 30 years in practice, I have watched defense costs reach a point where they are getting out of sight. I have read recently where major law firms in this State, particularly in Newark, are being instructed by their clients to cut down on the work they do in preparing a case because it is such an expense. I think was addressed in Hershey, Pennsylvania at the Federal Bar Association just a week or so ago.

We see a societal problem here. The industry wants to help and wants to cooperate, but the industry cannot do it alone. The industry is not capable any longer of-- Well, it is not capable, period, of solving societal problems. The insurance industry is not saying that they are angelic in this context. We all have to work together, and this is what we hope and intend to do. As Mr. Klein so aptly stated, this is what the Task Force was designed to do.

Let's see. I think I've covered the points. In the context of the doctrines which I already mentioned, the Alliance believes that non-negligent persons should not be required to pay for the negligent acts of others. The Alliance supports a system of several liability, so that each party is responsible only for damages attributable to their actions.

As already pointed out, for reasons of bankruptcy, for just simple disappearance, legally speaking, and regardless of the degree of fault, a jointly liable defendant may be forced to pay an entire judgment. Traditionally and classically, insurance is a mechanism to spread risks. The premium for a pollution liability insurance policy should be determined individually by policyholders. Insurance companies should consider the toxicity of the substances handled, the safety measures applied by the potential insured, and the insured's claim experience.

I have heard with great interest a good deal of dialogue here about availability and affordability, and I must say, in being present here, I have learned a great deal about the very serious concerns which you and the distinguished Committee have expressed.

We feel, and I would now like to sum up, that there are several effective ways to deal with these problems. We feel that to simply set up a mandatory risk-sharing mechanism to force insurers to provide coverage to municipalities, waste handlers, and school districts at artificially low rates will not cure the underlying causes of the problem. So, we offer the following specifics. I know Mr. Klein and Ms. Casey will deal with these as well.

Arbitration Panels: Again, I have watched and experienced our State Judiciary, and very recently -- last April -- our Federal Judiciary, moved more and more to the arbitration concept, I think for reasons which are self-evident.

SENATOR LASKIN: Thanks to the prodding of the New Jersey Legislature, our courts are doing it.

MR. HEHER: Yes.

SENATOR LASKIN: Without our prodding, they would not be doing it.

MR. HEHER: Senator, that is correct. That is correct, and it has been most helpful. I know that many very respected and experienced trial lawyers are availing themselves more of the arbitration concept because they are very sensitive to their clients, and obviously sensitive to the enormous costs associated simply with the defense when there is no judgment at the end of the line.

SENATOR LESNIAK: I have to add my comment to that because -- there is no pun intended -- as far as I am concerned, the jury is still out as far as the arbitration system that the courts have structured for automobile liability claims. That is an aside.

SENATOR LASKIN: We're just talking about philosophically. All I am saying is that without legislative prodding, there wouldn't have been any arbitration system.

SENATOR LESNIAK: That is for sure.

MR. HEHER: The second, which I have already addressed and will be addressed much more specifically as I have already noted, is to modify the doctrine of joint and several liability.

I have heard questions here this morning about what is happening in other states. According to the July issue of The American

Bar Association Journal, New Hampshire and Vermont have abolished joint and several liability. Other states such as Nevada, Texas, Indiana, Louisiana, Oregon, Pennsylvania, Iowa, and Oklahoma have placed various limitations on the doctrine.

Thirdly, establish a threshold for triggering pain and suffering suits; a suggested figure would be \$2,500. Cap recoveries against public entities by occurrence. At least 28 states have placed some kind of limit on damage awards against cities, averaging \$150,000 for each person injured, and \$350,000 for each occurrence.

SENATOR LESNIAK: So, if I am injured by a city--

MR. HEHER: I'm sorry, sir?

SENATOR LESNIAK: If I'm injured by the negligence of a public entity -- seriously injured, loss of earnings, inability to provide for my family, can't walk, can't feed myself-- If I'm hurt by a city, my damages are limited, but if I'm hurt by someone else, it is unlimited.

MR. HEHER: These are not proffered, Senator Lesniak, in absolute terms. These are proffered in the context of meaningful system reform. There are no easy answers.

SENATOR LESNIAK: Are you suggesting that that is a fair system that we ought to even consider?

MR. HEHER: What we are suggesting, Senator, is that there ought to be some limit, as has been established in other states. This is what we are suggesting, as has been established for pain and suffering, as opposed to special damages.

SENATOR LESNIAK: You think that is fair?

MR. HEHER: We think that the system needs reform. I cannot say in absolute terms that these dollars are fair, but they are submitted as a beginning point for discussion of system reform, Senator.

Finally, as a practicing attorney, I do not say with tongue in cheek a sliding scale for attorneys' fees and disclosure of attorneys' fees--

SENATOR LESNIAK: I just want to make a point. Isn't there now a sliding scale for attorney fees for plaintiffs' attorneys?

MR. HEHER: I don't believe in this area, sir.

SENATOR LESNIAK: In this State, well--

MR. HEHER: There is in automobile, but I don't think that is across the board.

SENATOR LESNIAK: Tort actions.

MR. HEHER: I could be wrong.

SENATOR LESNIAK: You are wrong. Tort actions, the contingency there is--

MR. HEHER: Okay, I would stand corrected, Senator, if I am wrong.

In conclusion, the Alliance agrees with the concept and intent of Senator Lynch's bill -- I believe it is S-2545 -- but we do feel that the reforms we have discussed in our testimony would greatly assist in the efficacy of that bill as amendments thereto.

That concludes my testimony. I thank you again for the great privilege of appearing before you.

SENATOR LESNIAK: Thank you for appearing before us.

SENATOR LASKIN: John, let me just-- You and I are going have a little discussion which I hope will help both of us. The big issue is the joint and several liability, which is a complex issue, and I'm sure most of the people in this audience don't even know what we are talking about half the time.

Can't the problem of joint and several liability be resolved by private contract? Let's assume you have a site to be cleaned up. The municipality is involved, the polluter is involved if they can find one, the owner of the dump site -- everyone who can possibly be brought into the case. That is the joint and several liability.

Let's say there are 10 entities -- truck drivers, contractors, you name it -- all of these people who could possibly be jointly and severally liable. I'm going to maybe get a little more basic for everyone's benefit, because I really don't think everyone understands what we are talking about regarding joint and several. But, let's say everyone who had anything remotely to do with the site-- That is what joint and several means. I am oversimplifying it.

MR. HEHER: That is correct.

SENATOR LASKIN: Can't we, without the government establishing a new standard, resolve this issue by contract? In other words, I am a municipality. I want to clean up a site, so I say, "Let's make a big contract." You need good lawyers for this, and unfortunately, they are few and far between. Pardon me. You need good lawyers for establishing such a complex contract. But, can't the parties among themselves decide how much liability each will bear? In that way, their insurers will also know in advance a philosophical limitation of liability, if you follow what I am saying.

If I were representing a municipality, I would say, "Look, we have a dump now. I think we ought to enter into a contractual relationship with everyone who has anything to do with it, and sort of by contract, determine our percentage limits of liability." I know this sounds far-out, but it has just been going through my mind at these hearings that we are talking about joint and several. By contract, can't we establish the joint and several limitations? Then the insurance companies would know that their insured, whomever it may be, would only be liable for "x" percent, so their risk would be modified to that point.

Now, I may be way off, but it just seems to me it is something we can think about.

SENATOR LESNIAK: It is interesting. It can only take you so far, however, because that contract wouldn't be binding on the courts. So, you would have to try to enforce that contract.

SENATOR LASKIN: It doesn't have to be binding on the courts because let's say there is a judgment of \$19 billion, but there is a contract among the 10 defendants as to how that will be divided.

SENATOR LESNIAK: And, if one defendant can't pay his judgment--

SENATOR LASKIN: That may be, but that may be, even in the joint and several liability that we have now. I am just thinking out loud. Maybe there is a way you can do this by private contractor, at least better than if we change the rule.

SENATOR LESNIAK: But, I can be stuck for the entire tab, even if I do your contract, because that contract isn't binding on the courts.

SENATOR LASKIN: I understand that, but if there is a judgment rendered, and I am a party to a contract with nine others, and we have a contract that says, "If there is a judgment, here is how it is going to be divided among us," the judge or the court can say, "You are liable for the million," but then I would be in a contract with nine other people to divide that money.

SENATOR LESNIAK: It would reduce the risk.

SENATOR LASKIN: I don't know that that is an answer. It is just that I've been thinking about this the whole time we have been talking about strict liability. Why don't we start to think about lawyering and make a contract in advance of the problem? I don't know that that is an answer, and I don't that it can be done, but it is worth thinking about.

What would you say about that?

MR. HEHER: I can't wait to hear what I have to say, Senator. (laughter) Senator Laskin, what you say generically, I think, is possible. I have on my desk today, in a different context, language of indemnification and cross-indemnification involving several parties in a major construction project. I think our major concern-- I'll read, if I may, from the Jackson v. Hartford accident case. The court said, "The question of which carrier must indemnify," -- there were many carriers in this case -- "for the occurrence of occurrences of pollution is a separate and perplexing question."

I think the major concern we have is that regardless of what you put into the contracts, a fact of life is that everybody is in the swim, Senator, and everybody is going to pay if they are in the swim. I really don't know whether it is possible to draft contract language to obviate those concerns, and also the concerns of parties who are alive and well today entering into contractual arrangements who may not be alive and well tomorrow. That is another concern we have.

SENATOR LASKIN: But, their insurance company will. And, if you establish by contract the joint and several liability among the parties, then each insured's insurance company would know the limit of its liability. Isn't that what we are so concerned about?

MR. HERER: We certainly are concerned about it, Senator, and I can, in all candor, say to you that that is an intriguing underwriting problem that I am not qualified to address.

SENATOR LASKIN: And, I'm not either. I say it is something that has gone through my mind.

SENATOR LESNIAK: I thought you were considering establishing a consulting firm. (laughter)

SENATOR LASKIN: No, that is way above my head, but it is something that is intriguing, which I think could help.

MR. HEHER: Senator, one thing I can represent is that we are all interested and share the concerns, and we are open to all forms of suggestions. I will take this back to my people in Illinois, the home office.

SENATOR LASKIN: There is only one problem. The lawyers who drafted the language in the Jackson Township case should not be the lawyers to write this contract.

MR. HEHER: I will make a mental note of that. I won't put it in writing though. (laughter)

SENATOR LESNIAK: Do you have a question?

ASSEMBLYMAN SHINN: I don't know if I am asking you this question, or I am having a discussion with the Chairman, but I guess he asked you a question relative to the person who has a limit on liability and can't provide for his family, can't walk, etc., etc. I think that is an issue that each one of us has a concern about.

I think the issue I was trying to speak to before was, the governmental relationship under the different acts and the responsibilities -- the Environmental Health Act, the New Jersey Solid Waste Management Act -- and all the mandates that are in those for different levels of government. I think it is the heaviest trickle-down legislation in both of those packages that municipalities and counties have seen, and acknowledging the fact that counties are contracting with municipalities in this State as a health services contractor.

There are just all kinds of ripple liability issues, and I think to separate or identify the impact of both, we have to look at

the overall public benefit by enacting and implementing all of the legislation that has been passed by this State versus the impact on an individual. You can't erase or put an unreasonable limit on it, but maybe there has to be a limit, as you suggested. Maybe that is reasonable, and maybe we should have a separate body look at an unusual victim impact on a compensation board and provide some revenue for that.

I think the concept you have of limiting liability and narrowing the picture that the court sees, and providing legislative limits, is even going to restrict and sever the liability. If a contract could refer to a portion of a statute that defines that unilaterally, you're not depending upon all the good lawyers drafting contracts that have clear windows that the judges will see through.

I think the issue of being able to implement what the statutes have envisioned, with the different levels of government acting without this intimidation by, "Gee, I'm putting all of the assets of my municipality or my county on the table to do what the law says I have to do," is a nitty-gritty issue. That is the long-term environmental disposition of the State that we really have to address.

MR. HEHER: If I may, Senator, I would say that I know time runs nigh for the people who are so badly injured who cannot provide for their families. We are suggesting a threshold of \$2500 in the context of medical expenses. This threshold, I do not believe, is intended to affect the severely and permanently disabled person who can't provide for his family.

SENATOR LASKIN: So then, you wouldn't be in favor of a dollar amount. You would like a verbal threshold--

MR. HEHER: Yes.

SENATOR LASKIN: Depending on the severity of the injury.

MR. HEHER: I'll go out on a personal limb, Senator, and say, yes, that is my understanding.

SENATOR LASKIN: Well, I am not crazy about that with automobile accidents, but this would be okay.

SENATOR LESNIAK: That is not the issue. We were talking about the cap on liability; now you're talking about the threshold before you would be eligible to bring suit.

MR. HEHER: Yes. There are two separate concepts there, and I welcome and understand what Senator Shinn has articulated so well. I will carry that back.

SENATOR LESNIAK: Okay. He has just been elevated to the Senate, as well.

SENATOR LASKIN: He's a farmer; that is why he talks so logically. (laughter) He is a farmer, not a lawyer, and you can understand him.

MR. HEHER: I once referred to someone in the public forum as a doctor, and he said, "Please, I am not a doctor; I'm a plumber." (laughter) But, I figure, how can I go wrong?

SENATOR LESNIAK: Thank you very much.

MR. HEHER: Thank you very much.

SENATOR LESNIAK: We are now going to accommodate the Public Advocate, who should be well-aware that we are starving, but we are nevertheless going to hear from him. Alfred Slocum, Acting Public Advocate. I guess we haven't confirmed you yet. Is that correct? Senator Laskin, you'll have to make sure we take care of that.

SENATOR LASKIN: I was on the Judiciary Committee when he appeared, and I gave him a very difficult time. (laughter) But, he handled himself very well.

SENATOR LESNIAK: Senator Cardinale didn't give you too hard of a time?

SENATOR LASKIN: No, he's not on the Committee.

SENATOR LESNIAK: Oh, he is not on the Committee.

SENATOR LASKIN: No, the fact of the matter is, it was a very nice Committee meeting on both sides that day.

SENATOR LESNIAK: Okay. Mr. Slocum, thank you very much for appearing.

ALFRED A. SLOCUM: You're welcome, Mr. Chairman. I am pleased to be here.

Honorable members of the Commission, the topic of the availability and affordability of environmental impairment liability insurance in this State has indeed reached a state of crisis. It is understandably of great concern to all segments of government. As the

Public Advocate, my greatest concern is for the potential effect this crisis has upon the potential victims of incidents which would otherwise be covered by EIL insurance, incidents which affect the public at large. These potential victims most certainly have been put at risk by the current minimal levels of insurance coverage. It is imperative that the necessary steps be taken to ensure that sufficient funds be available to make all victims whole for injuries inflicted should incidences of environmental pollution occur.

Because of the lengthy period it frequently takes before injuries associated with environmental pollution otherwise covered by EIL insurance are fully realized, the magnitude of this particular facet of the problem is difficult to assess. Yet, while the affordability and availability problems are certainly serious, over-estimating their severity can lead to consideration and perhaps adoption of overly drastic or inappropriate remedies.

Indeed, I am aware of a few proposals placed before the Commission that have these tendencies. They include, but are not limited to, the following:

- 1) Legislate a dollar limit of liability and create an insurance pool to cover the excess;
- 2) Require a showing of gross negligence or intent prior to an award for punitive damages;
- 3) Limit the amount of punitive damages award, for example, to treble damages;
- 4) Cap risk exposure. Either change from strict liability to a negligence standard, limit the individual liability of a party, or both;
- 5) Restore contributory negligence as a defense to tort claims; and,
- 6) Limit legislatively the retroactive liability of the insurance policy to the date on which the relevant law was enacted.

The purpose of my testimony is to direct the attention of the Commission away from those proposals which seem to suggest that the path of exodus from the EIL dilemma is best paved with a diminution of efforts to make victims of environmental pollution whole to an assessment of what is required to:

- 1) Increase available capital to a capital-intensive industry through expanded competition;
- 2) Prevent excessive industry responses to capital markets resulting in cyclical industry recessions; and
- 3) Guarantee that insurance coverage, when offered, is not so diluted with exceptions that its coverage becomes ineffective to meet market demands.

As an initial matter, it is clear that affordability and availability are real problems in the EIL insurance market. The average premium charged for EIL policies had risen dramatically, as has been noted in the testimony before the Commission. Further, many municipalities and private firms have been unable to secure EIL coverage at any price. Policies have been cancelled, renewals, withheld, and new policies refused.

Adding to this pressure is an approaching deadline set by Congress. Under last year's amendments to the Resource Conservation and Recovery Act, all operators of hazardous waste disposal and treatment facilities must, as a condition of licensure, have sufficient financial responsibility or insurance to pay any and all clean-up costs if something goes wrong. EPA officials have acknowledged that there is a significant number -- perhaps more than 200 -- of such companies that have yet to comply with this standard, in large measure due to their inability to find EIL coverage.

