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Asbestos Payments Continued to Pull Back in 2013

Snapshot of Recent Trends in Asbestos Litigation: 2014 Update

By **Mary Elizabeth Stern**
and **Lucy P. Allen**¹

Each year, we conduct an annual review of asbestos-related liabilities reported in companies' SEC filings. This information can assist companies in benchmarking their own data against trends observed for other defendants, which can help to forecast asbestos-related liabilities. Analyzing the 2013 data, we observed trends favorable to defendants: on average, total indemnity payments, legal costs, and reserves all dropped, while new filings held steady and pending claims fell.

On the other hand, average resolution values did not drop between 2012 and 2013, but instead remained at the higher levels reached in 2011. As we have noted in prior updates, we attribute the recent higher average resolution values to a shifting disease mix, in which malignant claims comprise a larger percent of current resolutions than those resolved in the mid-2000s.

Although per-claim values have remained high, they do not appear to have translated into increased liability for firms. Instead, total spending has fallen, on average, over the past two years.

Specifically, we observed that:

- Total indemnity payments dropped 17%, on average, even though average dollars per resolved claim were only slightly lower than the high averages in 2011 and 2012;
- Defense spending also dropped substantially, falling 22% on average compared with 2012 costs, and reversing increases in defense spending observed in 2011 and 2012;
- Counts of pending claims continued to decline;
- New filings were essentially flat; and
- Reserves declined over the past year, reaching the lowest level since 2006.

All of these trends are favorable to defendants, but are within the historical variability observed since 2005. The big shift in trends occurred following Judge Jack's Silica MDL decision in 2005, questioning the medical documentation of claimants, and which precipitated a dramatic decline in the filing and value of non-malignant claims.

Going forward, there are new sources of uncertainty that may affect asbestos trends. In particular, the biggest uncertainty on the near horizon may be the impact of Judge Hodges' January 2014 decision in the Garlock bankruptcy, which highlighted discrepancies in exposure evidence provided by claimants. Whether this decision will affect filings and settlements – and if so, how – is not yet known.

Methodology

Using publicly available data, we analyzed trends in asbestos-related liabilities of more than 150 companies. This study represents our sixth annual assessment of these data, and extends our analysis one year to include 2013.

To analyze these trends, we compiled data from over 150 asbestos defendants' Form 10-K filings with the SEC, from 2001 through 2013. We tracked six key metrics²:

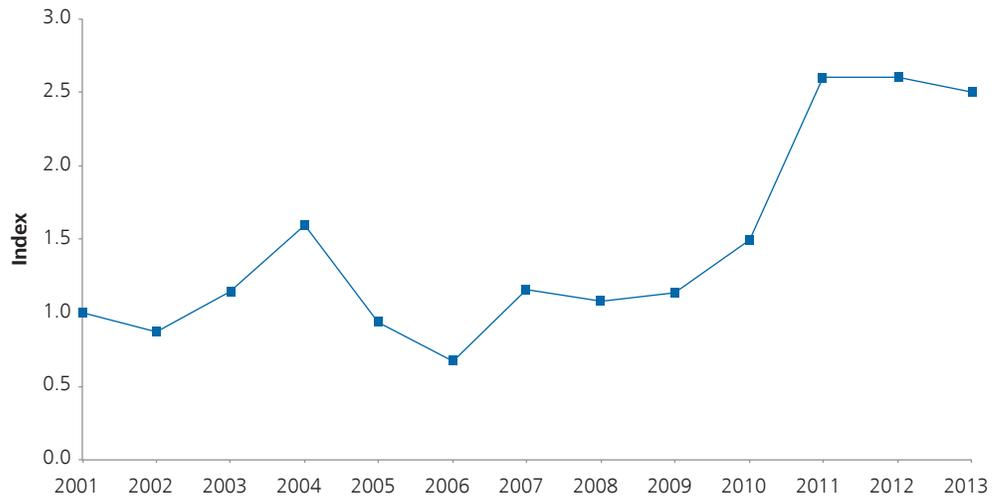
- *total indemnity paid*: the aggregate amount a company pays to resolve claims each year;
- *total defense paid*: the aggregate amount a company pays in legal fees and expenses each year;
- *number of claims resolved*: how many claims a company closes each year either by settling or obtaining dismissals;
- *average settlement paid per resolved claim*: the total indemnity paid divided by the number of claims closed each year;
- *percent of claims dismissed*: the fraction of claims a company closes without payment; and
- *annual filings*: the number of new claims a company receives each year.

