



## CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

October 2, 2003

### **S. 1125**

### **Fairness in Asbestos Injury Resolution Act of 2003**

*As reported by the Senate Committee on the Judiciary on July 30, 2003*

#### **SUMMARY**

S. 1125 would establish the Asbestos Injury Claims Resolution Fund (Asbestos Fund) to provide compensation to individuals whose health has been impaired by exposure to asbestos. Under the bill, a new Office of Asbestos Injury Claims Resolution would administer the Asbestos Fund and manage the collection of federal assessments on certain companies that have made expenditures for asbestos injury litigation prior to enactment of this legislation. S. 1125 also would establish the Office of Special Asbestos Masters within the U.S. Court of Federal Claims to process and evaluate claims made against the Asbestos Fund and to award compensation to individuals as specified in the legislation. Once the administrator of the fund has determined that the new federal process to compensate individuals is fully operational and processing claims, individuals affected by exposure to asbestos could no longer pursue awards for damages in any federal or state court.

CBO expects that sums paid into the Asbestos Fund would be treated in the budget as federal revenues and that amounts expended to pay claims and administer the fund would be considered new federal direct spending. Assuming enactment of S. 1125 in the fall of 2003, CBO estimates that the Asbestos Fund would begin paying claims during fiscal year 2005. Over the 2004-2013 period, we estimate that the payments to eligible claimants, start-up costs, and administrative expenses would total about \$58 billion. Over the same 10-year period, we estimate that the fund would collect about \$60 billion from firms and insurance companies with past asbestos liability.

CBO assumes that most of the fund's assets would be invested in nongovernmental securities. The net cash flows associated with such investments would also be direct spending. Including the effects of those transactions, CBO estimates that net receipts and expenditures of the Asbestos Fund would decrease projected budget deficits over the 2004-2013 period by \$600 million.

In addition, based on information from the Court of Federal Claims, CBO estimates that costs would amount to nearly \$0.7 billion over the 10-year period for salaries, computers, office space, and other expenses for the Special Asbestos Masters and support staff to process claims that the court would receive. Such costs would be subject to appropriation of the necessary amounts each year.

Over the 10-year period, we estimate that the Asbestos Fund would collect sufficient amounts from insurance companies and other firms to pay the claims that CBO estimates the fund would receive in those years. There is a risk that the actual number of claims received could exceed our estimate. There is also a risk that revenues collected could be less than we estimate. If either event were to occur, the amounts collected could be insufficient to pay all claims. In that case, the fund's administrator would probably borrow from the U.S. Treasury to pay claims. The bill would not limit the total borrowing authority available to the fund. Thus, if the administrator needed to exercise the borrowing authority provided by the bill, there is no guarantee that such borrowing could not accumulate beyond the capacity of the fund to repay its debt.

Under the provisions of section 404, the operations of the fund could be ended if resources are inadequate to pay awarded claims. Assuming the fund's operations are not terminated under section 404, we expect that the Asbestos Fund would continue to receive claims for around 50 years following enactment of the bill. CBO estimates that if the fund's administrator implements the contingent call provisions of section 223 and collects additional assessments from defendant companies and insurers above the minimum amounts required under the bill, the fund would have enough resources to pay anticipated claims over the coming decades. However, the cash flows of the Asbestos Fund under S. 1125 are uncertain and difficult to estimate; the uncertainty increases with the length of the projection. Such long-term projections are particularly speculative because both the Special Asbestos Masters and the fund's administrator would have considerable discretion in implementing their responsibilities under this legislation.

S. 1125 contains an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA), but CBO estimates that the cost of complying with this mandate would be insignificant and well below the threshold established in that act (\$59 million in 2003, adjusted annually for inflation).

S. 1125 would impose new private-sector mandates as defined in UMRA on certain individuals filing claims for compensation for injuries caused by exposure to asbestos; certain companies with prior expenditures related to asbestos personal injury claims; certain insurance and reinsurance companies; trusts established to provide compensation for asbestos claims; and persons involved in manufacturing, processing, or selling certain products containing asbestos. Based on information from academic, industry, government, and other sources, CBO concludes that the aggregate direct cost to the private sector of complying with all of the mandates in the bill would well exceed the annual threshold established in UMRA (\$117 million in 2003, adjusted annually for inflation) during each of the first five years

those mandates would be in effect. CBO cannot, however, determine the direction or magnitude of the net impact of the bill's mandates on each of the various affected parties in the private sector over the long term.

## **ESTIMATED COST TO THE FEDERAL GOVERNMENT**

The estimated budgetary impact of S. 1125 over the 2004-2013 period is shown in Table 1. The effects of this legislation fall within budget functions 750 (administration of justice) and 900 (interest).

CBO expects that the fund's assessments on firms and insurers would be treated in the budget as revenues and that payments to satisfy claims would be considered federal expenditures. In addition, because the fund's administrator would be authorized to invest the fund's balances, certain cash flows associated with investments in nongovernmental financial instruments would also be reflected in the budget. Specifically, under the Administration's current procedures for budget presentation, government funds invested in nongovernmental financial instruments are recorded as expenses (outlays), and the redemption of principal or interest amounts from such investments is recorded as a receipt (negative outlay).

## **BASIS OF ESTIMATE**

For this estimate, CBO assumes that S. 1125 would be enacted in the fall of 2003. We expect that the Asbestos Fund would become fully operational during fiscal year 2005.