According to the October 21, 1985 issue of Barron's, there were at least 14 carriers writing EIL policies in 1982. Barron's cites a July 1985 survey by the Hazardous Materials Intelligence Report that found only three still in the business. Another recent survey conducted by Thomas E. Sears, Inc. concluded that "carriers will be few, pricing high, and conditions strict." It did, however, find that there are currently seven active or soon-to-be active suppliers of EIL insurance.

According to Barron's, industry observers say that premiums for EIL insurance have more than doubled at the same time that coverage limits have been cut from \$100 million to \$10 million. Indeed, only one insurer -- AIG, Inc. -- currently writes policies with such a \$10 million coverage limit. All others have significantly lower limits.

As previously stated, without full coverage, the public risks the possibility that funds will not be available to make all victims whole for their injuries sustained as a consequence of impairments to the environment. Yet, there is no reason to act precipitously.

A number of recent developments suggest that the crisis may be easing, and that the EIL market is now rebounding. A recent article in Business Insurance, reporting on developments at the Annual Risk and Insurance Management Society Conference, suggested that "not only are EIL underwriters now more confident in their ability to properly assess pollution risks, but there's the possibility that at least two insurers that have dropped out of the market could again begin writing EIL coverage." Specifically, ERAS, a London-based EIL pool of 15 insurers that closed down last year, may be about to reopen, according to R. Malcolm Aickin, Director of ERAS International, Ltd.

Steward Smith, Inc. is also reportedly reentering the EIL market. Further, it should not be overlooked that several insurance companies have continued to offer coverage throughout this period, albeit with higher premiums and stricter safety and engineering standards. This availability is confirmed by EPA staff members, who have reportedly stated that EIL coverage can be found by any hazardous waste company with well-engineered and well-maintained disposal sites.

For insurers, it also has been and continues to be possible to write EIL insurance profitably. For example, the Pollution Liability Insurance Association, a pool of 49 property/casualty insurers that writes EIL coverage on a standard policy form drafted by the ISO, has also made a profit every year during the five years it has been in existence. As James C. Morrow, Chairman of PLIA and Vice President of Nationwide Mutual Insurance Company has stated, "You can underwrite pollution insurance and make a profit." I should, however, note that, according to Business Insurance, this is not a popular position to take within the insurance industry.

Finally, remedies to affordability/availability problems have already been adopted by numerous former EIL policyholders. Self-insurance, both among municipalities and industrial companies, is already occurring. For example, business is up 50% in the past year at

Risk Management Services, Co., a Dallas firm that administers programs and provides loss control services for self-insurers. Much of this business is from municipalities. Mayor Grubb's testimony before this Commission follows this trend.

In another approach, The Wall Street Journal recently announced the creation of a new insurance company by a group of 15 industrial corporations facing large increases in their premiums. These 15 agreed to contribute a total of \$140 million to start the company, which, in turn, will provide each participating firm with as much as \$150 million in liability coverage. A similar plan was used by ACMET, Inc., which was almost forced out of the asbestos removal business earlier this year when its insurer refused to renew its policy. ACMET, together with two partners, created a company specializing in insuring asbestos removal concerns.

Creation of such captive or group captive insurance companies is a solution suggested for many of the companies, and perhaps municipalities, that have suffered a major environmental liability loss or are connected with a Superfund site and thus cannot obtain EIL coverage for these risks. According to Richard W. Sears, Jr., President of Thomas E. Sear, Inc., an insurance and reinsurance brokerage in Boston, reinsurance for such risks is likely to be available if the capital base of those entities created for the sole purpose of insuring parent organizations is adequate.

A wide variety of explanations have been offered as to the cause of the affordability/availability problems in the market for EIL insurance. These explanations differ dramatically depending on who is doing the explaining.

It has been argued that the insurance industry is, in fact, cyclical, but at least some aspects of the cycle are contrived for the purpose of compelling legislative and judicial responses favoring the industry.

Further, the industry attributes much of its current dilemma to judicial intervention into the standard comprehensive general liability policy intended to provide coverage on an occurrence basis only for sudden and accidental pollution. The industry cites court

decisions such as Jackson Township Municipal Utilities Authority v. Hartford Accident & Indemnity Company. It has been proved that under recent New Jersey court cases, general liability insurers have not only been affected by ever broadening tort liability theories, but are being forced to shoulder retroactive obligations that they never contracted to assume and for which they collected no premium. It is the Public Advocate's position, along with others, that the populace is being victimized by an entirely different scenario.

Others suggest a slightly different focus for this litany of causes, suggesting:

- 1) That the insurance companies are themselves largely responsible for the current crises; and,
- 2) That these same companies are today exploiting the crisis for their own ends.

As Ralph Nadar stated in his testimony before Representative Florio's subcommittee last month, "There seems to be an underwriters' 10-year itch of greed operating here. This spoiled brat (the insurers) must be weaned of the fruits of its manufactured crisis and not allowed to increase prices while restricting coverage in insureds and the legal rights of victims."

Robert Hunter, President of the National Insurance Consumer Organization, has explained that much of the problem is related to the unique cyclical nature of profitability in the property/casualty insurance business. His observations of the insurance industry include the notion that the bottoming out phenomenon of the insurance industry occurred in the mid-1970s regarding medical malpractice and product liability unavailability and skyrocketing premiums. Soon thereafter, profits skyrocketed to all-time record levels. The industry, it is claimed, "Learned that State legislators would act to reduce victims' rights in the wake of panic. They are applying the lessons learned in the mid-1970s very well today," says Hunter.

Other assessments of the insurance industry's problems tend to confirm this analysis. The insurance industry is a capital-intensive industry. It profits significantly from capital investment. While traditionally a percent of the insurance premium had

been allocated for profit, high interest rates occurring in the late 1970s caused an abandonment of the profit portion of the premium in favor of potential increased market acquisitions, relying upon the return on premium investment to create profit. This situation was described in part as recently as October 20, 1985 in an article in The Sunday New York Times, which stated: "A tremendous amount of new capital came into the industry, both in new companies and old ones that wanted to expand," said Dennis A. Herman, President of American Federal Group Ltd., a major wholesale insurance brokerage based in New York. "Interest rates were near 20%, and the companies were begging for business, at any price, to get premium dollars to invest."

The competition for premiums produced some extraordinarily generous deals for businesses. In 1981, Mr. Herman noted, "A large retail electronics chain paid \$300,000 for liability insurance." Three years and more than \$1 million in paid claims later, its premium was down to \$125,000.

Another of Mr. Herman's clients, an automobile leasing company with a fleet of 10,000 cars, saw its premium fall to \$450,000 in 1983 from \$2.4 million in 1981.

The scramble for premiums reached a peak, at least symbolically, with the purchase by MGM Grand Hotels, Inc. of retroactive insurance after a fire at its Las Vegas hotel in November, 1980, that resulted in the deaths of 85 people and injuries to 591 more. Before the fire, MGM had only \$30 million of liability insurance. But, for a fee of \$38.3 million, an insurance service company, Frank B. Hall, Inc., underwrote up to \$170 million in claims from the fire. That was reported in The New York Times, October 20, 1985.

A recent article in Barron's also tends to confirm the criticism of past underwriting standards. As the article noted, many risk assessments were done on a tight budget and depended on samples rather than a full audit. "Inspections done specifically for underwriting were limited to a fraction of the potential premium," says Robert D. Taylor, an environmental risk control services engineer at Hartford Steam Boiler Inspection & Insurance Company.

Another engineer who did environmental risk assessments for insurance companies contends that "the amount of money committed may have been correct given the state of the knowledge then." But, he adds, "thinking about it now, I wouldn't be comfortable with our risk assessment."

As a consequence of these high interest rates, insurance carriers took note of the fact that there is a significant time lapse between the time the premium is paid and any responsibility is imposed upon the insurer to compensate for losses imposed as a consequence of a filed claim.

This long-term trial, or pay-out rate, in a spiraling economy of high interest rates created all too lucrative investment possibilities.

However, this process adopted by many carriers resulted in a disastrous down-turn in the industry as risk analysis went out the window to protect market shares. Ultimately, cash reserves were insufficient to accommodate existing liabilities, and surplus capital was required to buttress loss reserves. The insurance industry had accepted unreasonable exposure to liability while failing to acquire new capital through expanding market acquisition attempts.

Unfortunately, the reinsurance industry followed suit. The reinsurance industry experienced remarkable growth initially, but such growth, including newly created organizations, was short-lived. Both primary insurers and reinsurers began to utilize returns on capital investment to offset underwriting losses.

A capital-intensive industry found itself without capital. Now, having created the crisis, the insurance industry wishes to exploit the crises in favor of its own ends.

As a consequence of reviewing this situation in its entirety, the Public Advocate is of the view that somewhat newer approaches are probably appropriate to allow us to obtain coverage for potential injuries resulting from the non-sudden release of hazardous substances to the environment. We certainly ought to be able to minimize the risks associated with the slow release of toxic materials from dump sites, exposures related to the cleanup of hazardous waste sites, exposures to asbestos, and leaks from faulty underground storage tanks.

The solution to the dilemma may well lie in increased competition. As stated, a great deal of new capital was introduced to the insurance industry within the last decade. However, much of this new capital came from sources with little familiarity with the insurance industry. Therefore, it was not surprising that their efforts toward market acquisition failed. It is suggested here today that we look at other possibilities designed to enhance competition and acquire additional capital. We should look to those who have at least tangential familiarity with the industry, that is, other capital-intensive industries — the banking industry and the securities industry. Currently, both are barred in this State from entering into insurance markets.

We ought to take a second look at those policies behind the judgment to bar the banking industry from filling a void created in large measure by the reluctance of the insurance industry to concede its own mistakes. Most of us are aware of what happened to life insurance premiums for term insurance when savings banks in the State of New York were allowed to provide such insurance and premiums went down in the insurance industry.

There are persuasive arguments that the banking industry could benefit from this opportunity and the insurance industry could benefit as well. It is not suggested here, however, that banking and insurance business be amalgamated. Moreover, one could consider the possibility of banks acting as a holding company for an insuring entity subjected to current insurance regulations. Further, our current situation could have been avoided if the excesses associated with the move toward "premiums for investment at virtually any cost" could have been avoided. This suggests a second look at regulating not only commercial insurance coverage, but the reinsurance industry as well. Had the industry been precluded by regulation from excessive downward deviations in premium assessments, much of the present crisis could have been avoided.

Finally, the Legislature needs to seriously consider the imposition of minimum standards as to what a commercial general liability policy must contain. It makes no sense to offer alleged

coverage which is so riddled with exceptions as to render the coverage ineffective to meet those needs all too readily apparent in a rapidly advancing, highly technological, social order. Yes, we can take a second look at tort liability and its applicability to our modern societal needs and limitations, but certainly not without taking a second look at the industry and its readiness to serve.

Thank you.

SENATOR LESNIAK: Are there any questions from the Commission?

SENATOR LASKIN: I think at our first session, I talked to one of the witnesses about the limitation on investments of insurance companies. After hearing your testimony today, I guess my original thinking was just way-out scheme because someone with a little more seriousness as you has discussed the same concept.

In New Jersey, we have a law that governs fiduciaries. It says that if you are a trustee or an executor, without contrary instructions in the instrument, you can only make investments because you are a fiduciary in certain specific limited listed mechanisms. They are all in the statute.

I am thinking that an insurance company basically, or conceptually, is really a trustee in the same sense. They get money from insureds. They are supposed to hold on to it and invest it wisely, so that in the future, if they insured needs the money to pay a claim, it is there.

Are you saying in your testimony that perhaps insurance companies should be held to that kind of standard where they can only invest in certain what we'll call safe areas to make certain that there we don't have this up and down like we had when the interest rates were going sky high and all of a sudden they don't have any money now? Are we really saying that maybe we ought to think seriously about a statutory mandate which would prohibit insurance companies from speculative-type investments?

MR. SLOCUM: I have to be candid with you, Senator. That is not really the thrust of my position. It may well be appropriate to do so, but my position is, how low can you allow the premiums to go just

so you can get some immediate cash for capital investments without reeking havoc on the industry itself? When I talked downward deviations, Senator, my concern was that not only did the primary insurers, but the reinsurance industry as well, sacrifice sound business policies just so that they would have on-hand capital for investment.

My suggestion is, had they been regulated to the point that the cost of the premiums were monitored, we wouldn't have allowed such significant downward deviations.

SENATOR LASKIN: Which really is not unlike what I am talking about. They did this speculating -- I'll use that in the general sense -- when the interest rates went sky high, so they said, "Let sell insurance at any cost because we can make so much more money investing it the high interest areas."

What I am saying is, in line with that, maybe we should think about some kind of a statutory fiduciary expansion, which would include insurance company investments in the same general umbrella as trustees and executors of wills. It is just something philosophically to think about. In that way, you won't have the speculative investment of money and the lowering of premiums to a ridiculous amount.

MR. SLOCUM: There is no question in my mind that their investment program ought to be monitored.

SENATOR DALTON: Just on that, through you, Mr. Chairman, on the same point, sir, you are talking about monitoring the investments of insurance companies to begin with.

Insurance companies are national corporations that are regulated by 50 different states. How would you do that? How would you propose to regulate the investment?

MR. SLOCUM: Well, it may require Federal legislation, but I'll tell you this. We also have licensing in this State, and my position is, for those companies that want to do business in the State of New Jersey, we ought to make it a requirement, with regard to licensing, that they engage in a certain limited program of capital investment. If they want the business, they'll do it.

SENATOR DALTON: If, in fact, you are limiting them to "x" percentage of profit in order to be licensed--

MR. SLOCUM: But, you see, Senator, that wasn't my position.

SENATOR DALTON: Okay. You are, in effect, if you followed Senator Laskin's question. His point was that you regulate them to invest in certain "safe investments." That effectively is regulating profit.

MR. SLOCUM: Indirectly it may have some relationship to the rate of return.

SENATOR DALTON: Well, if you do that, what you are doing is, you are taking their investments from of a speculative nature to a fairly safe predictable area.

MR. SLOCUM: Yes, I understand that to be the Senator's statement.

SENATOR DALTON: So, you are.

MR. SLOCUM: But, as I tried to indicate, my biggest concern is how much you can lower the premiums just for the purpose of capital on hand for investment purposes. Where you put the money wasn't my biggest concern, but it is matter that ought to be monitored.

SENATOR DALTON: If I am the Joe Doke's Insurance Company, and New Jersey says to me, "Well, you can only take your premium dollar that you earn and invest it is safe investments," I'm liable to say, "Well, that is fine, well, and good, but I'm going to do business in the other 49 states then."

MR. SLOCUM: You might well say that.

SENATOR DALTON: Okay. Additionally, how would you propose regulating reinsurers who are not necessarily national companies, but international companies? In other words, some of our reinsureds are located-- Lloyd's in a reinsurer in Great Britain; it is a multi-national company.

MR. SLOCUM: The only thing you could do would be to get a commitment from the primary insurers. As a consequence of writing insurance in this State, you have to have them provide you with information regarding their reinsurance program.

SENATOR DALTON: Well, I'm not suggesting, via my question, Mr. Slocum--

MR. SLOCUM: I didn't think you were.

SENATOR DALTON: Okay. What I am trying to figure out is, you are talking about one of 50 states that has an Insurance Department that by admission of its last four Commissioners is totally understaffed. Then you are going to take on regulating national and multi-national corporations. I just don't know how practical that is. Let me just raise that point.

If you are saying to me that— If this is Congressman Florio's Subcommittee and you're suggesting that the Federal government ought to get back into regulating the insurance industry, which amongst my brother insurance agents would probably cause cardiac arrest, you suggestions then become, to my mind, a lot more reasonable as far as suggestions are concerned. You are talking about an entity that may be able to grapple with the goal of regulating the investments of national and multi-national corporations.

MR. SLOCUM: In terms of what I think I am proposing, I don't think it is an awesome burden that the Department of Insurance in this State couldn't carry. We are not taught in the law school. I would refer from time to time to the awesome power of the State.

When students asked me what I meant by that, my response was somewhat tongue in cheek. God giveth and God taketh away. The State has the power to determine who is going to write insurance in this State, and it can determine what standards it wants to impose to achieve the objective. I am in no way persuaded that it is impractical to do that, even though it may well be. But, from my perspective, I don't think so.

SENATOR DALTON: Thank you, Mr. Chairman.

SENATOR LESNIAK: Let me make one point, if I may. I concur with the part of the your testimony when you say we are not to be panicked in terms of responding to the cyclical nature of the problem. However, for the record, let me disagree strongly with one of the points you made.

I don't believe we ought to be complaining about low prices. As long as the insurance industry, and industry itself, have-- They write many lines, and our Department has made a determination that they have the adequate assets to cover the losses. If they want to take a

risk out there in order to get capital to make money, the people who are going to benefit from that are the insureds by lower prices, as municipalities benefited by those lower prices. I don't think we ought to preclude the market from people having to pay lower prices as long as the company has the solvency to cover that, and as long as we, as the Legislature, do not panic and look at when the market changes and all these companies say, "We're losing such great money; therefore, you have to change some tort concepts or liability concepts that have far-reaching effects."