In addition, for those firms reporting asbestos-related reserves, we also tracked the average reserve amount.

Average Dollars per Resolved Claim Remained Approximately 67% Higher than in 2010

- Average dollars per resolved claim jumped approximately 75% in 2011, and remained at a similar level in 2012. Over the past year, average dollars decreased slightly relative to 2011 and 2012, but still remain significantly higher than 2010 levels.
- Average dollars paid per resolved claim remain almost two and a half times the level observed in 2001 and one and a half times the 2004 peak.

Figure 1. **Average Dollars Per Resolved Asbestos Claim**
Indexed to 2001



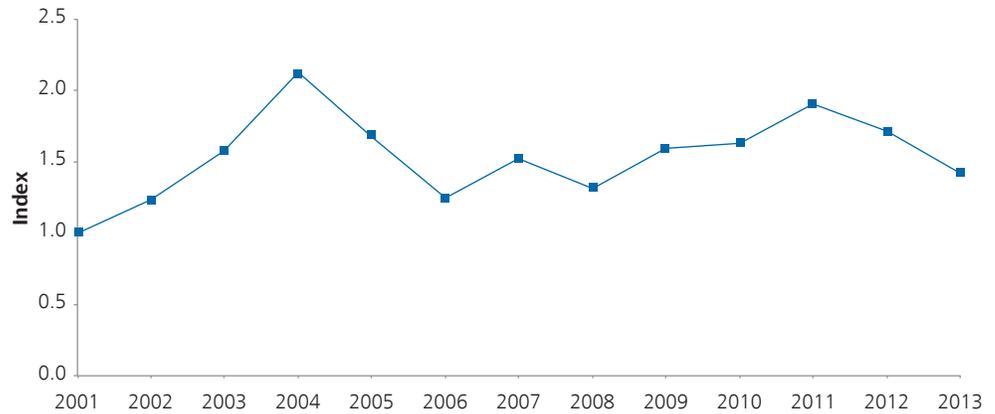
- As we noted in our 2011 and 2012 reports, without information on average settlements per disease, the public filings cannot tell us definitively:
 - whether there has been upward pressure on individual settlements (*i.e.*, whether settlements within each disease category were higher than in prior years), or
 - whether there has been a shift in the disease mix of claims resolved (*i.e.*, if the claims resolved were comprised of a greater mix of malignant diseases than in prior years).

Either circumstance would drive up the average cost of claims, but would have different implications for individual claims.
- Our hypothesis that the recent increase in average resolution values represents a shift in the disease mix is supported by other information, including the experience of individual defendants.
 - As we observed in prior updates, one company, Honeywell, reported both the disease mix of its pending claims and average settlement values for both malignant and non-malignant claims. From these data, we continue to observe a movement of pending claims toward malignant filings, but with average settlement values paid to either group of claims remaining fairly stable.
 - Several other companies also reported an increase in malignant filings as a mix of their pending claims in their recent filings, but did not provide data on per disease settlement values.
 - This shift in the disease mix is consistent with the experience of a number of defendants for which we have reviewed their individual data.

Total Indemnity Payments Fell almost 20% in 2013

- Total indemnity payments reached a post-2004 spike in 2011, but have pulled back over the past two years, falling 10% and 17%, respectively, in 2012 and 2013.
- Since 2005, average total indemnity values have ranged from 1.25 to almost 2 times 2001 levels. Even with the recent decline, 2013 payments still remain within this range.

