Staff Information Report
(SR-7)

Governments at Risk: Liability Insurance and Tort Reform

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Advisory Commission on Intergovernmental Relations

Washington, D.C.

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Preface

During the past two years, one of the most thoroughly studied and discussed issues on state legislative agendas has been the liability insurance crisis. While most observers agree that the crisis has eased considerably, debate about the reasons for the improvement and the search for remedies continue.

Once primarily a concern of higher risk businesses and occupations in the private sector, the availability and affordability of liability insurance now is a major issue for the public sector as well. Many insurers consider coverage for governments a riskier enterprise than for private clients, in part because governments—and government officials—today are more vulnerable to lawsuits. In fact, according to the Insurance Information Institute, local government liability insurance is among the most difficult types of coverage to obtain today.

In April 1986, the Advisory Commission on Intergovernmental Relations sponsored a panel session on tort reform and the liability insurance crisis as part of its annual conference of state advisory commissions on intergovernmental relations. The conference brought together nearly 40 representatives of these counterpart organizations and other federal, state and local agencies and associations to discuss the nature of the crisis and to exchange information about how to remedy the situation.

This staff information report presents the results of the panel presentations and discussions, and was prepared by Jane F. Roberts of the ACIR staff. Significantly, this document represents the first joint publication activity of the national ACIR and the state counterpart agencies.

John Shannon
Executive Director

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Introduction

Escalating premiums, policy cancellations, lower limits of coverage, higher deductibles, and a decrease in availability of insurance have produced a "liability crisis" that hit states and localities particularly hard during the past two years. In fact, many local governments throughout the country have been forced to operate without liability insurance because they could not afford coverage, while other localities have closed facilities and curtailed programs and services to reduce their risks.

Last year, for example, it was estimated that two-thirds of the local governments in California operated without liability coverage. One Ohio town went to court when it was confronted with a 2,000% premium increase and settled out of court for a more reasonable policy. The officials of a small Delaware town resigned en masse for fear of being sued because of an action they might take as members of the town council. County officials in Wisconsin took police cars off the road because they could not afford insurance. A Texas town council was forced to double property taxes in order to pay a liability judgment. At least a half-dozen states had their liability policies canceled.

The Factors

A number of factors have combined to produce the latest liability crisis. In the legal arena, the nature and extent of government liability have grown considerably over the past 20 years as the doctrine of sovereign immunity has been eroded by legislative actions and judicial decisions. This erosion of protection from lawsuits has occurred as government services and programs have expanded in many areas. The number of claims against governments and governmental officials has grown, and the increasing size of the awards in these cases has helped to reinforce what some have described as the "sue syndrome" or "litigious society."

Local governments have been especially hard hit because they are viewed as having both "deep pockets"—substantial resources and the ability to pay—and "long tails"—involvement in activities where liability is hard to predict and may result in a legal action long after an event has occurred. Local government vulnerability to lawsuits is furthered by the concept of "joint and several liability" that enables a plaintiff to recover the full amount of damages from one defendant when other defendants are unable to pay. This combination of factors in the civil justice (tort) system has helped to increase the demand for government liability coverage, yet at the same time, to reinforce the view that governments are not good risks.

In the insurance arena, the increasing demand for coverage has coincided with a major downturn in the economic health of an industry prone to cyclical changes. Companies experienced major losses in 1965 and 1975. However, the most recent decline, beginning in 1984, is significant because of its size and duration. Insurance companies have reported that 1984 and 1985 were the worst loss years ever for the industry, about $9 billion. The effects of this loss cycle have been immediately felt in two areas: a reduction in availability and sharp increases in premium prices.

The reasons for the severity of the most recent downturn are varied and the topic of considerable debate. Insurers maintain that losses in interest income, larger settlements, increasing numbers of claims, and tort law have exacerbated their financial problems. Critics, however, maintain that the industry's precarious position is due to its own mismanagement and the high level of competition in the 1970s when interest rates were high and insurance companies engaged in price wars to attract new businesses and investment dollars. Critics also challenge the contention that the number and size of claims and settlements have risen as substantially as insurers maintain they have.