As long as we are intelligent enough to realize that, I don't see any problems with municipalities or whomever getting the benefit of lower premiums because insurance companies themselves want to take higher risks. If they lose the money, it is their shareholders who are going to have to bear the burden of that mistake.

One thing I agree wholeheartedly with is that we have to look not at what the cyclical problems are, but are there any long-term problems that are institutionalized either through the judicial system or through legislation that create needless uncertainty where we can establish certainty.

By the way, one of my intentions is to call the banking industry and the securities industry for our Committee to respond to the suggestion you raised and Congressman Florio raised as to what their position is on this topic.

Assemblyman?

MR. SLOCUM: If I could, I would like to respond.

SENATOR LESNIAK: Sure.

MR. SLOCUM: I don't disagree with a single thing you had to say, Senator. My concern is, if you are going to take those risks, you can, but don't take those risks and then say, "Oh, because we have done something that has caused us to be in a threatened posture, we are not going to write insurance in this State in this area anymore." That is what my concern was.

SENATOR LESNIAK: Okay, fine. Then we agree. Assemblyman?

ASSEMBLYMAN SHINN: Yes, briefly. In the last statement of your testimony, you touched on the tort claim review. I think you were

here when I made comments relative to my concern over the ability of lower echelons of government to implement the Solid Waste Management Act and some of the environmental legislation that has been passed that mandates that lower levels of government implement environmental tests and the creation of solid waste facilities.

I'm interested in some of your comments relative to the consideration of a tort claim's type of protection for counties and municipalities. Do you have any specific feelings?

MR. SLOCUM: Well, my view is, I think that in the past we may not have had sufficient knowledge to be able to assess the risk associated with environmental pollution. But, I am persuaded that with sound engineering management, we can monitor the risk in the future, make accurate assessments after what the risk consists of, and assess premium costs such that we can obtain for ourselves full coverage.

I am not persuaded that we have to impose tort claims' limitations when, in fact, I am of the view that we can, in the future, acquire full coverage.

ASSEMBLYMAN SHINN: It has been my experience that the municipalities that are having problems getting coverage are municipalities that have either recently closed or operating non-state-of-the-art solid waste facilities, i.e. dumps.

MR. SLOCUM: I understand, and I am of the view that we should get together a sufficient amount of capital by whatever means to, without notions of liability whatsoever, clean it up, because in the past, I wouldn't want to attribute responsibility to a singular entity. I think we all to take all of the Superfund money, all Spill Fund money, and assessments against those industries that produce the toxic materials, put together that package, and say, "Okay, gang, let's clean up everything and start anew."

ASSEMBLYMAN SHINN: That separates Superfund from municipal.

MR. SLOCUM: Yes.

ASSEMBLYMAN SHINN: Just going back to my point, which is the right-now problem, the worse thing in the world that could happen is for the counties that are mandated under the Solid Waste Management Act to say, "Forget it. It is a certified failure. Let the State do it."

That is a task that I feel the State cannot deal with. If we provide anymore disincentives for them, aside from the political disincentives that are out there, not to perform under that Act or any other environmental acts that we pass, by the liability issue and not address it in the short term-- Maybe in the long term there are solutions, but the short term is my concern because the fires are under municipalities and counties to perform. We have a crisis. Even the State has an environmental impairment liability crisis.

We have to have some short-term solutions. I don't see it out there in the private sector as laws exist currently.

MR. SLOCUM: Well, the only thing I can say is -- again, I reiterate -- I think there is too great a concern for assessment faults and assessment of liability. I think we all ought to conceded that in the world we live in, we grew at such a fantastically rapid rate that we couldn't foresee a sufficiently far distance down the road to make a determination as to what it was we were doing. We ought to call time out now and say, "Hold it. Let's just clean up the mess and take all of our available resources that we can put together to get rid of this."

I think if we were able to do that, then we would be able to make assessments with regard to risk allocation with regard to the future, and do it in a manner that doesn't hurt potential victims.

SENATOR LESNIAK: I believe Mayor Grubb's proposal incorporates part of that concept in terms of carving out certain risks that would have to be handled in a way beyond the insurance issue.

I want to make one other point. Your testimony comes very close to saying that the insurance industry is engaged in antitrust violations.

MR. SLOCUM: It did come very close to that.

SENATOR LASKIN: And, it is apparent it was unintentional.
(laughter)

SENATOR LESNIAK: Thank you very much. We are going to break for 45 minutes for lunch.

(LUNCH RECESS)

AFTER LUNCH

SENATOR LESNIAK: Patricia Casey?

PATRICIA CASEY: I think, Jeff, you wanted to start?

MR. KLEIN: I'll start, and I will be brief, since you have heard me already today, and let Pat give you some new perspectives that you have not had so far.

I am with the American Insurance Association. I am Jeff Klein, Associate Counsel for Government Affairs. We represent 178 property and casualty insurers in this State that account for about 43% of the general liability premiums written in New Jersey. Included in my membership are three big New Jersey companies -- Selected Risks, Chubb, and Crum and Forster, that have an interest in this State.

I am not going to read this rather lengthy 26-page statement. I will only refer to excerpts from it. What I want to do is break it down into four topic areas, that is, give a little factual background on exactly what the underwriting cycle is, and what some of the figures have been with respect to it; then talk a bit about what we like to call the underwriting uncertainty in all of this, and what some of the judicial interpretations have stated. But for most of those, I will refer you to the written record.

At that point, Patricia Casey will give some background as to what is happening in Washington and in other states. We will try to provide the Commission with any information you have.

I would then like to very briefly respond to some other comments made at the two prior public hearings, and then give you an idea of our support for some of the suggested solutions that have been thrown around.

There are certain principles that we want to lay down at the outset with respect to some of this, and that is, while we concede that a part of this problem deals with the underwriting cycle, it is our belief that the affordability and availability problems deal to a great extent, with the culmination of increasing litigation and adverse judicial determinations which in essence have made this problem uninsurable.

Secondly, while we support what this Commission is doing and we compliment you on taking the responsibility to address this issue, and we support whatever the State of New Jersey can come up with, we have to understand that a lot of what is considered here must also be considered in Washington at the Comprehensive Environmental Response Act, better known as Superfund. Its interrelation with state statutes around the country is so great, and the liabilities that have been discussed here this morning and at the other two hearings are so affected by it, that changes simply have to be made on the Federal level for some of these insurance problems to be addressed as well. But we understand that we have to start someplace, and that you have taken the responsibility to do that. I have asked people in my industry, legitimately, whether if the State of New Jersey made some of these changes, it would have an impact. Without telling me how much, they said yes, and that is why we are here.

Much has been said -- and I refer to page two of my testimony now -- at the prior hearings about the underwriting cycle, and insurers cash flow underwriting and bad business practices, and I just want to give an overview of where we are and what it has led to. Traditionally, these cycles have been of approximately four years' duration. Just as demand for insurance has been influenced by the health and growth of the nation's economy, supply is influenced by other basic economic trends. Supply, or capacity, in our industry, is directly related to insurers' surplus, which is defined as the amount of funds and the number of funds that stand behind the liabilities undertaken by insurers. The amount of the surplus in the industry is not only affected by the stock market and investments, but also by underwriting losses and profits that expand or contract the surplus and the amount of capital that flows into the industry.

The property and casualty industry is just beginning to emerge now from the longest down cycle in its history. There were high interest rates in the 1970s; this brought, as has been said, a tremendous amount of new capital into the industry. Then there was competition for market share, which led to what has been referred to as cash flow underwriting, where insurers were willing to accept certain

underwriting losses in anticipation of high levels of investment income on loss reserves that would produce a bottom-line profit.

We acknowledge that the high interest rates of the 1970s did not continue in these losses. These underwriting losses turned into real net losses. To give you an idea of the extent of this, in 1984, underwriting losses jumped from \$8 billion to \$21.3 billion, and I have been told, at least orally, that 1984, in terms of losses, was as bad as something like the previous 20 years combined. The experience on commercial liability lines has been particularly negative. As I said earlier, the combined loss ratio for those lines in the industry has been 152. The Insurance Services Office, which is a statistical organization for the industry, has reported that insurers surplus fell approximately 10% over the last several years. They are estimating that based on that, there will continue to be capacity shortfalls between now and at least 1987.

As a result of this, reinsurers in London, and domestic reinsurers as well, have begun taking very— (telephone rings) That may be them right now.

I forgot to mention this morning that when my three and a half year old son asked me where I was going today, he asked whether the presidents of China and Russia were going to speak here today. I said, "No, these are global issues, but that is up at the UN, on another matter."

SENATOR LESNIAK: I am sure he didn't laugh, either.
(laughter)

MR. KLEIN: I am paying for my puns and my humor.

So, there is no question that there have been real losses and the problem has been exacerbated in the last couple of years.

The problem that I would next like to address concerns the uncertainties and ambiguities that underwriters have to face in writing insurance policies. Before insurers can spread any risks, they have to assess the risk's financial position and determine how much of the risk it will spread and where it chooses to accept that spread. The underlying determinant of an insurer's capacity is its surplus. The loss ratio differs for different lines, depending on the book of

business. The liability lines, where losses can be paid years after the policy is written and where claims are not known until years after they have occurred are called long-tail liability lines; some of us have heard that before. Those include items such as medical malpractice, product liability, and environmental liability in particular.

In this area, it seems to me from what I have been able to learn in a quick amount of time, although science tells us that certain products cause certain injuries, we have not yet arrived at that state of knowledge where we can determine whether a particular individual's exposure, as part of a group, is directly attributed to that particular product, and I am not suggesting that does not mean there should not be compensation. I am only suggesting that those same difficulties in scientific analysis make an insurer's job that much harder.

Insurance companies look at many things, including risk management and safety practices, and try to make a determination to whatever extent possible exactly how hard a risk this particular insured may or may not be. Recent experience in the liability system, though, has indicated that although courts and legislatures are trying to deal with this problem, some of them are trying to reverse the burden of proof, or reinterpret policy coverage and languages, and that is causing a severe problem for carriers. There are a couple of decisions which have been mentioned, which are cited on page 10 and 11 of my statement, one of which was a California decision, *Sindell vs. Abbott Laboratories*. In essence, it said that where an injured party in particular could not identify the manufacturer of the product that caused the injury, but where the plaintiff could identify that either a manufacturer or substantial number of them have produced a product, that any and all of them could ultimately be found liable and ultimately be called upon to pay the damages.

The other case that was mentioned is the *Beshada* case, and we won't go into that again, and the *Feldman vs. Lederle* case, with respect to state of the art. Another area of problems for our underwriters consists of the damages that are ultimately awarded in cases like the *Ayers* case, the original trial court case which was in

Ocean County in 1983, which included a verdict for compensation involving loss of quality of life and medical surveillance. These types of items were admitted, at the time, to be speculative, and yet a court found that they should be compensable and that the existing insurance policy, which was not intended and could not have foreseen those damages, would be called upon to pay for them.

SENATOR LESNIAK: Can I interrupt?

MR. KLEIN: Sure.

SENATOR LESNIAK: I am trying to conclude these hearings some time by the end of next week. If we have your written comments, and I think we are well aware of the problems associated with judicial decisions. I am really interested in the response -- the part of your testimony that relates to a response to other suggestions that have been made, because that is really what we are looking for. We will read the entire testimony--

MR. KLEIN: No, I didn't intend to read it. I will get into that, and then I will leave the forum open for Patricia.

There have been comments made with respect to banking deregulation, both today and from Congressman Florio. I am not going to get into that whole area of financial services-- we have addressed that in other areas, including before the Banking and Insurance Committee. Our only comments are, if the banks think that they can have a better time assessing the risk than some of our underwriters can, then we would be interested in seeing how and why. I am also told that since they don't have the past experience of their general liability policies to draw on, that they might be able to deal with this in a much narrower area, perspective, and could claim that they could write it better. But the same standards of risk that apply for underwriters for the Aetna or the Travelers would apply to someone trying to write this for Citicorp, and you are still left with the fundamental problem of whether or not this is insurable.

Others have talked about the Commercial Lines Deregulation Act as being a problem in the State, and as having somehow contributed to the availability and affordability problem. I only want to say that there are other states that have commercial lines acts, and there are

other states that don't. Many don't; most of them don't. New Jersey, I believe, is one of less than 10 that has such an act, but this environmental problem is occurring country-wide, so we reject assertions that the commercial lines act is a prime cause of this problem.

Mayor Grubb, in his testimony on October 15, talked about the formation of an inter-governmental environmental impairment liability fund. We are studying that now. We don't know whether he is talking merely about a risk sharing mechanism or about some expansion in the laws for self-insurance pools, meaning group self-insurance, to expand the authority to permit municipalities to pool with school district and other entities as well. If he is talking about that type of approach, I get back to the same question with respect to the banks, and that is, that these pools will have the same difficulty obtaining reinsurance that primary carriers are, and I don't know that that is anything other than a shifting around.

Sir?

SENATOR LESNIAK: You can pool for self-insurance as well as for insurance reasons.

MR. KLEIN: Well that is— Yes. I don't know if the concept he is espousing is having various municipalities pool in the sense that they contract together with an insurance company, or whether he espouses expanding what has been the experience in Bergen County, and that is, the government itself setting up the pool. Now, obviously, those of us in the industry, both agents and companies, have problems with business drifting away, if you will. But that aside, the question is whether the pools could obtain the insurance, and we don't see how. Some say they could, but it has not really been tried.

Commissioner Gluck made a four-point proposal, one of which dealt with the question of arbitration. I believe her first suggestion concerned development of a system of mandatory apportionment of damages. We are in favor of that conceptually; I would like to see that in writing from the Insurance Department and meet with them on that. It is consistent with our Association's position that if you take more and more of this problem out of the court system and deal

with it on as voluntary a basis -- whether as far as Senator Laskin suggested or not, I don't know -- but on as voluntary a basis as possible. That would take a large portion of the problem out of the courts and into actual cleanup activities, at least with respect to cleanup and the litigation costs in determining who is responsible for cleanup costs.

There is a California approach, of which we have a summary to distribute to the Committee, in which that State has set up, as I said, pursuant to a 1984 law, a mandatory apportionment system. I believe it goes beyond what Commissioner Gluck has suggested, and that is, it covers not just damages but cleanup costs as well. So it is probably more comprehensive.

I also know that the New York State Business Council, which is the equivalent of the Chamber of Commerce, has recently contracted, if you will, with the Department of Environmental Conservation in New York State to help set up a mediation system whereby companies would voluntarily come in and sit down with a mediator, try and distribute information so that the mediator can determine, as much as possible, who contributed what to the dump site, and they would voluntarily arrange some apportionment of damages. I will make that available to the Committee as well; I think it is a good type of voluntary approach.

Thirdly, Commissioner Gluck spoke about a governmental excess guarantee or reinsurance mechanism. I am not sure, honestly, what she was referring to there. Some comments were made that it would be along the lines of the Federal flood insurance program. We don't know whether that is applicable to environmental liability; we would be interested in hearing from the Department there.

And finally, she talked about maintaining strict liability for those who illegally dispose of hazardous waste and about changing to a negligence standard for those who conduct a beneficial activity of cleanup and mitigation of waste. Although we, as you well know, would like to see a greater change than that, that would certainly be a start and would certainly dislodge the current problem we are having with cleanup activity. Some major change in the tort standards for those who are merely coming in and trying to clean up the site should be placed into law.

With respect to a suggested solutions, it has been suggested several times in these hearings that maybe the Legislature or the Insurance Department should take a look at legislatively, or by regulation, defining a general liability policy and a pollution liability policy, or by defining sudden and accidental, to try and overturn the Jackson Township case. We checked with people in our industry, and I can said that AIA as an Association has been studying this question for about eight months on a national scale, and at least as of October 24, there is still a very serious difference of opinion as to whether you can do it successfully -- whether in essence you can prevent the type of court decisions we have seen in the Jackson Township case -- and actually, in a foolproof manner, define a policy term by statute and have it withstand adverse judicial determination. But we think it is a good idea. We are continuing to study it, and it may be do-able. There are some who suggest it can be done.

SENATOR LESNIAK: Let me suggest that nothing we ever do is foolproof, and that is why you need insurance.

MR. KLEIN: Okay. I won't make another joke.

Senator Dalton's bill, S-3206, with Senator Contillo-- We are in support of that bill to the extent that it limits the liability of cleanup contractors and we throw our full weight and support behind it. There appears to be a necessity, however, for some other changes with respect to any liability that contractors could still have under Federal statutes, and we would be willing to provide whatever expertise we could to address that issue and perhaps even strengthen that concept in S-3206.

