



Benchmarking for

It can be difficult to estimate potential liabilities for fringe companies that have had only a small number of asbestos claims. **Mary S Lyman** and **Jessica B Horewitz** of Navigant Consulting* explain how benchmarking analysis can be useful in this situation



Mary S Lyman



Jessica B Horewitz

Companies often undertake estimation of asbestos liabilities as part of the financial disclosures they are required to make in a variety of situations, including mergers, acquisitions, IPOs, and reporting to the Securities and Exchange Commission (SEC). Asbestos liabilities may arise from long abandoned operations or from legacy companies bought and sold throughout the company's history.

Companies with material liabilities generally have obtained formal estimates of these liabilities, if only for reserving purposes. However, companies that have had only a small number of claims often have no need for such formal estimates until they undertake a transaction requiring full disclosure of potential liabilities. Estimating the liabilities of companies with sparse claiming history presents an analytical challenge. This article presents some examples of how benchmarking analysis can provide such companies with a range within which their liability is likely to fall.

Introduction

Companies that have been only on the fringe of the asbestos litigation may nevertheless be asked to estimate their exposure to asbestos-related liabilities. This presents them with the challenge of estimating something that is not well defined. Companies in this situation often hire experts to perform analyses to help them assess their potential exposure; however, their scant claims data and litigation experience present challenges to any analyst performing liability estimation. Such companies often have fewer than a thousand claims, or even fewer than a hundred claims, on which to base an analysis.

Benchmarking

In any situation in which data are unavailable or limited, benchmarking can be a useful tool. In the case of asbestos, many companies have been involved in asbestos litigation on a daily basis for over two decades, providing a rich source of litigation history and claims data. By undertaking a study of the claims data of many asbestos defend-

ants from a broad range of industries, it is possible to benchmark any corporate entity to a group of companies with similarities in product lines, corporate history, geography or other distinguishing factors.

Recently, Navigant Consulting undertook a benchmarking analysis for a company with under 50 claims. The process began by identifying several companies whose products were similar to existing client data. These companies have agreed to provide information on a confidential basis, that, when combined, allows for the creation of composite indices.

Specifically, the data were used to calculate composite average settlement values and composite acceptance rates (the rate at which claims are paid relative to all claims resolved) for these firms as a group. The group averages were used as a benchmark allowing the valuation of claims already pending against the individual client and estimation of how many of them would be accepted for payment.

The next step in the process is to



asbestos liabilities

address future claims. For companies with ample claims data, projecting the number and value of future claims typically involves a comparison of the number of mesothelioma and lung cancer claims filed against the company in prior years to epidemiological models of future incidence of asbestos-related diseases. This enables an estimate of how many of those becoming ill in the future would file a claim. Claims for other cancers are then estimated based on the historical ratios of such claims to claims for mesothelioma and lung cancer. Claims for nonmalignant disease are estimated based on the historical ratios of such claims to claims for malignant disease, with adjustments for recent trends.

If the entity has very few claims, however, the estimation may be based entirely on benchmarking. While this approach cannot provide a precise estimate, it can, based on the experiences of similar companies, establish a range of estimated liabilities. It is then possible to ask and answer the questions: 'What would this company's liability be if it continues on with the same low claims experience as it has seen in the recent past?' or 'How would that change if the company experiences an adverse settlement or verdict?' or, as a worst case or upper bound scenario, 'How would that change if this company becomes a typical or more active defendant in this industry?'. The benchmarking method can also be used to create a range of

estimates by varying our assumptions with regard to claiming rates, acceptance rates, and claim values based on the range of experience found among

similar companies.