The difficulty in finding information about insurance company operations is one of the key problems in assessing the liability insurance crisis. Regulations and reporting requirements vary considerably from state to state, and the public (and policymakers) currently must rely on the insurance industry itself for information.

The Responses

There are at least eight reforms of the tort system which are considered priority issues:

- cap on noneconomic damages for pain, suffering and mental anguish;
- a limit on punitive damages awarded to punish gross negligence or fraud and to deter future occurrences;
- installment payments of claims;
- abolition of the collateral source rule;
- substantial modification of the joint and several liability doctrine;
- modification of the contingency fee system for attorneys;
- imposition of stiff penalties for frivolous lawsuits;
- restoration of a restricted form of sovereign immunity.

On the insurance side of the equation, other regulatory and legislative remedies have been suggested:

- strengthened state regulation of the insurance industry;
- structured insurance premiums based on past experiences;
- separate risk classifications for local governments;
- a prohibition on mid-term policy cancellations; and
- the development of pools and other alternatives to the commercial insurance market.

According to the National Conference of State Legislatures (NCSL), during the past two years every state legislature has considered proposals to deal with the liability crisis. Over 40 states have enacted some form of tort reform or insurance legislation. For the longer term, nearly half the states have established study committees to review a wide range of civil justice and insurance regulation issues. Of special interest to local governments, a dozen states have altered their joint and several liability doctrines, while others have modified sovereign immunity provisions; and a number of states have established insurance pools, authorized risk management programs, or enacted provisions for self-insurance arrangements. At least two states—Michigan and Washington—have made comprehensive, across-the-board revisions of their tort systems.

At the federal level, the Reagan Administration's Tort Policy Working Group proposed that major changes to the federal tort system be enacted, including caps on damages for pain and suffering and on punitive awards, limits on attorneys' fees, restrictions on joint and several liability, and structured awards (installment payments of claims). Although a number of legislative proposals were introduced in the Congress and well over 60 hearings were held, only one insurance-related bill was enacted: the *Risk Retention Amendments of 1986*. The measure allows entities (including governments) which face similar risks to form self-insurance groups, within certain limits, to provide liability coverage. The act limits state regulation of these self-insurance (risk retention) groups and permits them to operate on an interstate basis. It is still unclear, however, whether the act will facilitate local government self-insurance activities in light of a number of restrictions and ambiguities that are in the law. For example, a risk retention group must be chartered or licensed as an insurance company in at least one state, and only can provide liability insurance. Local government pools are not chartered or licensed insurance companies, and generally offer other types of insurance (i.e., workers compensation, health) to their members.

The need for further federal action which would set national standards or preempt state insurance laws and regulations remains one of the more controversial intergovernmental issues in the liability crisis debate.

The Panel

In light of the involvement of a number of the state advisory commissions on intergovernmental relations (ACIR) in formulating solutions in their own jurisdictions, a panel session was included as part of the fourth national conference of the state ACIR counterpart agencies in the spring of 1986. Nearly 40 attendees, representing 14 state ACIRs and several federal and state agencies and public interest groups, participated in the discussion. The text of the panelists' remarks and highlights of the ensuing discussion follow in this report.

The five panelists each addressed a specific issue area in the presentations:

- Michael Bird, of the National Conference of State Legislatures, discussed state actions to regulate the insurance industry, to reform the civil justice system, and to develop nontraditional alternatives for liability coverage.

- Nolan Jones, of the National Governors' Association, focused on the federal role, with specific attention directed to the question of federal intervention and preemption of state laws.

- Don Jones, of the National League of Cities, provided a national view of the impact of the liability crisis on local governments, and suggested that remedial actions were needed at both the federal and state levels.
- Lois Pohl, of the Missouri Commission on Local Government Cooperation, described her state's efforts to provide an insurance option for local government units faced with escalating premiums or policy cancellation.
- David Mattek, of the New Jersey Commission on County and Municipal Government, reviewed the findings and recommendations of his commission's major study of the tort system.

Neither the panelists nor the other participants could agree on a single strategy to resolve the current liability insurance problem.

Questions remain about the need for federal intervention or preemption of state laws, tighter state regulation of the insurance industry, and a better balance between the protections provided by sovereign immunity and the preservation of an individual's ability to seek redress from negligent and fraudulent actions. Nevertheless, a consensus did emerge about the severity of the situation. The liability crisis is not just an "insurance problem" but rather a public policy issue with important fiscal and federalism implications.