And finally, before I turn over the microphone, since everybody, including myself, is tired of hearing me, the Association, as you know from my participation on the Task Force, supports the concepts in the Lynch bill. We would go one step further as a trade association and that is suggest that, if this Legislature sees fit, those concepts be extended to a broader class of defendants than public entities. Obviously, not to limit its sovereign immunity, but a pure negligence standard for private defendants, a technological state-of-the-art defense as is contained in A-814, and the Victim's

Compensation Proposal that I believe Senator Dalton sponsored a few years ago contains such a proposal; and a several and apportioned liability standard for those defendants as well.

We know there is a limit, realistically, to how much change can be accomplished. But if we are talking about providing insurance, and providing some certainty in the area, we think that has to be seriously considered.

SENATOR LESNIAK: Let me ask you one question before Senator Dalton, who is on the edge of his seat to ask you a couple of questions.

If we were to change liability concepts, isn't there a fairness issue that we would have to wrestle with, and that is, if we were to change it, wouldn't they be changed prospectively? In other words, you have risks out there that you have already written. Those risks are based on the law at that time. If we change liability standards now, to the extent that they affect your risk in the past, it is not going to have any impact at all in terms of the availability and affordability of insurance now.

MR. KLEIN: I would say at the very least, if the standards were changed, let's say, effective Feb. 1, 1986, and that as underwriters, started-- If new facilities came up-- Let's forget the item of facilities that have policies under existing policies, and those that would have them continuing under the new tort system, underwriters would be much more able to write this insurance prospectively for these new facilities, with these new rules of the game to come into play. But one of the things I would like Patricia to address to you is the extent of the retroactive exposure out there, and how massive it is for the insurance industry. We really don't know what to do with it. And I don't-- You know, if you make these changes prospectively, it does not solve 90% of our problem, with respect to environmental impairment insurance.

SENATOR LESNIAK: That is my policy; I don't know if that is the purview of this Commission to pull your chestnuts out of the proverbial fire--

MR. KLEIN: No, I understand.

SENATOR LESNIAK: --and past practices.

MS. CASEY: Let me just add on there that if you were to change the liability rules prospectively, that would be to us a significant step in the right direction. We do have to deal with this retroactive problem, but what we are finding is a real problem in the way the liability rules are operating, and I would say that that change has come about mostly since 1982. It is a really pretty recent development, and case law and the construing by the courts of the Federal Superfund Act, and then all the state acts as well. But what we are seeing is that the Legislature -- with the best intentions in the world -- has made no distinction between the past, the present and the future, so that there is no incentive for anyone to continue in the future, to act in a more careful manner, because you are held joint, severally, and strictly liable. We think that amounts to a more of an absolute liability, for anything that occurred before, for anything that occurred even if you had very little -- a tangential -- interest involved in the handling of that substance.

So, I think that prospective relief would really be a good signal that you have begun to understand a part of our problem. But it is not just our insurance problem, it is our insureds' problem, and if you could do that, I just think that would be the beginning step in making some sense to allowing us to underwrite a particular individual's risk based on that individual's conduct. And that is our problem right now; we are not able to do it.

SENATOR DALTON: Through you, Mr. Chairman -- You have Mr. Klein indicating that 90% of the problem that the industry faces is a retroactive problem. Now you are suggesting that we make some distinctions, prospectively, that, say, is an excellent step forward. You want to resolve those two statements?

MS. CASEY: Can I correct you, Jeff? I think a large-- 90% of our problem-- When he said that, what he means is, that has generated fear within the insurance industry, without any doubt, because we have written policies out there for many different insureds, for all sorts of-- you know, the problem with this hazardous substance, or hazardous waste or hazardous material, whatever you want to call it. It is not just Dow Chemical, it is not just the big

companies; it is the little dry cleaners -- it is anybody. So it is a lot of people that we don't even know, and we are afraid about those past liabilities, to the extent that that has generated within our industry a lot of fear about the pollution exposure. It is true to say that that is 90% of our problem. But we are looking for relief any way we can get it, and if we could get some legislative assistance in making the dividing line between what has been the sins of our collective industries as a nation for the last 60 years, and what we could provide, maybe, to meet some of these financial responsibility requirements for the future-- If we could get some help with that, I think that would be a very encouraging thing to our industry.

That doesn't mean that everybody who has ever dealt with hazardous substances will, overnight, be able to get insurance. But it will mean that we can at least begin to provide some of the market, which is what some companies definitely want to do.

Well, I really don't want to take too much of your time, but I would like to tell you what I do. I am a lawyer for the insurance industry, and my primary job is to watch what is going on in the state legislatures on the issue of pollution. I can only tell you that in 1978, there were about 80 bills involving the subject of toxic torts in all the 50 states, and in 1983, it was about 1,000. So, I am extremely busy, and I have also authored a survey of the state liability laws on hazardous substances for three years now. I first did it in 1982, when it was about 200 pages; then I did it in 1984, when it was about 550 pages. And I am about to complete it at the end of this year, and it will be 770 pages, which shows you that the legislatures have been extremely active in this subject.

I wish that I could tell you that they have been active on the technological side, because I think that is the real problem, but they have in fact been active on the liability rules and all sorts of legal concepts, because that is what they and many of the people -- even the environmentalists who come before them -- are much more familiar with. I mean no disrespect, but we all talk our own language. If you get a group of engineers up here, it would be really a sleeper.

I am also a secretary at the AIA to the group that has been involved, as an industry, with developing the proposal that we have put forth in Congress this year. The reason we did that is, starting with 1982, we began to be quite worried about our past exposure. And at that time, Mr. Slocum recognized -- in 1982 -- about 14 companies were willing to try to write this environmental impairment insurance. They really thought this would be great -- "We've got all these new premiums coming in, new companies, everybody seems to be involved in these substances one way or another, so here is a new market, a new automobile, if you will, in the 1980s." What we did not understand, and the law itself was unclear, which is to say, the Federal laws on the subject were only beginning to be construed as of 1982 -- that is, the Federal Superfund law -- and what we did not anticipate was, obviously, not just the coverage decisions but the retroactive application and the standards of liability as they would be construed under the Federal Superfund law.

In 1984, we were sure, as an industry, that we had a real problem with the liability rules as they were going to operate in the pollution area. In addition, as Jeff has mentioned, we have our own economic fiscal problems stemming from a variety of causes, so the result was that many insurers simply pulled out of the market for pollution, particularly after the reinsurers did.

If I made no other point here but that the retroactive problem is very much hurting the cleanup effort in our country, I would be really happy. Many of the environmentalists and most well-meaning people felt that the strict joint and several standard would be a club to bring people to behave in a more fruitful manner and in a more responsible way. It has been our view that it has not worked that way at all, that in fact, it has been such a wide escalation of when you may be held liable that, in effect, it means that everyone can be held liable, and basically no one is. And the search then remains for the funding to do the cleanup.

SENATOR LESNIAK: And you litigate.

MS. CASEY: Pardon me?

SENATOR LESNIAK: And you litigate.

MS. CASEY: And you litigate.

We have hired an outside consulting firm to estimate the costs of cleanup litigation based on our efforts at the Federal level to convince them that we have a problem. I would point out that insurers are always ahead of the litigation system, because they get the claims first, before it even goes into the court room. They get the claims, and so they begin to pile up records which they are not very good about explaining to other people, but they have records, and the beginnings of trends within their companies that is the basis for many of their underwriting decisions.

SENATOR LESNIAK: Let me ask you a few questions. In terms of the Superfund cleanup, you said there is a California arbitration system--

MS. CASEY: Right.

SENATOR LESNIAK: --that has not really been started yet. Is that correct?

MS. CASEY: It was enacted in 1984, and the reason it has not-- It is starting now. It is a method of having three arbitrators come and allocate, according to a several liability standard, the responsibility of the various parties and give them a release.

SENATOR LESNIAK: Do they do that on Superfund sites?

MS. CASEY: They do that on any sites that the state has. You mean Federal Superfund sites, or California Superfund sites? It gets very--

SENATOR LESNIAK: California Superfund sites.

MS. CASEY: They do it on-- California has about 280 of its own sites that are not listed on the Federal Superfund. And so, this is an operation in the state--

SENATOR LESNIAK: For California sites--

MS. CASEY: Right.

SENATOR LESNIAK: --not California Superfund sites, because they could not do that with California Superfund sites.

MS. CASEY: It is not clear whether or not they could not do it for the Federal Superfund--

SENATOR LESNIAK: It is not clear.

MS. CASEY: --but they probably would not, because they have the joint and several club under the Federal enforcement mechanism.

SENATOR LESNIAK: Do they say— Who determines how clean is clean?

MS. CASEY: The arbitrators set out a remedial action plan or program. It has to be approved by the Department—

SENATOR LESNIAK: By the Department of Environmental Protection?

MS. CASEY: It is called the Department of Health and Safety in California, I think — the equivalent. And I believe it has to be publicized.

SENATOR LESNIAK: Okay. So they determine how clean is clean. Then, they identify responsible parties.

MS. CASEY: Right.

SENATOR LESNIAK: Okay. Say there were five, and then they apportioned their liability.

MS. CASEY: Right.

SENATOR LESNIAK: Do they apportion their liability for the entire cleanup sum?

MS. CASEY: You mean to say, there should have been six and only five come to the table? The Department reserves the right— If that sixth person is still there and active, the Department reserves the right to sue that person for the whole amount. But, the--

SENATOR LESNIAK: I am more interested in--

MS. CASEY: --fund, the orphan's share--

SENATOR LESNIAK: Orphan's share--

MS. CASEY: --concept is behind the California approach. So, in other words, they would only be responsible for what they, as polluters, did. The fund would pick up the rest.

SENATOR LESNIAK: Okay. Who pays for the orphan's share?

MS. CASEY: The fund. They have a fund.

SENATOR LESNIAK: The fund?

MS. CASEY: The California state fund.

SENATOR LESNIAK: Okay. And how big is that fund?

MS. CASEY: It is a collection of things. It is at least \$250 million now. Their voters put in-- They suggested last November a bond act that would allow them to-- I think it is \$100 million or

\$150 million, and the voters overwhelmingly said okay, have the state issue bonds for that, so they did.

SENATOR LESNIAK: Does this system apply to just cleanup, or does it apply to personal injury?

MS. CASEY: No, it only applies to cleanup. We cite the California law— not that it is perfect, but we think that it really has a lot of good elements to it, and it is designed to expedite the cleanup program, which we think— The insurers are very scared about this. The more the cleanup does not get done, the more the likelihood is that we are going to face bodily injury and property damage claims further along the line.

SENATOR DALTON: Can I ask a question?

If in fact, I don't agree with the allocation of liability, and I am one of the companies that dumped at a site, do I have recourse?

MS. CASEY: Can you contest that through judicial review?

SENATOR DALTON: Yes.

MS. CASEY: I believe that you can. I am not sure on that detail. I think that you can.

SENATOR LESNIAK: I would presume, for the system to work, it would only be on the standards of review of an Appellate Court or an arbitrator's decision, which would be based on fraud or collusion. I don't think that they would be allowed to be— If you were allowed to go into court, then maybe the whole system would fall apart, I would think.

SENATOR DALTON: Has the history of this -- and I guess when you talk about history--

MS. CASEY: We are not talking a long history, no.

SENATOR DALTON: --we are talking about a year. Have you seen, as someone who watches over these types of things, a considerable number of people coming to the table and sitting down, in California, to clean up sites?

MS. CASEY: I have asked the California Department that, and they have a much farther along program for the remedial action plans for these various sites. They have a really good identification of who

are the responsible parties, who will come to the table, and who won't. It is, however, very young, but they have started cleanup at a number of sites and there is actually a report coming out on that, on how it is working, because they have to do that. If you want, I can make sure I get that to you.

SENATOR DALTON: Yes, I would love to see that. Can I ask one question-- Raymond sort of talked about-- What is "the club" in California? What is "the club" to get them to the table?

MS. CASEY: Several liability. It is not a club, it is a carrot.

SENATOR DALTON: Okay.

MS. CASEY: It is that they would then be judged by the several liability standard, and they would not have to pick up for somebody else. It is not just the damages or apportionment among the various people who are left holding the bag, so to speak. It is that they come to the table and only pay for that part of their conduct which caused the harm. Which is quite different from the Federal system-- and in fact, it will be interesting to see how the California system works, because the Federal overlay -- the Federal Superfund -- is so strong, it does create a tremendous problems for the states. You've got these two different systems.

SENATOR DALTON: Does Minnesota have a similar type of mediation?

MS. CASEY: No, I don't believe they do. They just passed their Superfund law two years ago. I believe it was effective 1983, and they have strict joint and several liability. They have an extraordinarily extensive set of damages that one can be held liable for in the personal injury side. After they passed that, there was a great hoopla over insurance, and Lloyd's of London made a rare, for Lloyd's of London, which does not like publicity-- But they just talked about the Minnesota law, and wrote in an exclusion for the Minnesota law and any policy that they wrote. So, that has had the effect of making the Minnesota Legislature go back and delete the joint and several liability for the personal injury side. But they have left it for the cleanup side. They have about 27 sites on the Federal list,

and about 68 on their own list, but the citizens are still angry because there is not a lot which has been actually cleaned up, which is a real problem. This is what we see all the time.

SENATOR LESNIAK: Sounds familiar. Get that on the record.

SENATOR DALTON: Would you -- I don't know if this was alluded to -- would you be a proponent of setting up some type of similar mediation board for victim's compensation? You made mention of the Victim's Compensation Bill, Mr. Klein, that I had introduced a year and a half ago -- obviously a very progressive bill. How does the victim's comp part fit in? Obviously, in this political climate, we are fooling ourselves if we think we are not going to have to address that issue.

SENATOR LESNIAK: This can be applied to third-party liability, this same system.

MS. CASEY: Yes. In fact--

SENATOR LESNIAK: As a matter of fact, you wouldn't be duplicating--

MS. CASEY: Congressman Breaux from Louisiana, I think, suggested that, in the Federal Congress.

SENATOR LESNIAK: In fact, you would avoid a lot of duplication in litigation, because you already apportioned the liability in terms of the payout. You just have to determine the causal effect, and the damages.

MS. CASEY: In answer to your question, Senator Dalton, I would have to say that at this time, we would not be a proponent, because at this point, we want to see that there is a little more evidence of damage before we set up any more compensation systems.

I don't know whether you are familiar with it, but Minnesota did quite a study on whether or not there were victims in Minnesota. What they came up with was at some point, there will be somewhere between 10 and 100, which was not a very helpful analysis.

SENATOR DALTON: Well, Minnesota obviously is not New Jersey. I mean, we are the second largest home to the petrochemical industry--

MS. CASEY: That's true, absolutely.

SENATOR DALTON: —and we have the largest number of Superfund sites, so if it is going to happen, unfortunately, it is going to happen here. And the question becomes, as representatives of the insurance industry, do you want to attempt to address victim's claims now, perhaps under certain parameters? For instance, a person claims a loss of income because of exposure to a site. And now, this person is sitting home; he or she is not only losing income, he or she is also going to a doctor, with some pain or suffering. If you don't somehow address that at least initially, and say, "Listen, the causal relationship is still in question, but we want to at least address this question now, so that we are not going to get literally bombed later on, financially."

MS. CASEY: I couldn't agree with you more, and neither could our companies. We do want to address that issue; in fact, the only reason we wanted the cleanup program was because they told us that was the only thing that Congress would listen to us about. But we have subcommittees at very high levels which are dealing in the insurance industry with trying to come up with ideas for a facility, or something, that would help to be there, to compensate people for third-party injuries.

And we looked into a lot of ideas: group health insurance things-- We continue to study those, and we would very much want to be a part of that. Our concern is that a lot of the compensation systems -- people always drag out the black lung as an example -- but we are concerned about how those compensation systems are set up. The one in Minnesota, which went through, would be so expensive to industry, that in fact, industry threatened to leave. So we would want to be part of it, and we are trying to study the issue.

SENATOR DALTON: Mr. Klein, have you looked at that bill yet?

MR. KLEIN: We looked at it, but in all honesty, we have not taken a fresh look at it within the last few months. But we did--

MS. CASEY: Our Committee looked at it last year, but--

MR. KLEIN: Forgive me, but I don't recall whether there was a provision in that bill which also permitted recourse to the courts as an additional route. And if there is, that is one of the problems.

MS. CASEY: Yes, we would want an exclusive system, because what we found with the 301-E study-- Do you remember that, the victim's study?

SENATOR DALTON: Yes.

MS. CASEY: --Is that they could go from one system, and finance through the administrative compensation system all their expert witness fees, lawyers' fees, into the tort system where they could get a much higher settlement and we would be paying a lot of money on that.

SENATOR DALTON: Wouldn't there be a payback to you if, in fact, there was a higher settlement reached in the tort system?

MS. CASEY: There were supposedly barriers between the two, but our feeling about that was that they just did not work. And we priced that compensation system as costing American industry \$28 billion per year, just on the first part.