To estimate the cost of processing claims, we reviewed prior government experience with similar compensation funds, operations of privately run asbestos funds, and estimates provided by the Federal Court of Claims. To estimate the number and types of claims the Asbestos Fund would receive, and when they would be received, CBO reviewed a number of projections of asbestos injury claims that were prepared for different purposes by several private groups and individuals, including those presented to the Senate Committee on the Judiciary during its consideration of S. 1125 by the Asbestos Study Group, Navigant Consulting, and Legal Analysis Systems. In addition, we studied the history of claims paid and projections of those anticipated to be paid by the Manville Trust Fund (the oldest and largest private trust fund for asbestos claims). We also considered the inaccuracy of projections of future asbestos injury claims that have been made in the past and the significant discretion that the Special Asbestos Masters would have to determine eligibility and awards under the bill. Finally, to determine whether the Asbestos Fund could be expected to collect the amount of assessments from defendant companies and insurance companies that are anticipated in the legislation, CBO examined financial information for some of the public companies that would likely be contributors to the fund and the reserves held by insurance companies for asbestos claims.

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**TABLE 1. ESTIMATED BUDGETARY IMPACT OF S. 1125**

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	By Fiscal Year, in Billions of Dollars									
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
<b>CHANGES IN DIRECT SPENDING</b>										
Claims and Administrative Expenditures of the Asbestos Fund										
Estimated Budget Authority	0	11.3	11.4	11.2	5.1	5.1	5.1	5.1	5.0	4.9
Estimated Outlays	0	2.9	5.8	8.7	9.9	8.3	6.7	5.1	5.1	5.0
Investment Transactions of the Asbestos Fund										
Estimated Budget Authority	7.7	6.4	4.6	-3.7	-4.8	-3.4	-2.1	-0.9	-0.8	-0.8
Estimated Outlays	7.7	6.4	4.6	-3.7	-4.8	-3.4	-2.1	-0.9	-0.8	-0.8
Total Direct Spending										
Estimated Budget Authority	7.7	17.7	15.9	7.4	0.3	1.7	3.0	4.2	4.2	4.1
Estimated Outlays	7.7	9.3	10.4	5.0	5.2	4.9	4.6	4.2	4.3	4.3

**CHANGES IN REVENUES**

Collected from Bankruptcy Trusts <sup>a</sup>	1.4	0	0	0	0	0	0	0	0	0
Collected from Defendant Firms	1.6	2.3	2.8	3.0	3.0	2.6	2.6	2.6	2.3	2.3
Collected from Direct Insurers	6.2	7.8	7.8	0	0	0	0	0	0	0
Collected from Reinsurers	0.5	0.8	0.9	1.0	1.0	0.9	0.9	0.9	0.8	0.8
Contingent Call from Firms, Insurers, and Reinsurers	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0.5</u>	<u>0.5</u>	<u>0.5</u>	<u>1.0</u>	<u>1.0</u>
Total Revenues	9.7	10.9	11.5	4.0	4.0	4.1	4.0	4.0	4.1	4.1
<b>Estimated Net Increase or Decrease (-) in the Deficit from Changes in Revenues and Direct Spending</b>										
	<b>-1.9</b>	<b>-1.6</b>	<b>-1.1</b>	<b>0.9</b>	<b>1.2</b>	<b>0.9</b>	<b>0.5</b>	<b>0.2</b>	<b>0.2</b>	<b>0.2</b>

**CHANGES IN SPENDING SUBJECT TO APPROPRIATION**

Federal Court of Claims										
Estimated Authorization Level	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Estimated Outlays	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1

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NOTE: Numbers in the table may not add up to totals because of rounding.

a. Cash and financial assets of the bankruptcy trusts have an estimated value of \$5.5 billion. The federal budget would record the cash value of the noncash assets when they are liquidated by the fund's administrator to pay claims.

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## Direct Spending

To estimate the amount and timing of new direct spending under S. 1125, CBO considered the cost of administering the Asbestos Fund and the length of time it would take following enactment for the fund to be fully operational and processing claims. We estimated the number of claims that would be submitted to the fund over the 2005-2013 period, including those claims that have been filed or will be filed in federal or state courts but not settled by the time the fund is fully operational (these claims are known as pending claims). To estimate the cost of paying valid claims submitted to the fund, we considered the number of claims likely to be submitted by persons with malignant and nonmalignant medical conditions due to asbestos exposure. Finally, we estimated the net disbursements and receipts associated with the fund's investment activity.

**Administration and Startup of the Asbestos Fund.** Based on the cost of operating existing government compensation funds and the operation of privately run asbestos trusts, CBO estimates that administration of the Asbestos Fund would require a staff of about 100 persons at a total cost of about \$10 million annually, beginning in fiscal year 2004. Such administrative costs would be paid from the Asbestos Fund and would not require further appropriation action. The costs of the Special Asbestos Masters within the Court of Federal Claims would be paid with amounts provided in future appropriation acts. The estimated cost of that work is discussed in a subsequent section of this cost estimate.

Individuals seeking compensation from the Asbestos Fund would need to file a claim with the Court of Federal Claims within the time specified by the legislation (four years from the date of enactment for pending claims or four years from the date of diagnosis for future claims). Once the Court of Federal Claims receives a claim, a judge would refer it to the Office of the Special Asbestos Masters. A special master would then have 60 days to determine the appropriate award according to the medical criteria and awards values specified in the legislation. If the claimant chooses to accept the award, the Asbestos Fund would pay the claimant over the next four years. A claimant could appeal a decision by the Office of the Special Asbestos Masters within 30 days upon receiving the award determination. A decision on the appeal would be required within 60 days.