Other considerations

While the fringe company's claims

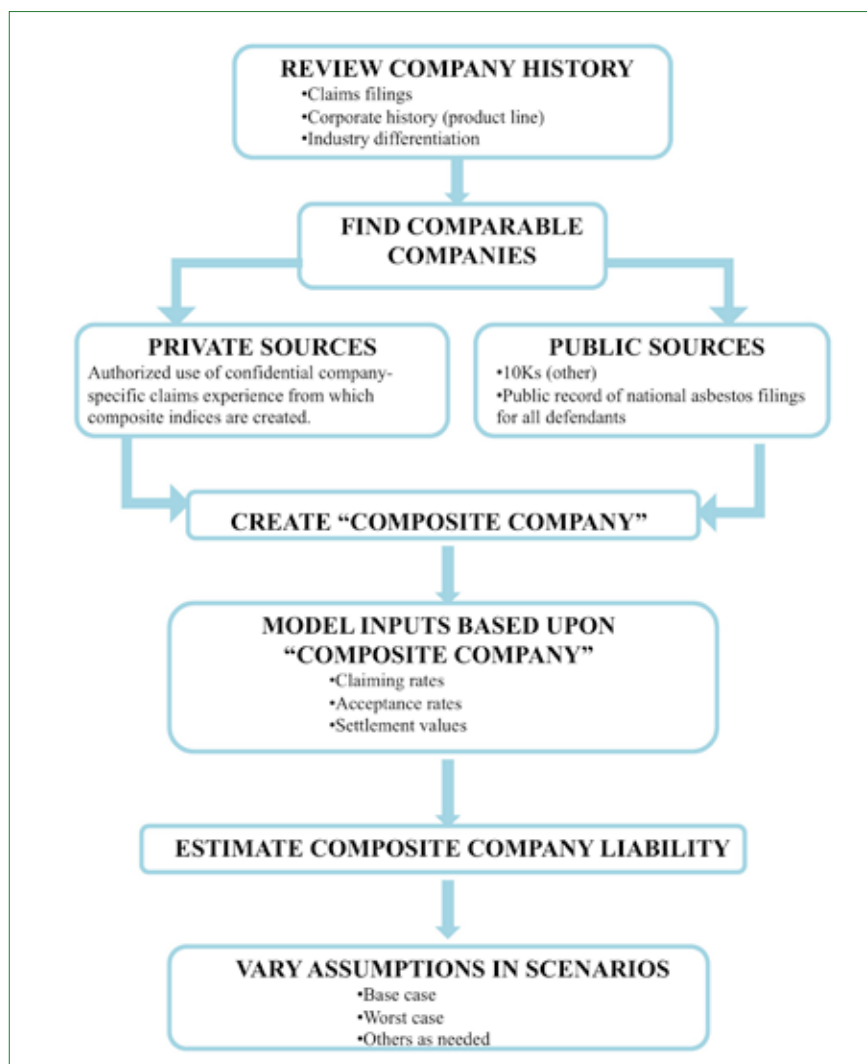


Figure 1. Typical benchmarking process



Estimating the liabilities of companies with sparse claiming history presents an analytical challenge

history and that of the companies serving as its benchmarks are critical components of any liability estimation, they cannot be considered in isolation. Other factors that may have a critical effect on liability should be examined and may be incorporated into the assumptions used in the estimation. These include the litigation environment, the company's corporate history, and asbestos-related bankruptcies in the industry and among the company's present or past subsidiaries and affiliates.

Litigation environment

If the litigation environment were unchanging, past claims history could easily be used to predict the future. Asbestos litigation, however, has gone through a number of changes over the past several years, including changes in the mix of diseases claimed, in the states with the highest numbers of claims, and in claim values. For example, the ratio of claims for nonmalignant disease to those for malignant disease, has changed dramatically in recent years. Such changes are likely to continue in the future. It is thus important to look at the way these and other factors are trending not only for the individual company, but in the company's industry, in the jurisdictions where claims against the company are most likely to be filed, and in the country as a whole.

Developments such as tort reform legislation and important court decisions which may change current patterns also need to be considered. For companies whose lack of claims history makes it difficult to discern individual trends, these more general trends can be helpful in obtaining a sense of future possibilities.

Corporate history

Complicating liability estimation

for firms outside the mainstream of asbestos litigation is the fact that their potential liability often stems from the asbestos-related activities of entities that the company has acquired, spun off, and/or sold. Sometimes the company still owns the entity responsible for the liability; sometimes it was sold off years ago. Even brief ownership of an entity with asbestos operations can create problems later. Some producers of asbestos-containing products have been bought and sold by several companies, seeding each with liability during the years it was held.

For this reason, it is important to have detailed knowledge of both corporate history, including all corporate divisions, subsidiaries, and affiliates which may have produced or used asbestos-containing products and the history of each, and the laws in such areas as successor liability that govern the various rela-

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tionships. For example, an analysis was performed for a client that had a subsidiary which once manufactured asbestos-containing products and which had obtained that particular business as the last in a long chain of owners which began with a major asbestos defendant. For this client, the particular successor liability law of each state in which it was likely to be sued had the potential to significantly impact its litigation costs and liability. This factor was considered in constructing an upper bound scenario.

Bankruptcies

Bankruptcies are another factor that

must be considered. On the one hand, asbestos-related bankruptcies of several major players in an industry can have the unfortunate effect of shifting the focus of plaintiffs to the lesser players, potentially increasing the liabilities of the fringe companies. This is a factor to consider when assessing the litigation environment.

On the other hand, if one of the subsidiaries or affiliates contributing to the fringe company's liability has been through the Chapter 11 process, it will likely have emerged with a 'channeling injunction', a court order that diverts all asbestos claims away from the reorganised entity to a claims trust. Depending on the wording of the injunction and the nature of the fringe company's relationship to the debtor that obtained it, the injunction may protect the fringe company from liability stemming from its relationship to the debtor.

Conclusion

Estimating the potential asbestos-related liability of a fringe compa-

ny in the asbestos litigation can be challenging when there is a scarcity of claims data on which to conduct traditional analyses. By benchmarking to similar defendants, learning the details of the corporate history, and carefully assessing the litigation environment at both the micro and the macro level, however, it is possible to provide the client with an analytically sound range of potential liability and the assurance of an upper bound should the worst case develop. ●

** Mary S Lyman is an associate director and Jessica B Horewitz is a director of Navigant Consulting in the USA.*

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