SENATOR DALTON: Just to re-emphasize what I said, however-- Given the problems that we have here in the State, it just seems fruitless to me for us to, in any way, attempt to minimize the potential liability of the industry without, at the same time, acknowledging some sort of compensation system for the victim. And I think--

MS. CASEY: We are in agreement with you on that.

SENATOR DALTON: --Mr. Chairman, that is just a suggestion to the Commission. I think we have to pursue that as a two-pronged approach.

SENATOR LESNIAK: Wouldn't superimposing the arbitration system on the current tort liability system at least be an improvement over the situation we have now?

MS. CASEY: I think so. If you had a mandated several standard in there, and if you did not require pickup of other people's shares--

SENATOR LESNIAK: And often, the share would have to be financed by some kind of reinsurance or underwriting, some kind of risk-- something or other.

SENATOR DALTON: You could even limit the awards that you get through an initial compensation system. And, as a result, that

really it does not make it-- Well, it does. It adds, somewhat, to the predictability of a risk.

MS. CASEY: Oh, yes.

MR. KLEIN: In the same sense that an artificial cap would, sure.

MS. CASEY: That's true. We would like to--

SENATOR DALTON: No, no, no-- I am not finished yet.

SENATOR LESNIAK: Neither am I.

SENATOR DALTON: Okay. What I am suggesting is, you still have-- If you are going to limit any potential awards via a victim's compensation system, then what you have to then say is, if in fact, the victim feels that he or she has been shortchanged in any way, then you have to give him some sort of recourse, don't you?

MR. KLEIN: From the victim's fairness sense, I suppose yes.

SENATOR DALTON: Yes.

MR. KLEIN: From an insurer's sense, from a business sense, with respect to all the amounts of money-- Obviously, everybody is in business for business purposes--

SENATOR DALTON: Sure.

MR. KLEIN: --but the amounts of money to set up this thing, to have the mechanism set up which, I am told, would be incredibly expensive and also, to have to face the possibility of continuing litigation costs. It is that duplication, and there is no magic to it. I am just restating my position.

MS. CASEY: And we may have to, as a society, accept certain limitations because of 60 years of-- I mean, we all go to McDonald's, we all use those plastic things, you have got those plastic things-- you have got them down in your cafeteria. Those things are very dangerous, and hard to dispose of. You know, we have got the benefits of that but there are going to have to be some trade-offs. The victims' movement-- Everybody today is a victim, and it is really-- I really hate that word, because it is not usually very accurate. But if you characterize somebody that way, then they seem to be entitled to everything, and maybe what we should be doing is really looking at paying for any medical expenses and future medical monitoring and

inconvenience costs for having to transport water. Maybe that should be right.

SENATOR LESNIAK: We'll bring Senator Kennedy in to talk about national health insurance.

But what I was about to say, is that I agree that if you loosen the causation requirements, which victim's compensation does--

SENATOR DALTON: That's right.

SENATOR LESNIAK: --then there certainly is an argument for limiting the damages.

SENATOR DALTON: That's correct.

SENATOR LESNIAK: I thought I had one other question.

MS. CASEY: You did want to know about some of the--

MR. KLEIN: Excuse us for a second. I feel like John Dean at the Watergate hearings, I have to speak to my counsel.

MS. CASEY: I'll give to you our proposal that we put forward in Washington, and I will tell you that everybody, but everybody, said that intellectually, it is tremendously sound. Politically, they felt that it was not very viable.

SENATOR LESNIAK: This is your third party liability clause?

MS. CASEY: Yes.

SENATOR LESNIAK: Yes. I, by the way--

MS. CASEY: The Federal what?

SENATOR LESNIAK: Third party liability clause.

MS. CASEY: Okay, yes.

SENATOR LESNIAK: I agree. I am familiar with it; I have been familiar with it for quite a while.

MS. CASEY: Even Mr. Slocum said, we have got to get to the point where we forget about some of this past stuff, and start so that we can have a future and for our children's children, have them operate in a fairly safe environment.

SENATOR LESNIAK: Oh, I knew I had a question. The arbitration system--

MS. CASEY: In California?

SENATOR LESNIAK: Right, or whatever. Whatever arbitration system that we come up with-- I hear that will cut down on litigation

costs, but I am not quite sure how, because if I were representing Exxon, as an example -- I don't represent Exxon -- I would argue over what my share is. I would argue over how clean is clean, which means I would want my experts in, and I am going to want my best defense attorney in, and Union Carbide, the same thing-- Do you believe that the arbitration system does cut back on litigation expenses?

MS. CASEY: People within our industry go both ways on that. Some people think arbitration is just as expensive as litigation; others feel that it is much better and it is easier to make your case, you don't have lawyers and court fees--

SENATOR LESNIAK: You don't have those nasty rules of evidence--

MS. CASEY: Well, yes.

SENATOR LESNIAK: --so you can have less competent attorneys who don't know how to deal with them.

MS. CASEY: Or you can have--

SENATOR LESNIAK: I found that.

MS. CASEY: Or, you can have quicker getting-to-the-bottom-line with this cleanup, which is, how much are you willing to pay?

SENATOR DALTON: You get an earlier bottom line.

SENATOR LESNIAK: Yes, I think it is-- I just have a pet peeve, quite frankly. This has nothing to do with the issue we are talking about today, but I have to get it off my chest.

SENATOR DALTON: Okay.

SENATOR LESNIAK: Senator Laskin does this all the time, so let me. In arbitration systems, attorneys can get by with very little knowledge of anything in terms of getting the facts on cross examination, evidence, or anything, because everything is so loose there, anything goes, and you don't have anything to worry about.

MS. CASEY: That's why I got an "A" in it in law school. (laughter)

SENATOR LESNIAK: And that is why I don't-- I have a problem with arbitration systems.

MS. CASEY: I agree with that. If the California system did not have a mandated several liability standard, and the ability to give

a good release to anybody who then comes up and says they are going to pay several standard, as is written into the law, then they get a release from future liability for cleanup at that site, unless there is some other kind of additional negligence that has happened, or some other intervening factors come in. If it did not have those parts of it, just the fact of arbitration would not be, in our opinion, good enough.

We did try, at the Federal level, after we talked about our big proposal and they said, "It's too long to read," we then tried to have some settlement procedures put through. To some extent, we have been successful with this Senate version, S-51, which has the Domenici-Simpson amendments, and that allows EPA to provide a release. It is discretionary, so we don't like that, but it allows certain kinds of procedural things, really, that help a little bit. It is not too good, but there is even a weaker version in the House, just to bring you up to date with what is currently happening. In the House, it's 2817. There are two versions of that, and there is actually a strengthening of the liability rules in those versions. We feel what is contained in the House provisions is very dangerous. For example, there is a health assessment provision there-- If any citizen thinks he has a health problem in the community, the EPA is required to just answer that by coming in and doing all this testing, thereby using up all the funds we have for cleanup, which is-- If you talk to EPA, that is what they are always concerned about, the funds for the cleanup. That is why they want to keep joint and several strict liability, all that stuff.

I am trying to think of what else I was going to--

SENATOR DALTON: Is third party liability your proposal?

MS. CASEY: Pardon me?

SENATOR DALTON: Senator Lesniak is familiar with it, I am not.

MS. CASEY: Oh, okay.

No, our proposal only deals with cleanup--

SENATOR DALTON: Oh, okay.

MS. CASEY: And I tried to say, the reason we did that is not because we were disinterested in the third party problem -- not at all -- but because people told us this is the year that Superfund is going to be reauthorized, and the only issues they will listen on is cleanup because the Superfund does not allow bodily injury and property damage as a cause of action. Yet, in its current--

SENATOR LESNIAK: Yes, but RCRA does.

MS. CASEY: No, RCRA does not do that. It requires financial responsibility to cover third-party claims, but it is supposed that the third-party claims will come under State law, which was something that the insurance industry felt they could deal with at the time those things were promulgated, which was in 1982. That was very different from what is now happening. The House of Representatives wants to put in a whole Federal cause of action. They are perceiving many people who would like to come into Federal court and sue, using all sorts of different evidence than is currently allowable at the state levels, and different theories of liability, as well.

Okay?

SENATOR LESNIAK: Anyone else? Thank you very much.

MR. KLEIN: Thank you very much, Senators.

MS. CASEY: Thank you, Senators.

MR. KLEIN: We will make available to you through the Task Force an updated version of that survey, spelling out the Jersey statutes as well the Federal ones, if you wish, as soon as it is available.

MS. CASEY: Could I add two other things? Pardon?

SENATOR DALTON: Were you going to-- Mr. Klein indicated that there are several recommendations made by Commissioner Gluck. You, as one of the representatives of the industry here-- I would assume that you were going to attempt, through the Chairman, to seek some sort of a clarification.

MR. KLEIN: Yes, see it in writing, study it, and meet with them as expeditiously as possible.

SENATOR LESNIAK: If you do that, I would like to be included as a representative of this Commission.

MS. CASEY: Given that you are interested in what is also going on in other states, I would just like to make two small points. One is that in Vermont, they recently passed a Superfund law that was effective just this year.

SENATOR LESNIAK: Vermont?

MS. CASEY: July-- In Vermont, right. And that was a key state because Senator Stafford, who is big in the Congress and the public environmental committees -- he is a Chair of that -- His state went out and copied much of the Federal Superfund. However, they exempted municipalities from the strict joint and several aspect of that law and said specifically that municipalities shall only be governed by a several standard, because they were aware. Now, how that will, in effect, work with the Federal law is anybody's guess as to how the courts are going to construe these two laws in opposition for municipalities, but that does create a problem for them.

The other thing that I just said--

SENATOR LESNIAK: That is for cleanup. That does clarify third party liability claims.

MS. CASEY: Pardon me? It does not-- It is silent on those.

SENATOR LESNIAK: Oh, it is silent on those. It could, if it had.

MS. CASEY: Well, in a common law nuisance action in court, I suppose, it could say, well, we should hold the municipalities to a several standard.

SENATOR LESNIAK: Right. Okay.

MS. CASEY: The other thing that I would just like to remind you all of is that there is a terrific proliferation of these financial responsibility requirements, for everything from underground storage tanks to you name it, and there is a due date -- I am surprised that the fellow from EPA did not mention it in greater detail -- of November 8. Companies are supposed to be in compliance with these financial regulations and they will not be able to. The state of Massachusetts just decided, in its Department of Environmental Quality, that they should recommend to their Legislature that they be able to waive these requirements, because nobody was going to meet them. So, all of the

state legislatures are going to have quite a problem, because the Federal government— I don't know if I am explaining this well— The Federal EPA may very well say, "We don't want those regulations to be effective as of November 8. We are going to waive that requirement." But if they are already on the state books, as they are in New Jersey, Massachusetts and about 48 other states, then those states have a problem.

SENATOR LESNIAK: Those are regulations, though.

MS. CASEY: Right.

SENATOR LESNIAK: We haven't passed any laws in that regard.

MS. CASEY: No, but you might have to pass a law which would allow your Department to waive the regulations, which is what Massachusetts is going to have to do. And I just heard from the Ohio EPA yesterday on this same subject. They are looking to be able to do that.

MR. KLEIN: There is a bill before the Legislature now, A-667, which deals with underground storage tanks, but I am not exactly sure where that is.

SENATOR LESNIAK: We are.

SENATOR DALTON: We are very much aware of it.

MS. CASEY: That is another area where there are--

SENATOR LESNIAK: Senator Dalton released it from his Committee a couple of months ago, combined it with my bill and made it the same.

SENATOR DALTON: It is now called the Lesniak bill.
(laughter)

SENATOR LESNIAK: Wrapping it up, I think— Frank Gater, right? President of the Professional Insurance Agents of New Jersey.

FRANK GATER: Thank you, sir.

SENATOR LESNIAK: Is anyone else here to testify?

Okay Frank, you have four minutes.

MR. GATER: I am passing out the text of what our statement is today, and I am going to depart from it because much of what has already been said would just be duplication.

We are a trade association representing about 8,000 agents and their employees. I guess the first point I would like to make, and make strongly: As we became part of the Task Force on environmental issues, for the first time in my 28 years in the insurance business, I saw a uniform front by the industry. Everybody, for a change, was agreeing that this was a problem that had to be dealt with, and it really is a social problem and not just an insurance problem. That is rather unique, because we generally never agree on everything.

SENATOR LESNIAK: I have to say that I don't believe that is good, but I disagree also with everybody else, so don't mind me.

MR. GATER: We also support Senator Lynch's and Assemblyman Foy's bill as a first step toward helping the municipalities' problem, which is in a crisis state at the present time. Although I hope everybody recognizes, at least we believe, that that is not the real problem. The problem still seems to be the awards coming from our court system, which I think is where we are going to need to get some real reform. I guess that is my real encouragement, to take a look at the court system and what they are giving out, because the awards are just too high. The industry can't afford it, and we can't have businesses like taverns going around with no insurance, which of course is happening right now. I personally have had some clients that just can't afford to buy the coverage.

SENATOR LESNIAK: Let me ask you-- I have heard the testimony. You can insure pools, right? That does not take business away from them-- not saying that that is your purpose, okay, but just--

MR. GATER: Yes, you can.

SENATOR LESNIAK: So you don't really oppose pools per se, do you?

MR. GATER: We really oppose the entry of the government into pools, if the government is going to finance the pooling mechanism, because ultimately, what will happen is, you will have the bad risk going into that pool, you are going to have the problem of the citizenry at some point being asked to come forward and pay that bill. So that is our objection to the pool.

Our real offer to you today, Senator, is if we can help you in any way, we want to. We are not turning away from any solution or anything we can do to help — we will be glad to. It is this kind of Commission, I think, that is important to find the solutions to the problem. That is really what we need today.

SENATOR LESNIAK: I can appreciate that. Senator?

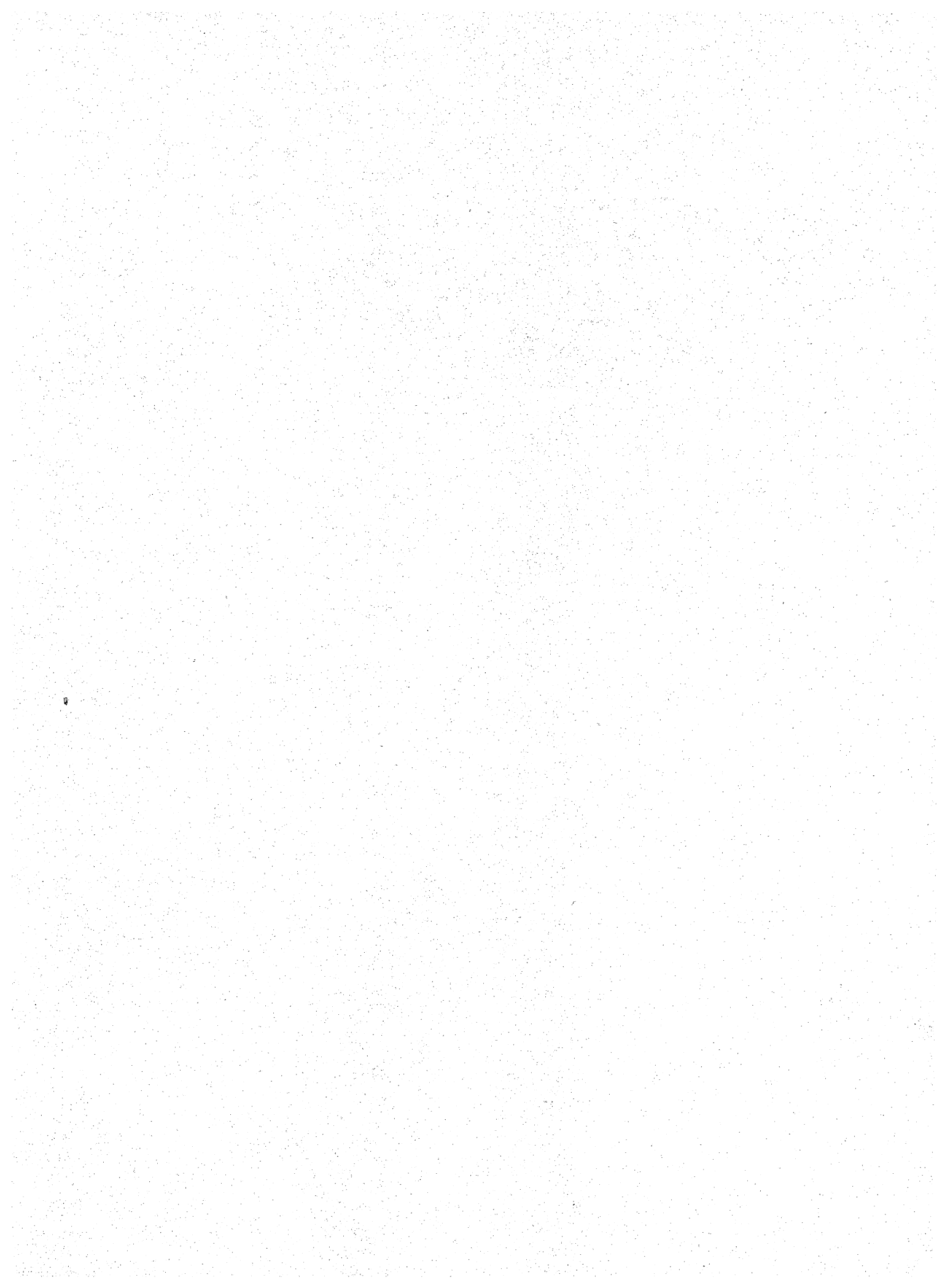
SENATOR DALTON: No questions.