Under section 403, asbestos claims could be pursued in federal and state courts following enactment of the bill until the administrator of the Asbestos Fund determines that the fund is fully operational and processing claims. CBO expects that the fund would not be fully operational until about a year following enactment of the legislation. This startup period would be needed to promulgate detailed operating rules and procedures and to recruit, hire, and train personnel to process claims and manage the fund's operations. (The Energy Employees Occupational Illness Compensation Program—a similar federal fund established in 2000—took slightly more than a year to become fully operational.) During this startup

period, the fund's administrator would also need to collect financial information from thousands of firms and insurers that have made prior expenditures for asbestos injury claims in order to set appropriate assessment rates for these firms.

Under S. 1125, the Asbestos Insurers Commission would determine the amount of some assessments on direct insurers and reinsurers. We expect that the commission would be able to collect the necessary financial information and determine how assessments would be collected within the first year following enactment of the legislation. CBO estimates that the fund would collect the initial payment from insurers at the end of fiscal year 2004.

**Payments to Claimants.** To estimate the cost of paying compensation claims under the bill, CBO reviewed projections of asbestos injury claims anticipated both under current law and under the bill that were presented to the Senate Committee on the Judiciary during its consideration of S. 1125. Such projections were based on a combination of epidemiological data, projections of disease incidence for the affected population, historical experience of bankruptcy trusts, and projections of the number of injured that would apply for compensation given the bill's medical criteria and compensation award values.

S. 1125 defines 10 medical impairments (levels) that persons exposed to asbestos have suffered and specifies a dollar amount of compensation that the fund would pay to individuals who demonstrate both specific medical conditions and exposure to asbestos. Over time, those award values would be adjusted for inflation. For the lung cancer levels, the bill specifies a dollar range of awards that depend on whether a claimant smokes tobacco or has in the past. For example, claimants with lung cancer and asbestosis would qualify for compensation under level IX, and awards at this level would range from \$300,000 to \$1 million, depending the claimant's history of tobacco use.

To estimate the cost to the fund of compensating claimants, CBO considered three broad categories—future claims that would be made by individuals with malignant conditions, future claims that would be made by those with nonmalignant conditions, and asbestos claims pending on the date that the fund would initiate operations. As detailed below, CBO used information from available projections and studies to project the number of claims in each broad category that would qualify for compensation under the specific medical conditions specified in the bill. Individuals who are determined to be eligible for an award would receive payments from the fund over a one- to four-year period. For this estimate, we assumed that payments would be spread over a four-year period. Table 2 shows the number and total cost that CBO projects for each category of claims.

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**TABLE 2. SUMMARY OF ESTIMATED ASBESTOS CLAIMS AND AWARDS**

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	<u>Initial 10-Year Period</u>		<u>Life of Fund</u>	
	<u>Number of Claims</u>	<u>Cost (in billions of dollars)</u>	<u>Number of Claims</u>	<u>Cost of claims (in billions of dollars)</u>
Claims for Malignant Conditions	59,000	27	127,000	84
Claims for Nonmalignant Conditions	627,000	12	1,230,000	33
Pending Claims	<u>300,000</u>	<u>19</u>	<u>300,000</u>	<u>19</u>
Total	986,000	58	1,736,000	136

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*Claims for Malignant Conditions.* For this estimate, CBO assumes that the total number of claims for malignant conditions that would be compensated by the fund would be near the average of the various projections we examined. Over the life of the fund, the estimates we examined vary from 100,000 claimants to 150,000 claimants that would be compensated by the Asbestos Fund for malignant diseases. This estimate assumes that there would be about 127,000 such claimants. We distributed those cases across the five categories of malignant diseases specified in the bill, based on the historical distributions of such claims received by the Manville Trust and the medical criteria and exposure requirements stated in the legislation. Based on the history of claims filed against the Manville Trust, CBO expects that a large majority of claimants compensated for lung cancer would be current or former smokers and would, therefore, receive compensation near the low end of the range of lung cancer award values. On this basis, CBO estimates that the average award for malignant conditions would be about \$540,000 and that total awards for such conditions would reach \$27 billion over the next 10 years.

*Claims for Nonmalignant Conditions.* The various projections of the number of nonmalignant cases and their distribution among the categories specified in the bill vary greatly. CBO expects that the ratio of malignant claims to nonmalignant claims under the bill would be similar to the historical ratio of claims compensated by existing bankruptcy trusts. For example, the Manville Trust has received an average of eight claims for nonmalignant conditions for every claim for a malignant condition. Based on these historical data and because claimants would receive larger awards under S. 1125 than those provided by existing trust funds, CBO estimates that during the first 10 years after enactment, the fund would compensate, on average, 10 claims for nonmalignant conditions for every claim for

a malignant condition. CBO expects that this ratio would decrease over time because of reductions in the use of asbestos. (Other analysts have estimated the ratio of claims for nonmalignant conditions to claims for a malignant condition to be as low as 7:1 or as high as 17:1.) In total, CBO anticipates about 1.2 million claims for nonmalignant conditions.

CBO estimates that more than 85 percent of claims for nonmalignant conditions filed with the Asbestos Fund would be eligible for medical monitoring reimbursement (Level I) from the fund. This estimate is based on available research involving a sample of the exposed population with nonmalignant conditions and the history of claims filed with the Manville Trust. To evaluate the history of such claims, CBO reviewed the trust's estimate of how claims received under its 1995 trust distribution process would have been compensated under the 2002 trust distribution process. The later process contains categories for nonmalignant conditions similar to those under S. 1125. Based on the medical criteria in the bill, CBO expects that about 90 percent of claims for nonmalignant conditions previously filed against Manville would have been eligible for medical monitoring reimbursement under the bill. Such reimbursement, about \$1,000, is the lowest rate of payment specified for nonmalignant conditions. Overall, CBO estimates that the average payment for nonmalignant conditions would be about \$22,000 and that total awards for such conditions would amount to \$12 billion over the next 10 years.