The Panelists

Michael Bird
National Conference of State Legislatures

Nolan Jones
National Governors' Association

Don Jones
National League of Cities

Lois Pohl
Missouri Commission on
Local Government Cooperation

David Mattek
New Jersey Commission on
County and Municipal Government

Michael Bird
National Conference of State Legislatures

Thank you very much for giving me the opportunity to speak on what continues to be a growing and more complicated problem for virtually every state: the availability and affordability of liability insurance. I think you are all aware of what the current crisis is: larger portions of public and private sector budgets are being directed toward the purchase of insurance. There is an additional crisis among the public interest groups as they pursue very different courses in seeking solutions to this whole situation. So it makes it more difficult for policy makers to try and weed out various approaches that have been proposed because different constituencies have very different perspectives on how to provide a remedy.

The National Conference of State Legislatures has published a variety of reports which not only spell out the issues but also explain some of the solutions that are being attempted. Each year as the legislatures adjourn, we summarize the kinds of actions that have been adopted, and also try to spell out those issues that were not resolved. I think it is safe to say that the issue is not going to go away in a short period of time. It is at the top of virtually every state legislative agenda, and it is going to remain there during the interim. Unless there is a dramatic turnaround in terms of the availability of insurance, exposure to liability will continue to be a major issue.

The remedies that are being applied generally fall into four categories, and I am sure you are all aware of the fact that each state is addressing the problems differently.

First, market system plans have been established in some states. Montana and North Carolina, in special sessions, authorized their state insurance commissioners to set up joint underwriting associations which essentially compel insurers to provide a line of coverage. There are a number of states that have taken the initiative to require the disclosure of an upcoming nonrenewal or cancellation of a policy.

The second area deals with the price of the product. I don't think that you will see that any legislature is very satisfied right now that it was able, in any way, to actually reduce premiums for anyone. There may have been mechanisms put in place to get a little bit of a break, but generally speaking, premiums have gone up. In various sectors, they have gone up exorbitantly, and I don't see anything on the near horizon (the next year or two) that is going to change that situation. Of particular concern are ways to temper some of the large peaks and valleys in the cyclical nature of the insurance industry.

Some states are demanding that more information, whether it be retrospective or prospective, be given to their insurance departments in terms of the coverage being provided in one state as opposed to another; and whether or not any of those mechanisms are going to change the cost of coverage. Ultimately, there may be some effect on how the cycle can be tempered, but I believe it is a very ill-defined art at this point, and I don't think anyone has an answer or could say for sure what will change the price of insurance coverage.

A third issue is in the area of tort reform. Virtually every state legislature has addressed the issue of whether or not it should modify joint and several liability; whether or not it should cap damages and awards; whether it should schedule or not schedule attorneys' contingency fees; whether or not it should limit liability or make local governments or nonprofit groups immune from various kinds of liabilities.

One thing that really stands out is that most states that have acted so far usually have tried to address the problem that local governments are having, either by limiting their liability or making them immune from various kinds of suits, but in some cases helping them to self-insure.

There are a number of states that do not allow any kind of pooling mechanism or joint purchasing mechanism to be put in place. However, that seems to be changing somewhat. And this is the fourth alternative that is being looked at with greater and greater interest: nontraditional mechanisms which can be used to enhance the availability of insurance. Should self-insurance pools be created? Should risk retention groups be established?

I think that state policymakers, and legislators in particular, are very keenly aware of the problems that are out there. At the same time, I think they are concerned by the fact that this is a very complicated issue with international repercussions. The reinsurance lobby is very influential, and many of the reinsurance companies are global firms.

I also would like to briefly discuss what is going on at the federal level to address the liability crisis. You can just about pick any day of the week and go to a congressional hearing on the liability insurance problem. Virtually every committee has found a way to obtain jurisdiction over the liability issue. But the Congress is dealing with an issue that they rarely deal with, except in very, very limited areas such as Superfund, the crop insurance program, and crime insurance. Liability is something that the Congress essentially stepped away from when the *McCarran-Ferguson Act* was adopted and left the regulation of the insurance industry to the states.