SENATOR LESNIAK: Thank you very much for your testimony.

MR. GATER: Thank you.

SENATOR LESNIAK: Thank you everybody, and that is it for today.

(Hearing Concluded)



APPENDIX

**STATEMENT
OF THE
AMERICAN
INSURANCE
ASSOCIATION**

BEFORE
NEW JERSEY LEGISLATIVE ENVIRONMENTAL IMPAIRMENT
LIABILITY INSURANCE STUDY COMMISSION
ON
ENVIRONMENTAL IMPAIRMENT LIABILITY INSURANCE

State House Annex
Trenton, New Jersey
October 24, 1985



The American Insurance Association is a national
trade organization of casualty insurers.

PROFILE

The American Insurance Association is a full-service trade organization of casualty insurance companies. In its present form, the association combines three earlier organizations. One of those, the former National Board of Fire Underwriters, was organized in 1866, making it one of the oldest trade associations in the nation.

The various departments provide members with up-to-date intelligence on legislative, regulatory, judicial and technical developments relating to our industry. The AIA also maintains liaison with insurance regulators, federal and state lawmakers, other state and federal government officials, insurance and non-insurance industry groups and media—supplying information and assistance on issues of mutual concern.

A countrywide system of regional offices and local legislative counsel ensures prompt and rigorous attention to casualty insurance matters. At the same time, technical specialists from disciplines as diverse as law, economics and engineering educate members and outside publics on developments that may affect the industry and its services to the insurance-buying public.

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Good morning. I'm Jeffrey Klein, Associate Counsel for Government Affairs in the New York/New Jersey Region of the American Insurance Association. At my side is Ms. Patricia Casey, AIA Counsel, with expertise in the area of general liability insurance and environmental matters in particular. Our Association represents 178 property and casualty insurers that account for approximately 43 percent of the general liability premiums written in this State. Included in our membership are three prominent domestic insurers, Chubb and Son, Crum and Forster and the Selected Risks Insurance Company.

We will try to provide an overview of our Association's position with respect to availability and affordability problems affecting the environmental liability insurance line; we will then attempt to respond to some statements and suggestions made at the two hearings held to date as well as make several suggestions for legislative and regulatory action which would help improve the climate in this State concerning this troubled line and which in turn we hope would ameliorate some of the insurance problems which you have been addressing.

Several axiomatic principles should be laid down at the outset. While as discussed below some part of this problem arises from the insurance underwriting cycle, it is our belief that this availability/affordability problem (to a much greater extent than others in the past) has arisen because of a culmination of increasing litigation, adverse judicial interpretations and enactment of what we view as extremely severe federal and state statutes, the combination of which has made environmental impairment liability insurance simply uninsurable. This uninsurability arises from the fact that underwriters cannot with any degree of certainty gauge the risks involved and

the potentiality of liability. Secondly, while we advocate and support various changes in New Jersey's legislative scheme, it must be understood that the interrelation of the state statutes with federal statutes, principally the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA") commonly referred to as "Superfund", is so great that full improvement will only come if ameliorative changes are made on the federal level. This State and this Commission have taken the lead in addressing these environmental matters and to the extent that suggestions have been made for changes at the state level, we are ready and willing to support them. We must start somewhere and we hope that this Commission's report culminates in a package of recommendations which address the problem, (both for public and private entities) and we believe that the problem can, and should, be addressed at least in part, at the state level.

(I)

The Underwriting Cycle

Much has been said at the prior hearings about the underwriting cycle, insurers' cash-flow underwriting and bad business practices. There is no question that insurers take a portion of the responsibility for current availability problems. However, an overview of what has happened and where we are would be helpful.

There is no question that the property and casualty insurance industry is subject to a cyclical situation affecting industry growth, profitability and pricing patterns. While liability concepts and demands for coverage have

expanded generally, leading to the industry's long-range growth, inevitable short-range economic trends have led to up and down cycles. Traditionally, these cycles have been of about four years duration. Just as demand for insurance is influenced by the general health and growth of the nation's economy, supply is influenced by other basic economic trends. Supply or capacity in our industry is directly related to insurer surplus, i.e. the uncommitted funds that stand behind the liabilities undertaken by insurers. The amount of premiums that safely can be written by an insurer are viewed by regulators and managers alike as a multiple of surplus. The normal rule of thumb is a ration of two or three dollars in premiums written for every dollar of surplus. The amount of surplus in the industry is not only affected by factors like the health of the stock market, which affects surplus investments, but also by underwriting losses or profits that expand or contract surplus and by the amount of new capital flowing into the industry. When insurance prices are at the high point of the cycle, new capital is drawn to the industry, which leads to price cutting because of the expanded supply. Eventually, price cutting leads to underwriting losses, which impact negatively on surplus growth and discourages capital inflow. This reduction of supply, in turn, leads to a firming of prices and the completion of the normal cycle.

Against the backdrop of these long-range trends, there are recent trends that have made the current market cycle different from others in the past. Our industry is just beginning to emerge from the longest down cycle in recent memory. Abnormally high interest rates in the late 1970s brought substantial

inflows of new capital to the property and casualty industry. Vigorous competition for market share led to "cash-flow" underwriting whereby insurers were willing to accept underwriting losses in anticipation of high levels of investment income on loss reserves that would produce a bottom-line profit. This volatile competition and cash-flow underwriting were especially evident on "long-tail" coverages like environmental liability where many claims are paid out years after the premiums are collected. The high interest rates of the late 1970s, however, did not continue, and underwriting losses turned into net losses after accounting for investment income.

An unbroken string of underwriting losses began in 1979 and grew at an average annual rate of \$3 billion through 1983. In 1984, underwriting losses jumped \$8 billion to \$21.3 billion. Underwriting losses for the six years 1979 through 1984 totalled \$55 billion. With investment income falling far behind underwriting losses, the industry's pre-tax operating income--the combination of investment income and underwriting results--plunged to a negative \$3.8 billion in 1984. The experience on commercial liability lines has been particularly negative, and the loss experience on general liability, (which includes environmental liability) leads all lines of insurance. For general liability insurance in 1984, the overall industry combined loss ratio (losses and expenses divided by premiums) was 152. This means that the industry paid out \$1.52 in losses for every dollar in premiums collected. The Insurance Services Office, a statistical and rating organization, reported that insurer surplus fell approximately 10 percent. ISO has estimated that the capacity shortfall will be \$7.5 billion or 5 percent of the market in

1985, \$22.6 billion or 14 percent of the market in 1986, and \$32 billion or 18 percent of the market in 1987. It has also been suggested the 91 percent of this shortfall over these three years will be in commercial lines. In the commercial area, the combined loss ratio was 129 percent in 1984 and by 1985 had deteriorated to 152 percent. The loss of surplus has been occasioned by losses in most commercial lines, particularly environmental and product liability.

Reinsurers have reacted to these conditions by withdrawing from the markets. They can't fathom the problems affecting the liability system.

There are many who believe that an upturn in "the cycle" and increased premiums will eventually lead to a restoration of insurance market soundness so that buyers may once again find a more stable market. There are many who feel, however, that the liability system itself has deteriorated beyond the capability of the insurance industry to restore its stability through mere premium increases. The satisfaction of demand for insurance capacity for environmental injury compensation must come from the same capacity base which provides liability for all the liability and property casualty lines, so that unless capacity expands, the resources to provide this coverage must come from some reduction in other lines of insurance. One thing is clear: insurers, regulators and others have all been to some degree at fault with respect to some of these excesses that have taken place but we must work together to find a solution to the problem before us.

(II)

Underwriting Uncertainty

Environmental injury compensation for bodily injury, property damage and cleanup costs is in an embryonic stage. There are uncertainties, ambiguities and unresolved questions in all facets of this type of liability. To understand insurers' concerns, it is helpful to understand what insurers do and how they do it. Then one can see how hard it is to apply these operations to environmental injury compensation. Before it can spread risk of any kind, an insurer must assess its financial position. It must determine how much risk it will spread and where it chooses to accept that spread, i.e., to which types or lines of insurance to allocate its resources. The underlying financial determinant of an insurer's capacity is its surplus. The loss ratio for various lines differs somewhat in relationship to the book of business that the insurer takes on. In lines with greater certainty, the ratio can be lower; in those with less certainty, it should be higher. The liability lines, where losses can be paid years after the policy is written and where often claims are not known about until years after having occurred, are called "long-tail liability lines" (e.g., medical malpractice, product liability and environmental liability). These long-tail lines are the most volatile, least predictable and most risky.

The individual insurance company uses its resources to make a determination of the degree of risk presented by any particular insured. In any line of insurance, such as environmental injury where there is a limited amount of statistical information, the process of risk management and

assessment is extremely difficult. The insurer cannot measure against a statistical notion which offers no guidance and predictability for likely future outcome. It is here that underwriting judgment and skill make the difference between success and failure. The insurer, operating in this climate, must decide which insureds to accept and how much premium to charge.

The first step in such risk management is to identify a firm's pollution liability exposure. This involves the use of engineering staff of the insurer or retained engineering consultants to determine with what types of chemicals and processes the insured may be engaged, and to determine what regulatory standards and policing powers may be exercised by the federal, state or local governments over the insured and its activities. The insurer will have to consider the characteristics of the products with which the insured deals. Also, their approach and attitude toward storage, transportation and disposal of substances; their current practices in engineering and safety; their locale in terms of geology and pathways of exposure; as well as local attitudes on environmental liability and local law. A history of past activities and complaints is also significant. To the extent that it is available, some estimate of the likelihood that there will be either sudden or gradual releases of toxic substances from the firm's site is warranted. Of particular significance would be the firm's entire attitude toward the safety of its community and of its employees. Its relationship to regulatory bodies and past conduct in this regard will all be factors influencing an underwriter's determination to accept coverage.

The insurer must also be alert to the opportunity to supplement a contract of indemnification. Here the uses of deductibles, retentions, excess, umbrella, and self-insurance plans come into play. Also, in some instances bonds and letters of credit may be considered. The existence of various risk management alternatives must be considered. The possibilities for controlling and preventing risk through enhanced safety practices or through the transfer of dangerous activities to others more skilled to handle them must be measured. The insurer may also have to consider various ways in which the insurance arrangements of the insured may make premium more affordable. These include arrangements where insureds retain a degree of coverage either through a deductible or through any of a number of various insurance arrangements which spread the risk of loss among several indemnifying parties

The insurance underwriter's judgment in this area is clouded by uncertainty in every aspect of the risk. Neither science, medicine, judicial law nor judicial contract interpretation offers any significant stable guidance in this area. Every one of these facets which go to determine liability is in a substantial state of flux. There is even a glut of scattered legislation both at the federal and state level which will indicate a tendency toward expanding or changing liability and damages.

We have seen remarkable developments in science which indicate a substantially increased ability to make determinations on the existence of minute and trace particles of individual substances in water, air and land. Science cannot with a degree of certainty identify the sources of those particles either by pathway or by identifying the party whose particle has entered the pathway and migrated from where it belongs. Science can in some

instances identify physiological changes caused by exposure to substances, but cannot always identify the nature and extent of that change. Whether changes are necessarily harmful is another difficult issue.

Recent experience in the liability system demonstrates that as far as that system is concerned, the difficulty that medical science has in answering these questions of causation makes the liability field fertile for the exercise of legal imagination and ingenuity. Science may be able to tell us that substance "x" may cause a particular type of disease, but it is important to note, that with very few exceptions, causal connection remains a weak one in most instances. Even where that causal connection is accepted as correct, science has not been able to tell us with any regular degree of certainty whether a particular illness in a particular individual was caused by exposure to a substance or whether it was a result of other causes not related to substance exposure. This means that the pathway to recovery through the liability system for many injured persons is difficult to traverse. The injured person must normally demonstrate in many instances that the particular disease present in their body was caused by exposure to a substance and activity of a particular defendant. Unfortunately one cannot readily identify which individuals out of a group had their illness caused by exposure to the defendant's activities. Courts and legislatures are wrestling with this fundamental problem and have repeatedly attempted to reverse the burden of proof and thrust it on the defendant. In many cases this turns out to be unfair.

The courts have dealt with these problems in numerous cases, with ambiguous and unpredictable results. Nevertheless, the development of decisions by the judiciary to cover a host of environmental issues continues.

A series of decisions beginning with Sindell v. Abbott Laboratories, 26 Cal. 3d 588, Abel v. Eli Lilly, 94 Mich. App. 59, Collins v. Eli Lilly #449-596 (Wis. Cir. Ct.), Bichler v. Eli Lilly, 55 N.Y. 2d 571, and followed by several other decisions, have crafted in some states a remedy for persons injured by products which are essentially fungible, where the injured party cannot identify the manufacturer of the particular product that caused the claimant's injury but where the claimant can identify, depending upon the state, either a manufacturer of that substance or a substantial number of such manufacturers.

Another major course of liability decisions relating to environmental liability involves the case of Beshada v. Johns Manville 91 NJ 191 (1982), right here in New Jersey. In that asbestos liability case, the State Supreme Court determined that a manufacturer could be held liable even if its conduct at the time it was performed met all of the best available scientific and technological standards and even if at that time it was not possible to determine whether the substance the defendant sold was harmful. The court appeared to imply in the Beshada case that there was ground for liability at least in part for a failure to warn of a hazard of which it was impossible to discover. That decision has been followed in a few other states. However, the New Jersey Supreme Court in a subsequent decision, Feldman v. Lederle

Laboratories, 189 N.J. 424 A.D. (May 10, 1983), 97 N.J. 429 Sup. Ct. (June 1984), decided to limit the holding in the Beshada case to the facts of the Beshada case. The fact that the decision in Feldman limited Beshada to its facts is of little comfort to insurers who must recognize that the impact of those two decisions is that whenever the court decides to, it can simply impose the Beshada rule on any particular substance.

Other courts have been busy in crafting expanding liability under determinations of what kinds of damages may be awarded. In the case of Ayers v. Township of Jackson, 189 N.J. Super. 561 (Ocean County, 4/5/83), a verdict (later overturned in part, see below) was rendered of approximately \$15 1/2 million which included compensation for disruption of lifestyle, evidently arising from a need to use alternate water sources, and also sums for medical monitoring to determine whether persons who were not presently ill might possibly become ill as a result of exposure to contamination of well waters by seepage from a municipal dump site. Similar sums of money and types of damages figured prominently in the Love Canal settlement of \$24.5 million and the Agent Orange settlement of \$185 million.

In addition, there have been some novel decisions attempting to find coverage notwithstanding various provisions expressly written in policies. These policies were intended to cover sudden and accidental and unintentional events which take place off the property of the insured and cause property damage and personal injury. Insurers did not believe this could lead to determinations that coverage would be granted for cleanup of the insured's site and property for events occurring over many years with the complete knowledge of the insured. Yet some cases have come to that strange result.

The crucial operative provisions in most of these policies included:

- The definition of "occurrence" as "an accident, including continuous or repeated exposure to conditions, which results in bodily injury or property damage neither expected nor intended from the standpoint of the insured" and;

- a pollution exclusion" included in most CGLs which read as follows:

"This insurance does not apply . . . (f) to bodily injury or property damage arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any water course or body of water; but this exclusion does not apply if such discharge, dispersal, release or escape is sudden and accidental."

- an owned property exclusion which said coverage would not apply to "property damage to: (1) property owned or occupied by or rented to the insured, (2) property used by the insured, or (3) property in the care, custody or control of the insured or as to which the insured is for any purpose exercising physical control."

- a definition of "property damage" meaning (1) physical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom, or (2) loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an occurrence during the policy period.

Other language in insurance contracts served to limit an insurance company's exposure on an occurrence basis to specific dollar amounts. The intention behind this language was that an insurer, recognizing that any liability system contains a degree of unpredictability, would specify a limit on the amount of money that that insurer could stand to lose as a result of a particular event.

One now infamous case was Jackson Township Municipal Utilities Authority v. Hartford Accident and Indemnity Co., 186 N.J. Super. 156, 451 A. 2d 990, (1982). The court determined that the particular occurrence involving the operation of a municipal dump site was an accident because the insured did not actually intend the injuries which occurred. The court further decided that "sudden" meant "accidental" and that therefore the fact that the permeation of groundwater occurred over a twelve year period of time was irrelevant to the question of coverage. There is a line of appellate decisions in several states which adopted essentially the same reasoning as the Jackson Township case.