*Pending Claims.* Individuals who have an outstanding claim with any firm filed in a court on the date of enactment of S. 1125 would have four years to submit a claim to the Court of Federal Claims for compensation. CBO estimates that over the first three years that the fund is operational, nearly 300,000 pending claims would receive an award from the fund. CBO assigned pending claims across the disease levels in this bill based on a study of disease incidence for that population completed by Navigant Consulting. For this estimate, CBO did not take into account the number of claims that are still technically pending with at least one company but have been inactive for several years. If the claimants' lawyers actively seek out those individuals to file a claim against the fund, the number of claimants seeking compensation from the fund in the first four years could be significantly higher. An award from the Asbestos Fund for such individuals would be reduced by the value of any private awards received prior to the day the fund is fully operational. CBO estimates that the average award from the fund for pending claims would be about \$63,000 and that awards for such claims would total \$19 billion over the next 10 years.

**Investments of the Asbestos Fund.** Section 222 would authorize the administrator to invest amounts in the fund to ensure that payments to claimants can be satisfied. That section appears to imply that the fund's administrator could invest surplus amounts in private securities. For this estimate, CBO assumes that the managers of the fund would keep 20 percent of the investments in Treasury securities and 80 percent in non-Treasury securities. The current budgetary treatment of federal investments in non-Treasury



instruments is specified in the Office of Management and Budget's (OMB's) Circular A-11, which states that the purchases of such securities should be displayed as outlays and the sales of such securities and returns, such as dividends and interest payments, should be treated as offsetting receipts or collections.

CBO estimates that investing 80 percent of fund balances in private securities would result in net outlays of \$2.3 billion over the 2004-2013 period. The fund would be making net investments from 2004 through 2006, when its collections would exceed its expenditures. In subsequent years, when its expenditures would exceed collections, the difference would be made up by drawing down assets from the fund.

Although private securities may well yield higher gains over the long term than government securities, such investments carry much greater risk than government bonds, which are essentially risk-free. The difference between projected returns on private securities and government bonds can be seen as the cost investors must be paid in order to bear the additional risk of holding private securities instead of government bonds. Thus, adjusted for the additional cost of risk associated with private securities, the net expected returns on private securities are the same as those on government securities. For this estimate, CBO used a risk-free rate of return to estimate investment earnings of the fund for both private securities and government securities.

## **Revenues**

Receipts to the fund would come from three sources: defendant companies that have spent more than \$1 million on asbestos injury litigation, insurance companies that have made more than \$1 million in such payments, and existing private trust funds formed to settle asbestos claims. Under the bill, defendant companies and insurance companies would be called upon to make collectively equal contributions according to specified formulas, while all assets of existing asbestos trusts would be transferred to the fund.

**Defendant companies.** Section 202 would specify \$52 billion as the amount to be collected from defendant companies (excluding other "contingent call" and "voluntary" assessments, should the specified amounts prove inadequate). However, the formulas in the bill would not guarantee the collection of either \$52 billion or the minimum amounts to be collected each year (which sum to \$45 billion).

Under the bill, defendant companies are classified into seven tiers. The first and last tiers consist of firms in bankruptcy proceedings during the one-year period prior to enactment and railroads, respectively. Assignment among the remaining tiers would depend on the amounts of previous asbestos claims paid. Firms in tiers two through seven would make fixed annual

payments into the fund over 27 years, generally scaled so that firms with greater prior expenditures for asbestos claims would have larger contributions to the fund. Within each tier, contributions would vary depending on the revenues of the firms assigned to that tier.

The actual amounts paid by firms might differ from that implied by their tier assignments because the bill would allow certain exemptions for small businesses and modifications of assessments, based on financial distress or inequity.

The defendants' contributions could decline over the 27-year period. The bill sets the amount of collective contributions from defendants at \$2.5 billion a year for the first five years, \$2.25 billion a year for the following three years, and \$2 billion a year for the next three years. The required total payments could continue to decline in later years, and each company's assessment would decline proportionately.

The amount the fund would collect from defendant companies depends on a number of unknown factors:

- The number of subject companies and the tiers into which they would fall;
- Which of those companies would be subject to exemption or modification of their contributions and whether some affiliated entities would elect to be treated separately or jointly;
- The size and nature of the assets of tier-one firms in liquidation;
- The number and characteristics of subject firms that may go into bankruptcy during the assessment period; and
- How the administrator would use the contingent call, guaranteed payment surcharge, and voluntary contributions provisions (explained below) in the bill.

Some sources have indicated that as many as 8,000 firms may have paid sufficient prior asbestos claims to be covered by the legislation. CBO could not verify such a figure. Based on information that CBO could obtain on firms that have incurred asbestos litigation expenses, we estimate that about 1,700 defendant firms would be required to make contributions to the fund under the bill. It was possible to determine the likely tiers for about 500 of those firms. The remaining firms were assigned equally to the two lowest tiers, based on the assumption that firms with unknown tier assignments were those with lower asbestos claims payments. No reduction in the number of firms was made for those exempt due to size. Similarly, CBO made no upward adjustment to account for defendant firms not identified.