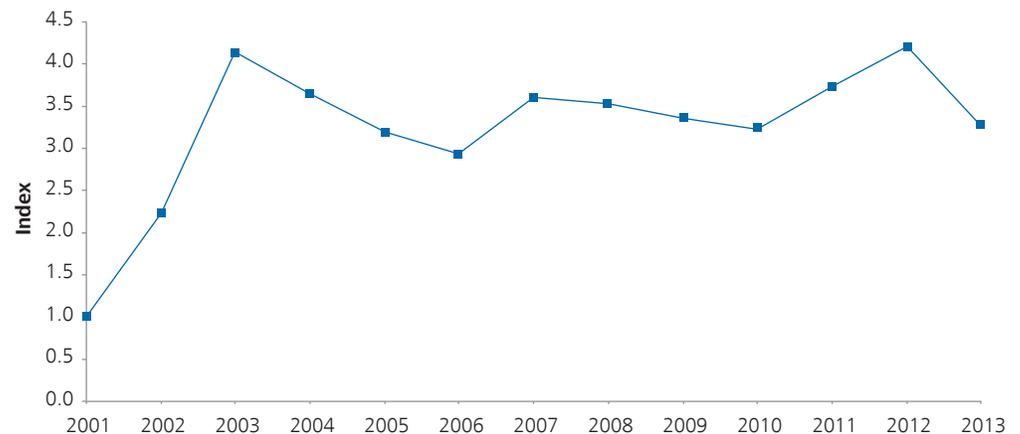
Figure 2. **Total Indemnity Payments per Defendant**
Indexed to 2001



Defense Costs also Dropped in 2013, Fully Reversing the 2012 Increase

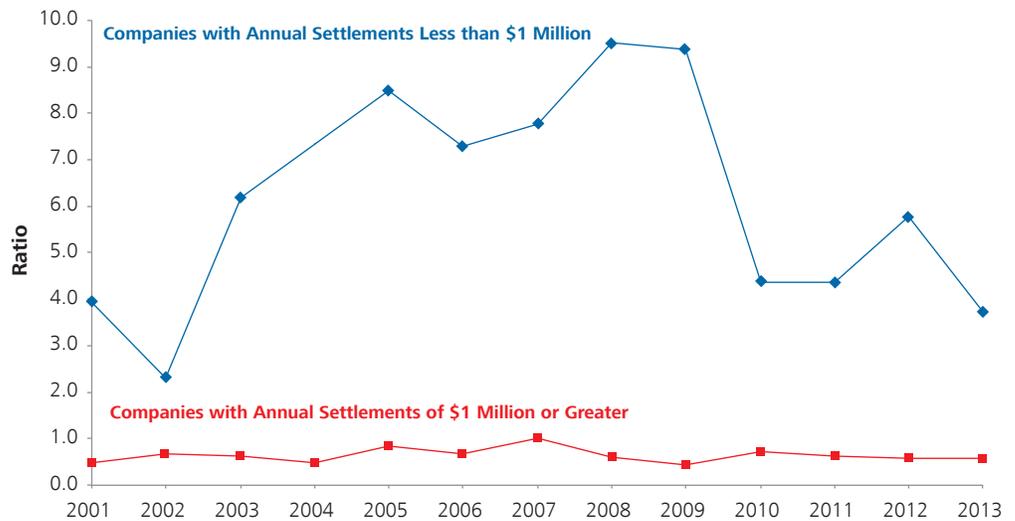
- After peaking in 2012, defense costs, on average, fell by 22% in 2013, returning to pre-2012 levels.
- Over the 2005 through 2011 period, defense costs were variable, rising or falling on average 10% each year, and ranging from approximately 3.0 to 4.0 times the 2001 level.

Figure 3. **Average Dollars Spent on Legal Costs to Resolved Asbestos Claims**
Indexed to 2001



- The ratio of defense to indemnity payments has also been variable, but more so for companies with lower aggregate indemnity payments.
- Since 2001, companies paying at least \$1 million in settlements each year paid on average \$0.44 to \$1.01 in defense costs per every indemnity dollar spent. Whereas for companies with smaller indemnity payments, average defense costs have ranged from \$2.31 to \$9.51 for every dollar spent on indemnity.