I don't think anybody initially was prepared to revisit *McCarran-Ferguson* again, although that now is a possibility. There is legislation that has been introduced by Congressman Boehlert of New York, and I think Senator Simon of Illinois is getting ready to drop a bill in the hopper. I wouldn't be surprised if Congressman Rodino from New Jersey also has a proposal, and that *McCarran-Ferguson* may be brought out, dusted off, and amended to some extent.

There have been calls for federal reinsurance, federal back-up insurance, and federal standards for the state regulators. All of these options are in the discussion stage, but I think the Congress really feels as if it doesn't have enough information as yet to deal with all the issues. There also seems to be a sense of "wait and see" what the states will do on their own without federal intervention. However, I think that attitude will change if states do not move to improve their regulation of the insurance industry and extract information from it, and if lines of insurance coverage no longer are available to major portions of the public and private sectors.

That is a real thumbnail summary of what is occurring from our perspective. I would be more than glad to answer any questions.

Nolan Jones
National Governors' Association

The National Governors' Association (NGA) has a liability insurance task force of governors headed by Governor Edward DiPrete of Rhode Island and consisting of Governors Thomas Kean of New Jersey, John Sununu of New Hampshire, John Ashcroft of Missouri, James Thompson of Illinois, Michael Dukakis of Massachusetts, Richard Bryan of Nevada, Mario Cuomo of New York, Richard Celeste of Ohio, and Gerald Baliles of Virginia, who have proposed a series of recommendations for the governors' consideration.

A major concern discussed in the task force report is the question of federalism. Essentially the governors suggest that in the areas of liability insurance and tort reform, highly compelling reasons are necessary to justify federal action or intervention. This position also applies to the area of product liability. The controversy over federal product liability law has reached a new peak, with a number of bills calling for a stronger federal role.

Supporters of these proposals argue vigorously that differences in state law governing product liability prevent manufacturers engaged in interstate commerce from operating predictably or knowing their responsibilities and obligations, leading to skyrocketing insurance and legal costs and negative impacts on product development. Opponents charge equally forcefully that proposed federal statutes would drastically curtail the ability of consumers to win compensation for product-related injuries, thus diluting the deterrent of current law and weakening manufacturers' incentives to design for safety and safer products.

Supporters of federal legislation also have continuously failed to demonstrate empirically the need for such legislation. They point out that business cannot exist with strong laws in one state and weak laws in another state, and no uniform guiding principles for the manufacture of products. They also contend this nonuniformity contributes to the high insurance rates. Yet, the industry, asked by NGA and others to present empirical evidence that insurance rates on products are a direct function of differentials in state tort laws, has been unable to do so. Supporters are left defending the idea of uniformity in product liability law or for tort reforms at the federal level just for its own sake. Meanwhile, they ignore the federalism question.

Even if variations in product liability laws between states were found to be responsible for some uncertainties in the marketplace for insurance, would federal legislation—no matter what the standards—produce the desired stability? There is some reason to think that this would not be so. In fact, it is perfectly possible that federal legislation would create even greater uncertainty and inconsistency, and more so than the laws that exist in the different states.

Each state, for example, would construe the law according to its own principles, resulting in potentially wide variations. There would almost certainly be a large amount of litigation. Many observers believe that the Supreme Court of the United States would intervene and be extremely likely to establish the desired uniformity by granting certiorari in these cases.

The Congress also would be almost certain to enact more legislation to clear up the confusion, which would lead to even more federal control of tort law. Many would argue that jurisdiction in these cases should be given to federal courts in order to try to have uniformity. This was, in fact, the thrust of the testimony by the state chief justices before the Senate Commerce Committee.

Nobody would deny the tremendous complexity of product liability law or that standards do vary between states, but these facts alone do not create a convincing case for federal preemption of state activity in this area. The development of tort law during the last 200 years reflects the slow evolution that can best be achieved through court-created case law. Product liability has developed through a cautious and deliberative process, reflecting the gradual adaptation of the law to changing concepts of justice and social responsibility.