Revenues for tier-one firms were obtained, where possible, from public sources, mostly for firms expected to emerge from bankruptcy. But no reliable information could be obtained for the contribution of tier one firms that are likely to liquidate. Most firms were assumed to make the required payments, and no reduction in contribution was made for firms' receiving hardship or inequity adjustments in their contributions or from consolidated payments made by affiliated groups. (An accounting for the risk of nonpayment was performed in a separate surcharge calculation described below.) CBO's estimate of the receipts from the defendant firms exceeds the minimum required in most years under the bill but falls about \$1 billion short of the requirement to pay \$52 billion over the full 27-year period even with the surcharge applied.

**Insurers.** Section 212 would specify \$52 billion as the amount to be collected from insurers (again, excluding other "contingent call" and "voluntary assessments" should the amounts specified prove inadequate). In the case of insurers, no allocation or formula for payments is specified in the legislation. Instead, the bill would create an Asbestos Insurers Commission to determine an allocation among the subject insurance companies. Either this allocation or one agreed upon by the subject companies would determine how much each would pay of the \$52 billion total.

While the total amount due would be similar to the amount owed by defendant companies—spread over 27 years in the same declining pattern of annual contributions as required for the defendant firms—direct insurers would be required to pay the present value of their share in equal installments over the first three years following enactment of the legislation. Reinsurers would pay their share over the entire 27 years. Should a reinsurer fail to pay its assessed amount, the requirement to pay would fall upon the direct insurer.

The total contributions actually collected from insurers would depend on many of the same factors that would apply to the defendant companies. But the estimate is even less certain because of the lack of any specificity in the bill with respect to the assessments. Based on information provided by an insurance industry association, CBO assumes that direct insurers would be responsible for 64 percent of the insurance industry's share of the payments, or the equivalent of \$33 billion over 27 years. The bill does not specify the discount rate that would be used to calculate the present value of the direct insurers' share (it is left to the discretion of the administrator). For this estimate, CBO uses its projection of Treasury interest rates to compute the present value, which comes to about \$22 billion. This amount exceeds direct insurers' current asbestos reserves by nearly \$3 billion, an amount that CBO assumes could be obtained by the insurers and paid to the fund. No financial information is available concerning the reserves and financial conditions of reinsurers with asbestos liability. For this estimate, CBO assumed that reinsurers would make the contributions required by the legislation, totaling about \$19 billion.

**Existing Asbestos Trust Funds.** Based on publicly available information, CBO determined that the existing private trust funds set up to compensate claimants currently contain about \$5.5 billion in assets. Under the bill, those assets would be transferred to the new Asbestos Fund in the first year following enactment. Until that transfer would occur, we assume that claims paid by these funds would roughly equal investment income. The assets of existing trusts, however, are invested in a variety of financial instruments, and only the cash and U.S. obligations in these trusts would be recorded in the federal budget as receipts to the government when transferred. The private securities in the trusts would be recorded as receipts only when converted to cash or U.S. obligations.

Based on the financial reports of the Manville Trust, CBO estimates that 25 percent of transferred trust assets (about \$1.4 billion) would be recorded as receipts in 2004. For this estimate, we assume that the remainder of the assets would only be sold as needed to finance spending in later years. The proceeds of those sales would be recorded as receipts to the fund at that time.

**Offsets, Guaranteed Payment Surcharge, Contingent Call, and Voluntary Contributions.** The bill would allow firms and insurers to reduce their individual assessments by the value of any asbestos claims paid between the enactment date of S. 1125 and 2005, when CBO expects full fund operations would start. In addition, it would authorize three other kinds of payments by subject companies that could raise the total amount collected.

*Offsets for Claims Paid Prior to Full Operation of the Fund.* In the interim between enactment of S. 1125 and the time when the fund would begin full operations, defendants and insurers may settle asbestos claims with plaintiffs. Firms and insurers could use those settlement amounts as a dollar-for-dollar offset against their assessments, reducing the payments required to be made to the fund. As a result, CBO reduced its estimates of contributions in the first three years by its estimate of the amount of claims that firms would settle before the fund becomes fully operational. Based on the recent pace of settling asbestos claims, CBO estimates that \$5 billion in settled claims would be credited against assessments in the first years of the fund's operations. This \$5 billion is assumed to be split evenly between defendant companies and insurers. Virtually all of the individual direct insurers, with their large up-front payments, would likely get the full offset in the first year. But many of the other individual participants might have to wait longer to exhaust their credits, so that the offsets of reinsurers and defendant companies were spread over three years, weighted most heavily in the first.

*Guaranteed Payment Surcharge.* The administrator of the fund could impose on each participant a surcharge to compensate for the risk that the participant might fail to pay its required contribution. This surcharge would be set by the administrator and would go into a Guaranteed Payment Account as a form of self-insurance by the fund. For this estimate,

CBO assumed that the administrator would assess a surcharge on all firms but that the surcharge would be imposed differently on defendant companies and insurers to reflect their different risks of nonpayment and to maintain their roughly equivalent contributions. For defendant firms, CBO estimated the possible reduction in contributions resulting from firms going into bankruptcy over the payment period and the surcharge necessary to compensate the fund for that reduction, roughly 8 percent or about \$4 billion over 27 years. The financial information necessary to perform a similar calculation for insurers is not available, and no surcharge for that group is included in this estimate. The absence of an insurance company surcharge from the estimate, however, mainly affects the pattern of payments over time rather than the total amount received by the fund.

*Contingent Call and Voluntary Contributions.* If the administrator determines that the collection of assessments will be inadequate to cover expected claims, the fund would be authorized to make a “contingent call” upon the participants for additional contributions. Under this provision, the scheduled reduction in annual contributions would be delayed for as long as necessary to guarantee adequate funding. Furthermore, if at the end of the scheduled 27-year assessment period the administrator finds that resources are inadequate to pay claims, the fund would be authorized to accept “voluntary” contributions totaling up to \$2 billion per year indefinitely. Defendant firms and insurers that chose not to make these voluntary payments would be subject to asbestos damage claims through the tort system in federal courts.