Figure 4. **Average Defense to Indemnity Ratio**
2001 – 2013

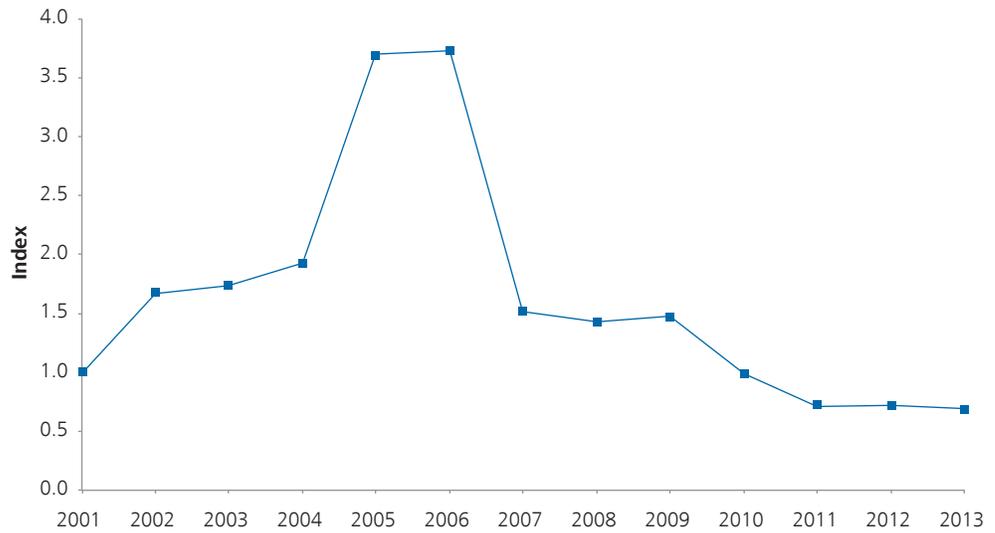


- Factors driving the difference in defense to indemnity ratios between the two groups of companies may include: stage of the litigation (established vs. new defendants) or magnitude of exposure (resulting in differing number of claims being filed each year). Both of these factors may result in differing amounts of fixed vs. variable costs (e.g., certain expenditures need to be made regardless of the number of claims, such as identifying the worksites/products at issue and building a defense strategy). Other factors affecting defense/indemnity ratios include differing litigation approaches (e.g., settling vs. trying claims) and the jurisdictional mix of filings.

The Average Number of Resolved Claims Remained Flat in 2013

- For the third year in a row, the average number of claims resolved was essentially flat. In 2011, the average number of resolutions reached the lowest level since 2001, and resolutions have essentially remained at this level for the past two years.

Figure 5. **Average Number of Resolved Asbestos Claims**
Indexed to 2001

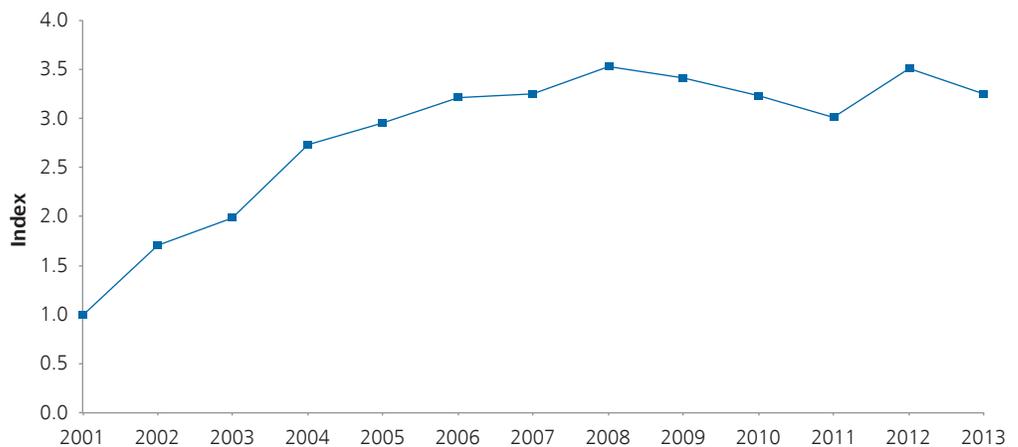


- All claims are not typically resolved in the year filed. Therefore, the claims resolved in 2013 reflect claims filed in years leading up to the resolution date. As we noted in previous updates, filings began dropping mid-decade. The current pace of resolutions likely reflects the lower levels of filings during the second half of the decade.

Dismissal Rates Dropped Slightly in 2013, but Remain within the Recent Historical Range

- Dismissal rates continued to be variable. Since 2005, average dismissal rates have ranged from 3.0 to 3.5 times 2001 levels. After reaching the high end of this range in 2012, dismissal rates in 2013 dropped back to the middle of the range.