In an extremely complex and controversial area of the law, the diversity represented by product liability doctrines developed in state jurisdictions can be considered a strength rather than a weakness. Today, a variety of doctrinal approaches are in use around the country. In product liability, as in other areas, the states are truly serving as laboratories of democracy, to use Justice Frankfurter's phrase, testing and refining concepts.

Given the President's commitment to federalism and his repeatedly expressed desire to reduce the burden of federal regulation and eliminate federal interference in issues of state sovereignty, it is hard to under stand why the Administration has proposed that federal legislation is needed in this area. A federal law with no federal question of jurisdiction, a law which must be enforced by state courts, is plainly and simply inconsistent with sound principles of federalism.

The development of tort law through the common law system at the state level has served our country well. The present insurance crisis should not be used as an excuse to destroy this principle whereby states have always been able to address the grievances of their citizens and to right wrongs that have happened to their citizens.

Federal uniformity, however attractive conceptually, is not necessarily consistent with this goal and should never be allowed to become the guiding principle behind tort reform. States are meeting their problems head on. Let us give their solutions a chance to work. Thank you.

Don Jones
National League of Cities

Let me comment, from a national perspective, on how municipal governments are approaching the liability insurance problem. At first, people began to wonder if the situation was worse in some states than in others, but I think that it is now well documented that we have a nationwide problem. Unfortunately, I think we have more anecdotes than good information on what has been occurring. Studies have been done by the Public Risk Insurance Management Association documenting premium in creases that municipalities have experienced in renewing their liability insurance. Other studies show that local governments are being sued more often now than in the past, that the judgments are larger, and that legal defense costs are higher.

Our (the cities) view on how we got to where we are is not shared by everyone. And when you start looking to assign the blame, we think there's plenty to go around. Clearly, the insurance industry has done some things in the past which have compounded the problem. They have engaged in price wars and underpriced their products. Then, suddenly, they changed direction as interest rates have gone down.

We do not take the position that the insurance industry is blameless, but we would likewise not take the position that it is an insurance industry crisis or insurance problem. In our view, it's a good deal broader than that. Our view is that state legislatures and state and federal courts can also readily share in the blame, as really can local governments themselves.

The notion of sovereignty was with us in most states until a relatively recent time—15-20 years ago. That is when we started chipping away at the notion of sovereignty, and the trend has been unmistakably in the direction of making local governments, and government generally, liable for their actions. Courts have thrown out state laws, and have made various interpretations which have compounded the situation. And certainly, we can trace a number of major federal court decisions which have greatly expanded the liability of state and local governments. You can't really blame those actions on the insurance industry. Those are developments for which the court system and the state and federal legislative bodies should receive full credit.

I think that those of us at the local level can't really escape completely the notion that we have some responsibility in the compounding of this situation as well. As much as it pains me, this is a criticism of my employer—the cities of this country.

I think our whole concept of managing and funding risk has developed only fairly recently. A few years back, nobody talked much about risk management. Cities had insurance buyers on the payroll, but not risk managers. Risk management really started in the private sector, and gradually has become a very fashionable item to talk about in the public sector. The growth of the risk management profession in state and local government has been one of the remarkable stories accompanying the liability insurance question.

I also think that in the recent past it was relatively easy for local governments to insure their risk. Insurance was cheap: don't worry too much, just buy insurance. Certainly, the present crisis has brought us up short and has forced us to take a much harder look at how we manage risk. I think we're doing a better job, and that may be one of the positive byproducts of this whole issue.

Well, so much for the way we assign blame. There's plenty to go around, and we're not too anxious to try to make it the fault of any single participant.

Now, what do we do about it?

As far as the insurance industry itself is concerned, I suspect that there will be, to a certain extent, a self-correcting phase. The insurance industry, as I think most of you know, has always gone through various cycles in which they underpriced and then experienced difficulties and shortages. Perhaps this is a worse cycle than in the past, but it's certainly not the first time we have gone through this type of experience. I suspect that the time will come when capacity will increase, and will once again make insuring local governments more attractive. As far as what happens at the state level, of course, the state legislatures have a heavy responsibility in setting the ground rules for the liability of local governments under state law. Some element of the liability issue has been discussed in most states this year: joint and several liability, attorneys' fee caps, structured settlements, collateral source rules, and all of those other buzz words the lawyers like to use.