CBO estimated the receipts that would be collected absent any contingent call or voluntary contributions. Those collections (\$90 billion from 2004 through 2030) and earnings on the fund’s assets would prove inadequate to finance spending for estimated claims and expenses after 2020. The bill would require the administrator to impose a contingent call if the availability of sufficient funds for projected future claims cannot be certified. CBO assumes that the fund would impose a contingent call as soon as possible and maintain it until sufficient funds were generated. Based on our projections of outlays and receipts absent its imposition, CBO projects receipts from the contingent call, totaling \$17 billion, would be required during the 2009-2022 period. As a result, CBO’s estimate assumes that required contributions from defendant firms and insurers would be set at about \$4 billion a year from 2009 to 2021 instead of declining. No voluntary contributions are included in this estimate because we estimate that the contingent calls over this period would be sufficient to pay claims.

**Secondary Effects on Other Revenue Sources.** The payments made by defendants and insurers and the sums received by claimants could affect taxable income under the federal corporate and individual income tax systems. This cost estimate includes no effects of these transactions on federal income taxes paid by claimants or businesses. These secondary effects are likely to be insignificant in any event.

Payments made into the fund would be tax-deductible and would thus reduce the corporate income tax liability of participating firms. But in the absence of this legislation, firms would have to pay asbestos damages set in the courts, which would also be tax-deductible. It is impossible to say with any confidence whether the amounts that would be paid out by defendant firms and insurers under this legislation would be higher or lower than what they would expend in its absence through the tort system. The best assumption under the circumstances is that the bill would have no significant effect on corporate taxable income or on the government's receipts from corporate income taxes.

Similarly, the tax treatment of payments received by claimants would be unchanged from what it is now—effectively excluded from taxable income and therefore having no effect on taxes paid by individuals. There might be some reduction in income tax receipts if a significantly larger proportion of payments goes to claimants rather than to their attorneys, who would pay tax on the income. But this would depend on whether more claimants think they can navigate the new system set up under the legislation without legal assistance than is the case under the existing one—a circumstance that cannot be known. CBO expects that any change in the allocation of awards between attorneys and claimants would be too small to significantly affect income tax receipts.

### **Spending Subject to Appropriation**

For this estimate, CBO expects that the Court of Federal Claims would begin to accept claims in the beginning of 2005. During the first three years of operation, CBO estimates that the court would receive around 185,000 claims per year. Based on information from the Administrative Office of the United States Courts and the Court of Federal Claims, CBO estimates that the court would need to have 70 Special Asbestos Masters for the first three years after enactment of the legislation to review and make award determinations on the large number of pending and future claims that would be submitted to the court. After processing claims received during the first three years of fund operations, the court would require, on average, 25 special masters over the remaining seven-year period to review projected claims. CBO estimates that costs to the court would be about \$100 million annually in 2005, 2006, and 2007 and about \$55 million per year from 2008 through 2013 for salaries and benefits, office and storage space, information technology, training, travel, and other expenses.

### **BUDGETARY IMPACT OF THE ASBESTOS FUND AFTER 2013**

In order to produce a 10-year estimate of the legislation's budgetary impact, CBO also needed to consider the fund's cash flows over the next 50 years. That projection yielded a total cost of claims payments of around \$136 billion. Assuming that the fund's administrator

would use the authority in the legislation to collect contingent assessments from firms and insurers, CBO expects the fund would have sufficient resources to pay \$136 billion in claims compensation over the next 50 years.

This (and other) long-term projections, however, should be viewed with considerable caution. The Asbestos Fund would be a completely new governmental task. With no operational track record, CBO and other analysts have little basis for judging how the individuals working for the Court of Claims and the fund's administrator would implement the legislation. The discretion available to the administrator and insurance commission with respect to the allocation of costs, provision of adjustments, levying of the surcharge, and time of the contingent call make the flows into the fund hard to predict with much reliability. Furthermore, the projections that have been made in recent decades of the number of asbestos claims likely to be brought to court and awarded settlements were, in hindsight, much too low, suggesting that there is a significant risk of underestimating the number of future asbestos claims. In addition, receipts to the Asbestos Fund would depend on the continued viability of the firms required to pay into it, and that is uncertain as well.

Finally, when considering the cash flows of the fund over the long term, the provisions of section 404 are critical. That section of the bill could terminate the fund's operations if its resources prove inadequate to pay claims. So long as the fund's administrator does not borrow from the U.S. Treasury beyond the means of the fund to repay such borrowing, CBO expects that the expenditures of the fund would not exceed its revenues and that the government's general funds would not be used to pay claims. If the fund's operations were terminated under this provision, claimants would seek compensation from private firms through the judicial system.

### **The Asbestos Fund's Operations Are Uncertain**

Contributing to the uncertainty of the cost to resolve claims under the bill are some significant features of the claims process that would only be defined in the implementation of the legislation. For example, under the bill, a Medical Advisory Committee would have significant discretion to determine the eligibility criteria and the award amounts for certain types of claims. The cost of the legislation could depend on the makeup, organization, and operations of the Medical Advisory Committee. Without knowing the procedures this new committee would use, it is difficult to assess how conservatively it might approach its responsibilities or how liberally it might rule on exceptional claims.