Figure 6. **Average Asbestos Dismissal Rates**
Indexed to 2001

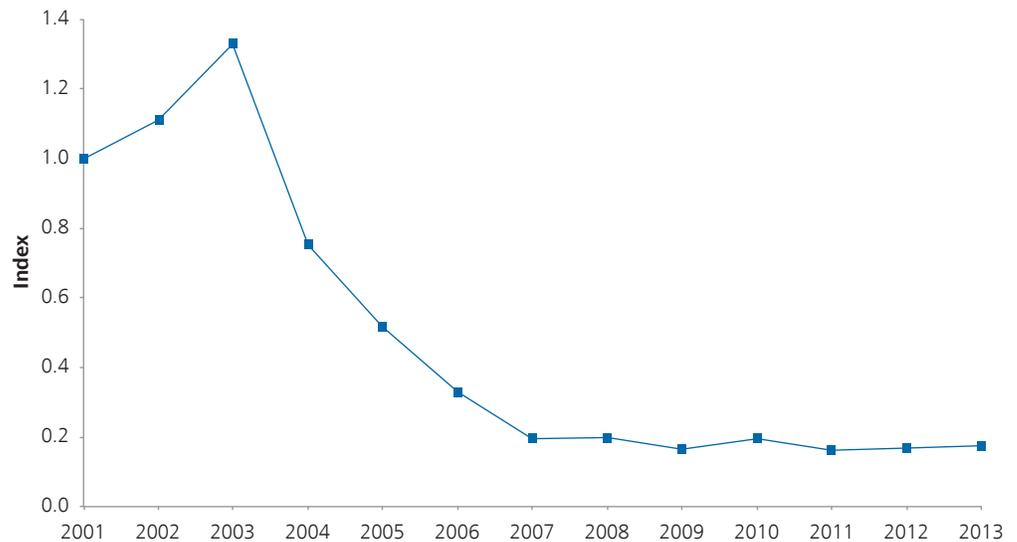


- In our previous updates, we noted that the increase in dismissal rates through much of the decade coincided with changes in the litigation environment. Tort reforms/ increased scrutiny for non-malignant claims by the courts and bankruptcy trusts, which reduced the likelihood that non-malignant claims would be paid. As such, the increasing dismissal rates observed through 2008 were likely driven by the dismissal of non-malignant claims.
- The trend in future dismissal rates is uncertain. As the backlog of non-malignant claims decreases (and the claims failing to survive the tort reforms are eliminated), we may expect dismissal rates to fall. But as time passes, it may be harder for plaintiffs to establish product identification (as claimants age and co-workers are harder to locate), resulting in more dismissals.

Average Claim Filings Have Stabilized at 20% of 2001 Filings

- Since 2007, filings have been fairly stable, hovering around 20% of the 2001 level. Filings continued at this level in 2013.