Yet, from an intergovernmental perspective, the problem is that despite what is being done at the state level, unless something is done at the federal level we're going to continue to have a very serious liability problem for local governments. Sly attorneys are quite creative in figuring out how to end-run state caps and various other restrictions in state laws by bringing actions under federal law.

Action at the state level must be accompanied by action at the federal level if we're to somehow get a handle on the situation.

Liability for local governments at the federal level comes in a number of areas, and is perhaps most readily seen where federal laws have imposed extensive local liability pressures.

Cities also have a certain amount of liability under federal antitrust laws, although the recent action of the Congress in eliminating monetary damages has eased that greatly. Trial attorneys, however, have become creative in the antitrust area by employing the *Federal Racketeering Act* because that law still provides treble money damages. As a result, we're already seeing some attorneys taking cities to court for violation of the *Racketeering Act* for the sorts of issues that a couple of years ago would have been brought under antitrust law.

Finally, there is what many consider the grand champion of our federal exposure: Section 1983 of the *Civil Rights Act of 1871*. Without some attention to the extent of liability exposure derived from that section it is awfully difficult for cities to believe that they will become attractive to the insurance industry again because civil rights liability knows no bounds. Cities will not be able to manage their own risk effectively without some better definition of the extent of liability under that statute.

It's a very difficult and extensive piece of legislation to deal with, as I'm sure you all know. The basic protections under the *Civil Rights Act* are something which I don't think anyone here would want to quarrel with, and yet it is being used—and cities would say abused—by creative attorneys who want to end-run state tort liability laws and get into federal court. For example, we're seeing it used for zoning cases. And another case just came to my attention the other day: a jogger in Palm Beach, Florida, who sued the city for a violation of his civil rights because the city required he wear a shirt while he was jogging on downtown streets. Examples like this have led the National League of Cities to a policy position in support of legislative help to keep traditional tort claims and actions out of federal court under the *Civil Rights Act*, and to once again use that Act for the purpose for which it was designed.

We also support an amendment to the *Risk Retention Act* to permit insurance pooling by local governments across state lines. And, we have been watching closely the discussions of President Reagan's tort policy working group. One option may be a "Federal Tort Claims Act" proposal, but that really does not help local government. It may be that a federal tort act will serve as a useful kind of model or standard by which state actions can be amended, but unless the state legislatures take similar actions, there is really no help there for local government.

We also are working closely with the municipal self-insurance pooling programs and strongly support those activities as an alternative to using conventional insurance to insure against risk. It is our view that, out of this whole crisis, governments may well find that they are less dependent on the traditional insurance industry by using some of those other mechanisms, and therefore may be less subject to future cycle changes in the insurance industry. To that extent, there would be a stabilization that would serve local governments well.

The National League of Cities also has established what we call a "pool of pools" through a national program that will help reinsure the State Municipal League pools. The 23 states that are involved in the state pooling programs now represent only a portion of the intergovernmental pooling activity going on around the country. There also are about 170 other pools that can be identified, half of them in California, where there has been a tendency to use small regional pools for cities and schools. There also are statewide county pools.

In conclusion, what started out as seemingly only "an insurance problem" really is a much broader issue that ought not to be driven just by our interest in what happens in the insurance industry, but by support for tort reform, better risk management programs, and a recognition of the intergovernmental ramifications of proposed federal actions. Thank you very much.

Lois Pohl
Missouri Commission on Local Government Cooperation

Missouri has the same insurance problems that everyone else has, and we agree it is not an insurance problem; it is a public policy problem. A product liability measure was tabled this year (1986), but we did pass a malpractice insurance bill.

Missouri also allows for pooling, and there are now five insurance pools in operation. However, there have been some problems with the pools. One is that you still are dealing with the insurance company. A second problem is eligibility: which cities or counties are eligible to join in these pools?

In response to these problems, the Commission on Local Government Cooperation began looking at ways these eligibility and related issues could be resolved. At the same time, school district officials were discussing the possibility of establishing an insurance pool with our state's risk manager. It was clear there was a mutual interest, and through a combined effort of the Commission, the local government associations, and the school district representatives we drafted a legislative proposal that covered everyone.