In addition, the cost to the Court of Federal Claims to process and evaluate claims is subject to further appropriation action. For this estimate, CBO assumes that the necessary amounts

would be provided promptly. If appropriations for the court were provided at a later date or in insufficient amounts, there could be a delay in making award determinations.

### **Past Estimates of the Number and Value of Asbestos Claims Have Been Inaccurate**

Forecasts of asbestos claims made over the last decade have failed to accurately predict the magnitude, scope, and evolution of asbestos claims. According to one witness that testified on S. 1125 before the committee, "in every instance where companies or trusts have attempted to project future asbestos claims, they have always seriously underestimated."<sup>1</sup> Most estimates of future claims rely on a combination of epidemiological information and statistical estimation techniques using historical data. Such models contain a number of potential sources of error in forecasting.

In 1988, experts estimated that the number of future claims against the Manville Trust would range from 50,000 to 200,000. By January of 1991, the trust had already received more than 171,000 claims. The most recent claims forecast performed for the trust estimated that the trust may receive up to 2.7 million additional claims. Through the summer of 2003, the Manville Trust had received 560,000 claims.

CBO's estimates of the number and distribution of claims that would be compensated by the Asbestos Fund under S. 1125 are based on forecasts similar to those that have been prepared for the Manville Trust. Therefore, it is possible that the number of claims that would be compensated under S. 1125 could deviate in significant respects from our estimates in terms of cost, timing, or both.

### **Revenue Collections Are Uncertain**

The revenue stream that would be generated by the legislation is highly uncertain as well. Although the levy on defendant firms and insurers is fixed in amounts, a number of unknown factors described earlier make it difficult to project the receipts with much reliability. Two factors make the projections in later years even more uncertain.

First, 50 years is a long time span for a business. Even under ordinary conditions, economic circumstances lead many firms to liquidation over time. Such business terminations often result from changing market conditions. The legislation would allow the administrator to

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1. Statement of Professor Eric Green, Boston University School of Law, before the Senate Committee on the Judiciary, June 4, 2003.



impose a surcharge to guarantee payment of amounts that some firms would be unable to pay. The success of the surcharge depends, in turn, on estimating the attrition among firms.

Normal attrition will be exacerbated by the costs of dealing with asbestos liability—either under the current system of litigation or under the legislation itself. The cost to the defendant firms and insurers may hasten their dissolution relative to normal business attrition. The legislation’s provisions for adjustments based on inequity or financial distress might mitigate business bankruptcies at the cost of even greater uncertainty in the value of the fund’s future revenue stream.

Second, the collection of sufficient funds to pay anticipated claims depends critically on the use of the contingent call provisions by the administrator. CBO’s projection of claims costs over 50 years indicates that a contingent call would be required. But the first opportunity to impose the call would precede the projected shortfall of funds to pay outlays by more than a decade. If the administrator fails to impose the contingent call well in advance of the projected shortfall, it might not be possible to obtain adequate revenues. The administrator would be limited in the operation of the contingent call to delaying a scheduled reduction in assessments. After scheduled reductions have gone into effect, the opportunity to obtain enough contingent funding might have passed.

### **Federal Liability if the Trust Fund’s Resources are Inadequate to Pay Claims**

Under certain circumstances, section 404 would require that the provisions of S. 1125 terminate if the administrator is unable to pay 95 percent of awards in any year. Furthermore, section 405 states that the legislation would not obligate the federal government to pay any part of an award under the bill if amounts in the Asbestos Fund are inadequate. Those two sections could prevent federal spending on asbestos claims from exceeding the amounts collected to pay such claims. However, the bill also would authorize the Asbestos Fund to borrow funds to pay claims. Using its borrowing authority, it would be possible for the fund’s lifetime spending to exceed its collections because the legislation would not cap total borrowing by the fund. For this estimate, CBO has assumed that the fund’s administrator would not borrow money to pay claims that could not be repaid with the fund’s own resources over the lifetime of the fund.

## **ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS**

S. 1125 contains an intergovernmental mandate as defined in UMRA. It would preempt state laws relating to asbestos claims and prevent state courts from ruling on those cases. CBO estimates that any cost associated with this mandate would be insignificant and well below the threshold established in that act (\$59 million in 2003, adjusted annually for inflation).

## **ESTIMATED IMPACT ON THE PRIVATE SECTOR**

S. 1125 would impose new private-sector mandates as defined in UMRA on:

- Certain individuals filing claims for compensation for injuries caused by exposure to asbestos;
- Certain companies with prior expenditures related to asbestos personal injury claims;
- Certain insurance and reinsurance companies;
- Trusts established to provide compensation for asbestos claims; and
- Persons involved in manufacturing, processing, or selling certain products containing asbestos.

Based on information from academic, industry, government, and other sources, CBO concludes that the aggregate direct cost to the private sector of complying with all of the mandates in the bill would well exceed the annual threshold established in UMRA (\$117 million in 2003, adjusted annually for inflation) during each of the first five years those mandates would be in effect. CBO cannot determine the direction or magnitude of the net impact of the bill's mandates on each of the various affected parties in the private sector over the long term.

### **Asbestos Injury Claims**

The bill would prohibit an individual from bringing or maintaining a civil action alleging injury due to asbestos exposure. Currently, individuals can file asbestos injury claims against any number of defendants in state or federal court. Under S. 1125, individuals would only be able to receive compensation for asbestos-related injury by filing a claim with the Asbestos Fund. A claimant would be able to recover from the fund if that person could meet the bill's medical criteria, which are based on the severity of the asbestos-related disease.

Claims pending as of the date of enactment would be preempted by S. 1125, except those “claims for which an order or judgment has been duly entered by a court that is no longer subject to any appeal or judicial review.” In addition, individuals could still pursue a civil action through the courts until the Asbestos Fund becomes fully operational.