The liability landscape is further clouded by state legislative actions. New Jersey has statutes (delineated in our environmental survey distributed to you today) which stand out as creating enormous potential for liability for anyone involved with the handling of hazardous substances. The Spill Fund Compensation and Control Act, N.J.S.A. §§58:10-23.11 et. seq., in particular, presents certain problems, tracking as it does the federal superfund liability scheme, with the "responsible party" concept. This works first by defining a number of classes of persons who may be "responsible" for the "release or

threatened release" of a hazardous substance. These are generally anyone who owned or operated a facility where the substance came to be located, anyone who arranged or contracted for the treatment, storage or disposal of the substance, anyone who accepted the waste for transport, who knew or should have known that the substance was hazardous and knew that the disposal site was operating in violation of the law, may also be liable.

While the federal law makes responsible persons liable only (and it is currently being litigated whether the standard is strict, joint, and several liability) for cleanup costs and for damages to the natural environment, New Jersey's law is broader in that it makes a responsible person liable for third party damages due to economic loss. That law provides, however, that damages are to be those resulting from a loss of income or a loss of earning capacity due to real or personal property damage above a de minimis level (10 percent of the amount the claimant derived from the property must be lost). The Spill Compensation and Control Act allows the administrator of the fund to disburse money for damages to third parties and then to seek recovery from the owner or operator of a "major facility" up to a limit of \$50 million. This type of facility is held to be jointly, severally and strictly liable for all direct and indirect damages, including personal injury and medical expenses, resulting from the operations of that facility. Please note that even here, however, the New Jersey law leaves the limit of a \$50 million cap on liability. In environmental liability under the Superfund statute, a party who places waste at a disposal facility may be liable for an entire cleanup even if its waste was but a miniscule portion of the waste at the site.

Further, that party may be liable even if none of its waste has been released from the site. It can thus be liable even where it bears no causal relationship to the damage to the environment.

A crucial common thread in many of the court decisions and one which illustrates the difficulties underwriters face is that they are all retroactive as to both defendants and insurance policies as well. Manufacturers, businesses and as a result, their insurers, can be found liable today even where their conduct was entirely legal and proper at the time it was undertaken. Environmental liability has been imposed on businesses whose activities were not only legal but even required by regulators at the time.

Insurers are concerned about their ability to survive under a liability system which is retroactive, imposes liability without causation, uses the most extreme versions of joint and several liability, and for which coverage has been found only by the most extreme distortions of insurance contract language so that insurers do not have the ultimate resources to repond. To the extent that the insurance industry could anticipate liabilities of the variety imposed by schemes such as the federal superfund, they sought to exclude such coverage from their policies. Superfund itself has evolved into a tremendous search of insurance coverage for litigation expense. These aspects of unfairness are the same elements of a liability scheme which render it uninsurable. An insurer cannot assess the loss potential and risk characteristics of any applicant for coverage. The firm may be exposed to total liability for losses primarily caused by the acts of others. It may

also be held liable even where its own activities were faultless and in complete compliance with the law. The system in place now provides no safe harbor and offers no reduction of liability for good conduct. It is a system entirely composed of punishment with no reward for good behavior. A liability system of this nature cannot be insured. It may well be that the pursuit of prominent, easily identifiable defendants who have kept records and behaved responsibly will result in bad actors which are relieved of their liability.

(III)

Impact of these Liability Schemes

It is also clear that, for example, the federal Superfund liability system has spawned a massive round of litigation in which the federal government has sought to compel responsible parties to pay for cleanup costs or to undertake cleanup activities themselves. Because of the enormity of the costs at stake and the perceived unfairness of the CERCLA liability scheme, potential responsible parties more often than not have contested vigorously enforcement actions that seek to impose cleanup liability.

Enforcement actions, in turn, produce litigation among potential responsible parties seeking to apportion liability and by these parties against their liability insurers. This litigation is and will continue to be complex, time-consuming and incredibly expensive. Parties suing their general liability insurance carrier seek, at minimum, coverage of their defense costs and indemnification of whatever cleanup liability is ultimately imposed upon them.

The American Insurance Association has commissioned the consulting firm of Putnam, Hayes and Bartlett, Inc. to investigate the magnitude of total CERCLA (Superfund) litigation costs. They have completed their report and their conclusions are startling:

-- Likely litigation costs range from \$3.5 to \$6.4 billion compared to \$14.6 billion in direct costs of cleanup. The best estimate of the litigation costs is \$5 billion.

-- Litigation costs are substantial. They represent 24 to 44 percent of direct cleanup costs.

-- Private party litigation costs account for 79 percent of this total cost, while government costs and coverage litigation costs account for 15 percent and 6 percent, respectively.

By comparison to asbestos litigation costs, superfund litigation costs are at least as large and possibly more than twice as large as asbestos litigation costs.

If two-thirds to three-quarters of Superfund transaction costs could be eliminated, then, using the best estimate of litigation costs, 400 to 450 additional sites could be cleaned up at no additional cost to society.

The report's Superfund litigation cost estimates are conservative, that is, actual costs may exceed these projections. The report assumed some reduction from current litigation cost levels in these projections. If costs continue at present levels, total litigation costs could exceed \$8 billion, 55 percent of direct cleanup costs.

We believe this experience on the federal level is very relevant in New Jersey, and what we are suggesting is that these liability schemes cause too much focus on litigation and associated costs and not enough on actual cleanup. What's more, as has already been stated, the crisis in the tort system for environmental exposures has caused underwriters to determine that such coverage is uninsurable, and hence the current availability problem.

(IV)

Responses to Others' Comments

Before we move on to a discussion of what we view as potential solutions for consideration by this Commission, we wish to address some of the comments made by others who have testified previously. First, much as been said of the underwriting cycle and cash-flow underwriting and we believe we have addressed that above. Secondly, with respect to comments by Congressman Florio concerning banking deregulation, we only wish to reiterate our position that banks have a unique role in commerce in our nation and that good reasons persist to this day for making sure that their roles are sharply defined and that they not be permitted through the rubrick of "financial services deregulation" to underwrite or sell property/casualty insurance generally; we have discussed our arguments concerning this issue in other forums in this State. But we do not see how lending institutions would find environmental exposures to be insurable, any more than insurers do. Much has also been said about the need for tighter regulation of the insurance industry in this State and we can only respond that, unfortunately, over at least the last decade or so, the regulatory environment has been extremely volatile and the system

itself so tightly confined as to prohibit insurers from being able to make long-range plans to expand or even maintain their present levels of business in this State. Insurers don't at present view this State as a particularly hospitable place to conduct business. Certainly, we hope that this will change. Finally, some have advocated partial or total repeal of the Commercial Lines Deregulation Act as a means of curbing the availability and affordability problems for environmental exposures. New Jersey, however, is one of only a small number of states with such an act and these environmental problems and availability/affordability problems are occurring countrywide. We respectfully suggest that the problems go much deeper and that they go to the harsh liability systems which have been created at the state and federal levels.

Mayor Grubb of the Borough of Park Ridge's testimony on October 15 concerning a risk-sharing system for towns and other communities, i.e. the formation of an "Intergovernmental Environmental Impairment Liability Fund", poses many interesting questions and clearly warrants further study. We wish to say only that with respect to the question of self-insurance pools, if that is what he has intended, that the same fundamental problems facing private carriers concerning availability of reinsurance, the tort system and the like, will face these pools and that they will have a similar degree of difficulty in writing these coverages without concomitant structural changes in the tort liability system.

Finally, we wish to comment on some of the suggestions made by Insurance Commissioner Gluck during her testimony on October 15. The Commissioner

recommended a four-point package of reforms. Her first suggestion concerned development of a system of mandatory apportionment of damages by an arbitrator based on actual causation, with payment of so-called orphan damages coming from a fund from polluting industries. As with her other three suggested reforms, we would be interested in studying them in more detail but we can say at this point that this first approach is consistent with our view that much of this problem has to be removed from the court system and addressed in a more logical, orderly and ultimately, less costly fashion.

With respect to her second suggestion, legislative or regulatory attempts to create binding definitions of issues such as sudden and accidental pollution, we believe that this issue clearly warrants additional study and we can say that our Association has been examining this question for some time. There seems to be a legitimate difference of opinion within our own industry whether or not such an attempt could be successful, i.e., whether any attempt to define certain coverages by statute or regulation (and a resulting attempt to exclude certain coverages) would be fool-proof and would withstand novel and creative court interpretations along the lines we've already seen in recent cases. But we think it's worth a try. In point three, Commissioner Gluck called for creation of a pooling arrangement backed by a governmental excess guarantee or reinsurance mechanisms. We're not sure if the Commissioner specified whether this would be for private or public exposures. We note that such a mechanism would be set up through a surcharge on all commercial liability insurance policies as well as annual assessments on pollution violators. The Commissioner likens this approach to the federal

flood program with respect to this reinsurance. We would like to see the proposal in more detail before we can fully comment on it.

Lastly, the Commissioner called for maintaining strict liability for those who illegally dispose of hazardous waste and a change to a negligent standard for those charged with the beneficial activity of cleanup and mitigation of waste. As we will discuss with respect to "solutions" we believe that as shown, strict liability inhibits and does not promote responsible behavior and that it exacerbates and does not improve insurance availability for these polluting defendants. We would suggest that, to ameliorate the insurance climate for these exposures, that strict liability be repealed for a number of types of defendants, including transporters or generators of hazardous waste, but we would certainly support such a change for those engaged in cleanup and for public entities we well. We are heartened by the Commissioner's call that this Commission consider the findings of the New Jersey Insurance Task Force on Environmental Issues, of which we are a part, with respect to public entities: limited sovereign immunity, a state-of-the art type defense and a several (as opposed to joint) liability standard to determine if any further refinements are necessary. As stated, however, we believe that this type of proposal, taken together with other reforms, will improve the ability of insurers to provide insurance and we understand how imperative it is that cleanups throughout this State proceed as quickly as possible.

(V)

Suggested Solutions

(A)

Statutory Definitions of Coverage and Exclusions

During these hearings, there has been interest in this approach through which the State of New Jersey might by legislation or regulation attempt to undo some of the damage done by cases such as Jackson Township by defining what "sudden and accidental" means, or what other policy terms and definitions mean. We certainly believe that this undertaking is worthy of consideration and that if the Legislature expressly overrules the interpretations of many of those cases that that would be beneficial and desirable. As we have stated, however, our Association has been studying this idea during much of 1985 and different industry experts disagree whether this is doable and whether this feat would ultimately prove successful.

(B)

Claims-Made Policy

Our industry has worked to develop strong new contractual language that should prove less susceptible to unexpected judicial expansion and should increase the predictability of losses and the ability of underwriters to price coverage. Insurers have filed forms, which recognizing the uninsurability of environmental liability insurance under current law and scientific knowledge, would exclude from policy forms this coverage. Similarly, the Insurance Services Office has developed and is seeking approval of new claims-made forms

throughout this State and throughout the country, which will reduce pricing uncertainty on long-tail coverage lines. Under these forms, coverage will be provided for claims made during the policy year rather than for events occurring during that policy year that might produce claims many years later. This change to a claims-made policy will substantially reduce the lag in claims payment and the time period during which loss reserves are held subject to fluctuations in investment returns, both of which in turn will increase the accuracy of insurance pricing. We only suggest that approval of these forms will help ameliorate availability problems for some other lines (problems which have been touched on during the course of these hearings) and that it would help isolate the pollution insurance problem and enable all to address it as a unique and separate liability problem.

(C)

Contractors' Liability

We wish to express our support for the principles set forth in Senate 3206 by Senators Contillo and Dalton. This proposal, pending before the Senate Energy and Environment Committee, would limit the liability of cleanup contractors and engineers involved in hazardous waste cleanup activities for injuries related to those activities by changing the liability standard from one involving strict liability, without regard to fault, to one involving liability only for those acts which can be shown, by a preponderance of the evidence, to have been negligent. It would also create a rebuttable presumption that if such contractors and engineers used the best available

technology, at the time of such activity, that such actions were not negligent. We are reviewing this bill at the present time to determine if any further refinements are necessary. As stated, however, we believe that this type of proposal, taken together with other reforms, will improve the ability of insurers to provide insurance and we understand how imperative it is that cleanups throughout this State proceed as quickly as possible.

(D)

Tort Liability Changes

We urge support for the recommendations of the New Jersey Task Force on Environmental Issues, of which we are a part, with respect to changes in tort liability standards. We have examined the provisions of Senate 2545 and Assembly 3073, sponsored by Senator Lynch and Assemblyman Foy, concerning public entities' pollution exposures, respectively, and pending before the Legislature and we have done so as a first step because that proposal has received so much attention and is supported by various public entities experiencing pollution insurance problems. We would only suggest, for the same reasons cited in the Task Force's preliminary report, that because of the predominance in our view of the various environmental statutes, such as the Spill Fund Act and Major Hazardous Waste Facilities Siting Act, that the changes addressed in that bill with respect to the liability standards affecting public entities (obviously, with the exception of the limited sovereign immunity issue) be considered as well for other defendants which are the subject of causes of action arising out of pollution incidents; this for

the very reason that pollution exposures are presently uninsurable for all classes of defendants because of the uncertainty and indefinability of risk. State-of-the-art defenses and several and apportioned liability for contractors, transporters, generators and others, are necessary in order to limit the huge scope of damages that are obtainable under present statutes and the only way to bring some degree of rationality to an underwriter's attempt to define a risk. While we support a limited sovereign immunity for public entities, we would support a negligence standard for other types of entities, (as opposed to strict liability) at the very least for contractors and others charged with cleanup activities. We would also recommend at the very least that the changes we're espousing be made on a prospective basis to ensure as much as possible that risks which have yet to come into being are susceptible of being insured.

With respect to Senate 2545/Assembly 3073, itself, section 1 is intended to create an express negligence standard applicable to actions brought against public entities under Title 59, the Tort Claims Act. However, the present draft of Senate 2545, in its attempt to create an express negligence standard, does so through an "unreasonable" standard in section 1, line 10 of the bills. This differs from existing Tort Claims Act section 59:2-3(d) which provides that public entities not be held liable for discretionary actions unless the entity was "palpably unreasonable". The bill may in fact be creating a lesser protective standard for public entities in pollution cases than in other cases brought under Title 59. Even if the bill were amended back to "palpably unreasonable", we believe that the several environmental

statutes cited in our Survey which has been distributed today, would be judicially interpreted to take precedence over the provisions of the Tort Claims Act. We therefore urge consideration of a limited sovereign immunity which would exempt public entities from the huge liabilities they face under the environmental laws. We suggest that they not be liable unless they have been found grossly negligent or if a pollutant incident has resulted from gross negligent noncompliance with relevant federal, state or local law or regulation.

We also wish to state our support in that bill for a state-of-the-art defense for public entities, albeit in a slightly different fashion. We think it only logical that a public entity be permitted to assert that it used all the technology, precautions and processes available at the time of the incident in question as an affirmative defense in any action. However, we suggest that public entities, unlike major drug or chemical companies, may not have the sophisticated means to have "state-of-the-art" technology readily at hand. Instead, we support clarification of that provision to provide a defense to a public entity which did all it could to comply with all requirements imposed on it by federal, state and local laws and regulations. We believe that this is a more workable and realistic approach.

We also support the adoption of several and apportioned liability for reasons discussed here today. It would make it emanately easier, in fact it would be essential, before an underwriter could with any degree of certainty assess and price a particular risk, that it knows that the premium which it is collecting and the losses which it may pay out, concern the individual

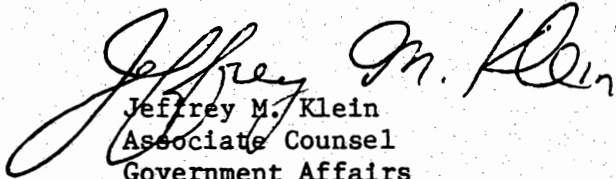
defendant it is ensuring. It is impossible under present circumstances for insurers to write coverage for a particular insured when that insured may ultimately be called upon to pay the damages caused by other parties as well, and for which no premium has ever been collected.

Finally, we believe that some of the more speculative damages, such as those for medical surveillance and loss of quality of life, should be prohibited in pollutant cases. Although an appeals court has overturned the \$8 million medical surveillance award in Ayers v. Township of Jackson (see Docket #A-2103-83T3, (Appellate Division, Superior Court, 1985), the trial court decision like others around the nation may foretell what is yet to come. Expansion of permissible damages awarded to environmental incidents victims to include emotional distress, medical surveillance and cancerphobia, involves expansion to damages that are speculative and non-quantifiable. What's more, they are uninsurable in the sense that they could not have been foreseen with any degree of certainty. Elimination of these damages would help reduce judgments and enhance the prospect for improvement in the environmental liability insurance picture.

We thank you for the opportunity to be present here today. Our

Association and our members stand ready to provide this Commission with any information which you may request. We commend you in your responsible effort to study this important problem which affects all of us here in the State of New Jersey. Ms. Casey and I will answer any questions you may have.