Figure 7. **Average Number of Asbestos Claims**
Indexed to 2001

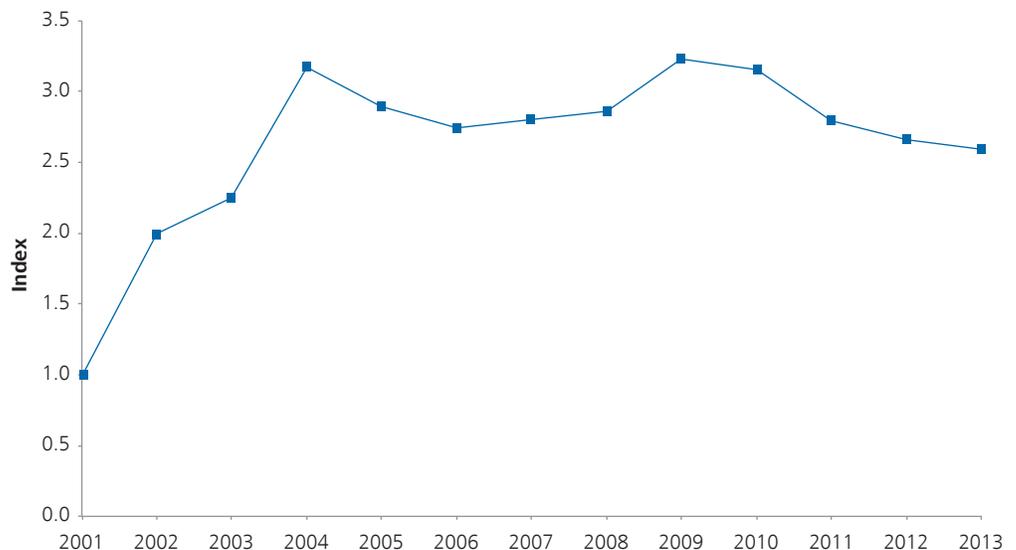


- As we have discussed in our previous studies, the mid-decade drop in filings followed the enactment of legislative and judicial tort reforms in multiple jurisdictions and the tightening of medical documentation requirements by several asbestos trusts.
 - Most companies included in this report did not report malignant versus non-malignant filings in their 10-Ks, but given the changes in the litigation environment, the drop in filings likely represents a drop in *non-malignant filings*.
 - Moreover, as noted above, a few companies did report the disease mix of their pending claims. For these defendants, the mix of claims has been shifting toward more malignant diseases recently.
 - Anecdotally, in our review of detailed claims data for a number of defendants, we have observed a decline in non-malignant filings since the early-decade highs.

Reserve Levels Declined in 2013, Reaching a Post-2004 Low

- In 2013, average reserves declined 2%, as average reserves dropped for the fourth year in a row. Over the past year, 60% of companies reporting reserves decreased their reserve.
- As we noted in last year’s update, reserve levels plateaued after large increases at the start of the decade. From 2004 through 2011, reserve levels remained fairly stable ranging from 2.75 to 3.25 times the 2001 levels. With the declines over the past two years, average reserves have fallen below the low end of this range.³

Figure 8. **Average Asbestos Reserves**
Indexed to 2001



Summary of Trends Through 2013

- Overall, the 2013 results were generally favorable for defendants –average aggregate settlement dollars, average defense costs, and reserve levels all declined. At the same time, filings remained flat and the number of pending claims fell.
- Although average dollars per resolved claim remained high, 67% higher than in 2010, this increase is consistent with a change in the disease mix of the resolved claims towards malignancies. And it has not translated into an increase in either aggregate settlements or defense costs.
- In our 2012 update, we observed an increase in average dismissal rates, reversing a three-year trend of declining rates, and an increase in average defense costs. Both of these were reversed over the past year, with average dismissal rates and legal costs dropping back to the ranges observed historically.
- One of the biggest unknowns going forward will be the impact of the recent Garlock decision on solvent defendants. As noted above, judicial decisions can have big impacts on litigation—following the 2005 Judge Jack decision, both filings of non-malignant claims and the value of these claims dropped. Judge Hodges’s recent decision in the Garlock bankruptcy might have a follow-on impact on future litigation:
 - With the wave of bankruptcies in the early 2000s and the delays before these Trusts came on-line, solvent defendants did not have full information on their claimants’ potential exposures to the bankrupt defendants’ products. Anecdotally defense counsel had reported that plaintiffs frequently held off on filings claims against the Trusts until they settled with solvent defendants.
 - If, with the Garlock decision, more defendants obtain information on settlements received or requested from the Trusts, this information may affect how they litigate or settled claims against them. Access to this information may give defendants more leverage to increase dismissals or put downward pressure on settlements.
 - For any one defendant company, this Garlock decision, as well as other industry-specific trends, may affect its future liability. In addition, company-specific factors, such as jurisdiction mix, industry, historical filings, and settlements may all influence future claims and settlements. And, going forward, other factors such as worksite and alleged exposure to other defendants’ products may also be important drivers of liabilities. NERA can incorporate these factors and trends into a defendant-specific model using forecasting techniques.

Endnotes

- ¹ The authors would like to thank Wendy Magoronga and Tanner Baker for their research. We also thank Stephanie Planchich for her comments and suggestions.
- ² Data from each firm's most recent Form 10-K were used whenever available. We included only data reported at the individual claim level for companies reporting at least two consecutive years in the period. The indexes shown below represent an average of trends observed at the company level. Each chart may contain different companies, depending on the data reported by each company, each year.
Data for prior years were updated if companies changed previously reported information. As a result, the graphs in the current update may differ from those in the previous update over the earlier period.
- ³ The index includes companies reporting at least two years of reserve data, so any initial increase due to the year in which a company first started reporting a reserve is excluded.

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Contacts

For further information and questions, please contact the authors:

Mary Elizabeth C. Stern

Vice President
+1 914 448 4054
mary.elizabeth.stern@nera.com

Lucy P. Allen

Senior Vice President
Mass Torts & Product Liability Practice Chair
+1 212 345 5913
lucy.allen@nera.com