Some individuals who would receive compensation under current law would not be qualified to receive compensation under the bill. Further, some individuals would receive more compensation for their asbestos injury claims under current law, while others would receive more if S. 1125 is enacted. The direct cost of the mandate during the five years after enactment would be the difference between the total settlements and judgments that would be obtained under current law and those that would be obtained under S. 1125.

Based on information from academic, industry, and other sources, CBO assumes that claimants who would be deemed ineligible for compensation under the bill would be predominantly from the "unimpaired" category. Because comprehensive data relating to asbestos exposure, litigation, and compensation are not available, it is difficult to predict the number of claimants who would receive compensation and the amount of the settlements they would receive under current law. Unimpaired claimants generally receive multiple settlements of a few thousand dollars each from as many as half-a-dozen defendants. According to several expert sources, settlements for unimpaired claimants may range in value from \$3,000 to \$50,000 per claimant. Also, according to several sources, a large proportion of claims currently pending could have their compensation precluded or delayed under the bill. CBO concludes that many individuals would probably receive less compensation in the first five years under S. 1125 than under current law. Consequently, the direct cost to the private sector of complying with this mandate would be substantial during those years and could amount to hundreds of millions of dollars from 2005 through 2008.

### **Assessments on Defendant Companies**

Section 202 would impose a new mandate on defendant participant companies, defined as certain companies with prior expenditures related to asbestos personal injury claims. Such defendant companies would be required to pay an annual assessment to the Asbestos Fund totaling a minimum of \$2.5 billion in each of the first five years. That amount would be reduced by any payments companies make to settle claims prior to full implementation of the fund. In addition, there is some risk that the minimum assessment might not be collectable.

Section 223 would require the administrator of the Asbestos Fund to impose a reasonable surcharge on each participant required to pay contributions into the fund to insure against the risk of nonpayment by some participants. The amount of surcharge to be paid would be determined by the administrator. CBO expects that the administrator would assess a

surcharge on all firms sufficient to compensate for this loss and that the surcharge would be imposed differentially on defendant companies and insurers to reflect their different risks and to maintain their roughly equivalent contributions. CBO estimates that the surcharge on defendant companies would be about \$200 million in each of the first five years. We did not have sufficient data to estimate the surcharge on insurers.

The amount the fund would receive from defendant companies would depend on a number of factors, including the number of subject companies and the tiers into which they would fall. In addition, the amount paid into the fund would be reduced by sums that companies pay to settle asbestos claims prior to full implementation of the fund. Based on data from industry and other sources, CBO estimates that the defendant companies would pay an average of \$2.5 billion per year into the fund over the 2004-2008 period. According to industry and academic sources, defendant companies in aggregate currently pay asbestos litigation and settlement costs on an annual basis close to the amounts that would be required by the bill in the next five years. Thus, CBO estimates that the incremental costs, if any, for those companies to comply with those mandates would not be significant over the first five years the mandates would be in effect.

### **Assessments on Insurance Companies**

Section 212 would impose a mandate on insurers and reinsurers with asbestos-related obligations. The bill would require those insurance companies to contribute to the fund, and specifies that their contribution would satisfy their contractual obligation with defendant companies to compensate claimants for injuries caused by asbestos. The bill does not, however, specify any allocation or formula for such payments to the fund. The amount of the contribution to the fund for individual insurance and reinsurance companies would be determined by the Asbestos Insurers Commission established under the bill.

The aggregate contributions of all mandatory participants to the fund could not exceed \$5 billion in any calendar year unless otherwise provided by the fund's administrator. However, the bill also would require every direct insurance company to pay 100 percent of its allocated amount within three years after the effective date of the bill. Based on information from industry sources, CBO estimates that direct insurers would pay a total of about \$22 billion into the fund during fiscal years 2004 through 2006 and that reinsurance companies would pay a total of about \$4 billion into the fund during the first five years. According to industry information on current asbestos liability costs, CBO estimates that the incremental cost for participant insurance and reinsurance companies above their expected costs (payouts) for asbestos claims under current law could amount to a total of about \$6 billion during the first five years the mandates would be in effect.

## **Asbestos Settlement Trusts**

Section 402 would require asbestos settlement trusts, established to provide compensation for asbestos claims, to transfer their assets to the Asbestos Fund no later than six months after the enactment of the bill. Such a requirement is an enforceable duty, and therefore, a mandate under UMRA. Based on information from the trusts and industry sources, CBO expects that such trusts would transfer approximately \$5.5 billion in assets to the fund in 2004. The cost of the mandate in that year would be the value of the assets net of amounts that would be paid for compensation and administrative costs in that year. However, under current law, those assets would be used to pay claims over a longer period of time.

## **Ban on Products Containing Asbestos**

Section 501 would prohibit persons from manufacturing, processing, or distributing in commerce certain products containing asbestos. The bill would require the Administrator of the Environmental Protection Agency, not later than two years after the enactment of the bill, to promulgate final regulations prohibiting commerce in such products (with some exceptions). In addition, the bill would require persons who possess a product for the purpose of commerce that is subject to the prohibition, not later than three years after the enactment of the bill, to dispose of that product by means that meet federal, state, and local requirements. A number of products and processes still use asbestos, including brake pads and linings, roofing materials, ceiling tiles, garden materials containing vermiculite, and cement products. According to industry and government sources, products are readily available to replace products containing asbestos, and the disposal of such asbestos products would not be difficult. Therefore, CBO expects that the direct cost of complying with this mandate would not be large.

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