Respectfully submitted,

A handwritten signature in cursive script that reads "Jeffrey M. Klein". The signature is written in dark ink and is positioned above the typed name and title.

Jeffrey M. Klein
Associate Counsel
Government Affairs
New York/New Jersey Region

Testimony Before New Jersey Legislature

I am John Heher, Counsel for the Alliance of American Insurers. The Alliance is an association of over 175 property-casualty insurance companies doing business throughout the United States. We appreciate the opportunity to comment on New Jersey's environmental impairment liability insurance problems, and suggest some solutions including, reform of the tort and environmental liability laws as well as proper risk management..

The Alliance believes the legislature and governor must decide what proposals will create the best program to achieve the goal we all share - protecting the public health and environment through prevention and early detection of hazardous waste contamination and reclamation of hazardous waste sites. We believe it is possible to reach this goal without threatening the solvency of New Jersey's insurance industry.

After five years of federal Superfund experience, we know better what effect such environmental laws have on insurance markets. We have learned still more from the court decisions which have interpreted insurance contracts in a manner never expected nor intended by insurers.

Though you have heard it before, I cannot stress enough the impact of the Jackson Township decisions. In one of the Jackson Township cases, the court interpreted a provision in an insurance policy which excluded coverage for pollution except pollution which was sudden and accidental. The courts, found that despite this exclusion, the insurer should defend the policyholder for claims based on seepage that took place over a number

of years. In a bold stroke, the New Jersey courts have served notice that they intend to expand on the coverage for pollution damage under insurance policies.

It is very clear the courts are assessing liability for both past and present damages caused by hazardous waste contamination, based on current technology. Companies and their insurers must often pay for the failures of yesterday's technology - for what may have been yesterday's state-of-the-art disposal methods - as they are judged by today's standards.

The combination of strict liability, deletion of all but the most limited defenses and joint and several liability virtually encourages carelessness among unscrupulous or financially troubled waste handlers. They can be relatively certain that joint and several liability will enable plaintiffs to find someone else to pay for cleanup of a waste site: perhaps the transporter, another generator, the disposal site owner or operator, a subsequent owner or operator, the state or an unsuspecting municipality.

The expense of proving oneself innocent in an allegation of joint and several liability may run into thousands of dollars, yet courts too often find that, with no other paying defendant available, they must rule a "minimal" defendant jointly liable for the full cost of damages. Insurers facing such vague and uncertain standards must evaluate the merits of providing this type of coverage at all. In recent months, many have withdrawn from writing environmental insurance after finding the system too unstable to predict, or to price. To do otherwise in the current market and tort liability situation would be irresponsible to other

policyholders in too many cases. Insurers are being told by the courts that, regardless of policy language, age of the policy or the specifics of the incident, they must provide coverage.

When society first focused on environmental pollution, insurers responded with additional policy language to cover the business community's liability for third party damage caused by "sudden and accidental" discharge of toxic substances in the comprehensive general liability (CGL) policy. Insurers later developed the environmental impairment liability (EIL) policy to cover damage caused by some gradual pollution incidents. As pollution liability cases were litigated, however, in New Jersey and nationwide, courts interpreted policy language to cover damage insurers never intended to cover, and for which they had not collected premiums.

Legislators and courts continue to view insurance as a "deep pocket" funding mechanism for cleaning up polluted sites and compensating those who allege harm from toxic substances. Insurance, however, is a business which cannot survive as a mechanism for restructuring society and curing its ills.

The costs to indemnify many municipalities, towns and other local entities, as well as businesses, have risen to the point where they are such high risks that insurers are not able to provide coverage at any price. Indeed, some communities can no longer afford liability insurance premiums and may have to cut municipal services to retain viable insurance. Officials throughout the country say they are being swamped by a surge of liability suits and multi-million-dollar court judgments are straining their budgets, forcing cutbacks in services and in some cases

threatening bankruptcy. Many of the most devastating suits result from damages caused by pollution.

Municipalities, up to now, have depended on their insurers to support them when they face large losses, but insurers can no longer provide this service. Reinsurers have withdrawn from the American pollution liability insurance market, and without reinsurance, there can be no liability insurance. Reinsurance provides additional coverage capacity necessary for primary insurers when they accept large risks. Foreign reinsurers have withdrawn from the market specifically citing our unstable liability system. American reinsurers are being forced by their large underwriting losses to follow suit. As long as our tort system continues to seek, find and penalize those with perceived deep pockets, reinsurers will not make reinsurance available for risks with environmental overtones.

In many courts, strict, joint and several liability is applied retroactively to a "deep pocket" defendant -- one who has insurance. The retroactive application of liability compounds the financial impact both on New Jersey businesses which may produce hazardous by-products, municipalities which own, operate or license landfills, and their insurers. The broad application of retroactive liability will not necessarily lead to the cleanup of New Jersey's environment, but it may be additional motivation for businesses to locate outside the state.

The Alliance believes that non-negligent persons should not be required to pay for the negligent acts of others. We support a system of several liability instead of a strict, joint and several system, so that each party is responsible only for damages attributable to their own

actions. The joint and several liability system imposes unnecessary legal and insurance costs on relatively innocent parties. A "jointly" liable defendant, regardless of degree of fault, could be forced to pay an entire judgment if there are no other known or available defendants or other defendants do not have the ability to pay.

The imposition of strict, joint and several liability, thus, directly affects insurers' ability to provide coverage to municipalities and businesses dealing with hazardous materials. Insurance is a mechanism to spread risks. The premium for a pollution liability insurance policy should be determined individually by policyholder. Insurers consider the toxicity of the substances handled, the safety measures applied by the potential insured and the insured's claims experience.

However, under the court decisions cited previously, these factors are becoming increasingly irrelevant. Liability exposure, very simply, is becoming unlimited. If insurers were mandated to cover such risks, they would be required to divert valuable capacity now used to provide essential insurance coverage elsewhere. And, whatever coverage remained available would be far more expensive. Thus, a joint and several liability system penalizes all of us for the negligent acts of a few.

Toxic and hazardous wastes are by-products of today's standard of living. Disposal of toxic and hazardous wastes and clean up of waste sites is our problem as a society. It is better addressed from a social perspective than as an insurance problem. The environmental problem is so large it demands creative solutions, and the insurance industry is willing to participate in the search for answers, but not willing to agree to potential unlimited liabilities.

Insurers are facing the threat of those unlimited liabilities if they accept new pollution risks, and losing much more than anticipated in litigation costs and unexpected coverages read into old policies by the courts. Most important, the environment is not getting cleaned up. The original threat remains and continues to grow.

There are several effective ways to deal with this disorder in New Jersey, including legislation to achieve tort reform. Simply setting up a mandatory risk sharing mechanism to force insurers to provide coverage to municipalities, waste handlers and school districts at artificially low rates will not cure the underlying causes of the problem.

Those who favor this approach point out that these mechanisms will ease the problems of cities and towns by allowing them to readily buy insurance. But the relief would only be temporary because mandated pooling mechanisms for liability insurance in and of themselves do not address the underlying problem. They do nothing but treat the symptoms and postpone dealing with the instability in our civil justice system.

Longer lasting solutions which could help restore stability to the liability insurance market involve changes in the tort liability system.

We offer the following specifics:

- o Direct municipal pollution liability claims to an arbitration panel.
- o Modify the doctrine of joint and several liability to cover only damages caused directly by an insured company or governmental body, instead of making partially responsible parties potentially liable for all of a judgment because it is the deepest pocket in the neighborhood. There are those who

argue that joint and several has been part of the legal system for hundreds of years. But if age were the only criterion for a doctrine's validity, taxation without representation, debtor's prison, contributory negligence, and the doctrine of sovereign immunity should never have been abolished. According to the July, 1985 issue of the American Bar Association Journal, New Hampshire and Vermont have abolished joint and several liability. Other states, such as Nevada, Texas, Indiana, Louisiana, Oregon, Pennsylvania, Iowa, and Oklahoma have placed limitations on the doctrine. In an effort to make its environmental liability laws more reasonable, Minnesota recently deleted provisions which retroactively applied joint and several liability in its Superfund Law.

- o Establish a threshold for triggering pain and suffering suits. The threshold could be set at \$2500 or higher in incurred medical expenses plus a requirement that there was permanent disability or disfigurement.
- o Cap recoveries against public entities by occurrence. At least 28 states have placed some kind of limit on damage awards against cities, averaging \$150,000 for each person injured and \$350,000 for each occurrence.
- o Establish a sliding scale for attorney's fees for plaintiff's counsel to discourage frivolous suits brought under the temptation of contingency.
- o Allow submission of existing collateral sources as evidence in pollution and municipal liability cases.

- o Require the disclosure of attorney's fees, both to the plaintiff and to the court.

The seeds of the current liability insurance problem have been clearly visible for some time. The Alliance has frequently presented these solutions to this and other legislatures as options for preventing a crisis. We may now have reached the crisis point where remedial tort reform measures cannot wait.

The increasing magnitude and frequency of lawsuits is difficult for municipalities, manufacturers and their insurers to bear. These trends reflect the general perception that insured organizations and government bodies are deep pocket defendants. And that kind of perception has caused courts to expand the scope of liability coverage to include exposures never intended by insurers. Environmental liability may be the most dramatic example of the courts' liberal policy interpretations.

Liability exposure is so large that self-insurance is possible for only a few very large municipalities and industries. Smaller entities don't have the financial capacity to assume these risks. Self-insurance pooling mechanisms and reciprocals may temporarily help to ameliorate the availability problem, these devices, again, do nothing to address the nagging and serious problems arising from the tort liability system.

Insured government bodies, industries and individuals can reduce costs by assuming some portion of the liability risk themselves. Consider the use of appropriate deductibles for some or all lines of insurance,

while retaining insurance protection for claims exceeding a specified amount. The proper use of deductibles would directly encourage loss control and reduce significantly the insurance premiums which would be charged for "first dollar" coverage. In the long run, a successful loss control program will reap a double benefit: (1) to reduce accidents, injuries and pollution damages caused to individuals or their rights; and (2) to help hold down the costs of insurance premiums.

During a recent meeting held by the New Jersey Insurance Task Force on Environmental Issues, school boards and municipal representatives expressed a willingness to work on tort reform and immunity proposals in the legislature as a means of helping to alleviate their present insurance liability problem.

In addition, the Alliance agrees with the intent of S. 2545 by Senator John Lynch, but we feel that the bill needs some specific changes to be effective. To that end, we have participated in the formation and development of the New Jersey Insurance Task Force on Environmental Issues, and fully support their proposals for municipal tort reform through amendments to that bill.

The Alliance of American Insurers shares the concern of everyone in New Jersey about developments leading to restricted insurance coverages and a lack of affordable insurance protection. The property/casualty insurance industry is deeply disturbed about the actions it has felt compelled to take in liability insurance lines. We indeed welcome the commitment of the affected policyholders and public policymakers in restoring the legal and regulatory stability needed to provide a responsive insurance market.



STATEMENT TO: New Jersey Environmental Impairment Liability
Insurance Study Commission

BY: Professional Insurance Agents of New Jersey

DATE: October 24, 1985

On behalf of the Professional Insurance Agents of New Jersey and the 8,000 agents and employees we represent, thank you for allowing me to speak to you today.

I would like to begin by stating for the record that our association stands by the position set forth by the New Jersey Insurance Task Force on Environmental Issues. The Task Force report, released only two weeks ago, is the result of a great deal of thought, research and discussion.

Our organization is proud to have been a part of this all-industry effort to develop solutions to the very real crisis we are facing in the liability insurance marketplace of today. We believe it is the first time this industry has banded together in this manner, and we wholeheartedly support the findings of this group.

Since you have already received copies of the Task Force report, I will not elaborate on its findings in detail.

PIANJ continues to support Senate Bill 2545 and Assembly Bill 3073, respectively sponsored by Senator John Lynch and Assemblyman Thomas Foy, with the Task Force's suggested amendments. We believe they are a viable first step toward the resolution of the insurance crisis facing public entities.

I would like to emphasize the words "first step." While we urge the legislature to enact this measure, we do not believe it goes far enough to totally resolve the problem.

However, it is a beginning, and an important step toward eliminating the problems facing municipalities and the insurance industry in this state.

As you are well aware, public entities are not alone in this crisis, nor is New Jersey unique. This problem is occurring throughout the country. Small businesses of all types, including day care centers, taverns, independent contractors and even small Main Street retailers have been unable to obtain liability insurance coverage, or are facing astronomical premium increases.

The insurance industry has been blamed by many for this problem. And while past pricing practices by insurance companies may have added to the problems we are now facing, they are not the sole cause.

In truth, this country's civil justice system, with its inherent "deep pockets" philosophy, is at the root of today's crisis. We are, quite bluntly, a lawsuit-oriented society.

Recent court decisions, including Ayers vs. Jackson Township, have opened the door even wider to individuals seeking compensation from municipalities for pain and suffering due to environmental exposure.

These decisions have held insurance companies financially liable for exposures which were never contemplated when they decided to insure the municipalities.

As stated before, the problem goes well beyond municipalities. Many bars and taverns across the state -- indeed, the country -- have been forced to close their doors due to astronomical premium increases, or a total lack of available insurance from any source. Why? Because insurance companies cannot afford to write the coverage, due to the enormous exposure inherent in this type of business -- again as the result of recent precedent-setting court cases.

The problem, then, lies in our nation's civil justice system. As long as individuals are free to seek unlimited financial rewards for pain and suffering claims, and as long as the courts continue to award million dollar claims payments, insurance companies will be unable to afford to write coverage for any business or entity with a high-risk exposure.

We therefore believe that ultimately this Commission should address itself to significant civil justice reform. And we believe it must urge our Congressional Representatives to take action in Washington, as well, since the problem we are facing greatly exceeds New Jersey's borders.

The following proposals appear to be reasonable propositions to which PIA could give formal support: a penalty for bringing frivolous suits; an end to the doctrine of joint and several liability; and structured settlements wherein judgments awarded to injured persons with a long term disability would be paid out over their life expectancy.

However, in general PIA would have difficulty with proposals which might tend to selectively restrict access to full recovery for those individuals injured by negligence.

In closing, I would like to comment on several of the proposals raised at earlier hearings of this Commission.

Representative Florio last week proposed limiting liability of environmental clean up contractors to negligence during the work performed. PIA could support this proposal, since parallels the changes being addressed in the Foy/Lynch bills for municipalities.

Commissioner Gluck has suggested the formation of an insurance pool for all problem lines of commercial insurance, backed by governmental financial guarantees

or a reinsurance program.

PIA has historically opposed pooling mechanisms. In particular, we oppose unregulated pools, especially if the pools are backed by government financial guarantees. A pool made up of risks which are probably far more susceptible to claims and judgments than the average risk is doomed to have extremely poor experience. Eventually, such pools will need a bailout, which in the case of government-backed pools, would ultimately be paid for by the citizens of this state.

PIA has also historically opposed government involvement in insurance. However, if government-backed reinsurance for the commercial market would improve availability, our association would definitely review this stance.

In conclusion, I would like to state that PIA does not have a closed mind to any potential solution to this problem. We hope to help effect a solution through our involvement in the all-industry Task Force, and through input to policymakers such as this Commission.

Thank you for your time.



NATIONAL ARBORIST ASSOCIATION INC.

ROBERT FELIX
Executive Vice President

174 Route 101
Bedford Station - Box 238
Bedford, New Hampshire 03102
(603) 472-2255

October 14, 1985

Environmental Impairment Liability
Insurance Study Commission
Ms. Denise Drace
NJ Office of Legislative Affairs
State House Annex
Room 305
Trenton, NJ 08625

Subject: Environmental Impairment Liability Insurance

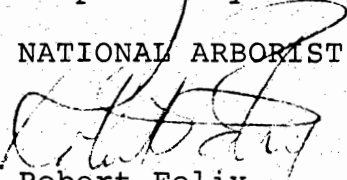
Gentlemen:

The National Arborist Association, Inc., a national trade association of commercial tree service firms wishes to be included in the record representing our many member firms in New Jersey who apply pesticides commercially.

1. *The casualty insurance industry has seen fit to eliminate coverages for gradual as well as sudden or accidental pollution or contamination liability that a commercial applicator of pesticides may face.*
2. *This decision is based on the broad spectrum of the exposure rather than the merits or risks of individual industries.*
3. *The tree care industry applies extremely dilute solutions of pesticides.*
4. *The tree care industry uses highly sophisticated technology and delivery systems to apply pesticides to target areas only.*
5. *There is no record to show that application of pesticides by tree service firms has resulted in liability insurance claims.*
6. *Accordingly, the insurance industry should be required to assess each risk in the tree care industry individually and provide environmental impairment liability coverage at a cost commensurate with the risk rather than arbitrarily denying coverage to all.*

Respectfully submitted,

NATIONAL ARBORIST ASSOCIATION, INC.


Robert Felix
Executive Vice President

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