Basically, the legislation is designed to provide comprehensive liability protection for all member public entities. All liabilities to which a state political subdivision, its officials and employees are exposed, whether in state court or federal court, will be covered. The State Office of Administration will administer the fund and will provide all claims and legal loss control services to participating entities. These services will be provided on a contractual basis. A board of trustees will be responsible for the proper operation of the fund, including all decisions relating to payments from the fund, and will have exclusive jurisdiction and control over the fund.

The board of trustees will consist of the state Treasurer, the Attorney General, the Commissioner of Administration, and four members from participating public entities who will be appointed by the Governor with the advice and consent of the Senate.

In setting the premium or contribution for each participating public entity, the board will consider and adjust for risk management and loss control programs by the entity, the entity's loss experience, and the amount each would pay for a commercial liability insurance coverage as calculated in accordance with accepted rating procedures.

The funds and property of the fund will be kept safely invested in order to earn a reasonable return. The fund and its investments will be regularly audited by the State Auditor.

The fund will provide a maximum of $800,000 for the payment and settlement of claims arising out of a single occurrence. Liabilities exceeding $800,000 may be protected by the purchase of commercial insurance. It is intended that for the investment of a reasonable contribution and support of the fund, public entities in Missouri will have comprehensive protection.

This fund will make Missouri unique at a time when such commercial insurance protection is either unavailable or unaffordable. All the public entities in the state are being surveyed to get an idea of their premium costs versus their claims and judgments. Five hundred and seventy-six entities have reported so far. In 1983, total liability premiums of those 576 entities was $1,589,000. The total liability claims judgments was $769,000. In 1985, the liability payments jumped to $9,704,000.

Missouri is a very conservative state, and I think we have been hit hard because our premiums are based on a national rate rather than a state rate.

Also, an interesting question in this situation was that no one responding knew exactly what their insurance coverage was. So those that had private insurance did not really know what insurance they had. It's amazing. They just knew they paid $500,000 a year.

Only six cities out of the 576 said they would not want to join the fund. The counties association, the municipal leagues, the public school districts, the fire protection districts, and our Commission on Local Government Cooperation all are actively supporting this legislation. We expect passage in the next few days, and we are really excited about it.*

*Signed into law on June 20, 1986.

David Mattek
New Jersey Commission on County and Municipal Government

I agree that the questions we are looking at today are a public policy problem rather than an insurance problem. What I would like to do is describe the conclusions and recommendations that my Commission reached in the study of tort reform and liability insurance.

In December 1985, the Commission decided to try a different approach to a major research project: complete the study recommendations in a short period of time, while there was a hot debate going on among all concerned parties. This approach was a significant change for our commission.

Thirty days later, we had two insurance consultants and an attorney under a six-week contract, with deliverables due by March 15, 1986. A 200-page report and recommendations was finalized by April 1, and has been approved by the Commission.

The basic decision we made early in the process was to concentrate on local government insurance and liability problems, and not include state government, any kind of product liability, or any other kind of insurance or liability question. We worked with our league of municipalities and counties association to send out a survey to all of their members. We evaluated the results, and they were similar to those discussed by the earlier speakers. Some jurisdictions have experienced 50% increases in insurance costs, and others have gone up 2000% in one year for identical coverage. A number of New Jersey local governments' coverage had been eliminated. They can't get any. These are really shocking figures. We have all heard about these horror stories already, and I suppose it should not be a surprise.

Another thing we discussed is that only a small number of suits, court settlements, or judgments seem to be having a major impact on this situation. Although we have statistics indicating that only a small number of cases push dollar costs up, there also is a feeling among virtually all members of our commission that local government is perceived as an "easy mark" by people who may want to be involved in suits. That is a question that we want to deal with separately and in conjunction with our analysis of the insurance side of things.

We have had a "Tort Claims Act" in our state since 1972 which more or less abrogated sovereignty and set the stage for how all governments were to be treated in tortious actions. The members of the Commission felt that the situation should be looked at separately, and we did that through a legal consultant.

One of our principal conclusions is that suits against local governments are suits against all people and the taxes they pay to support their governments. Further, governments should be treated differently, separate and distinct, from the way any other private entity is treated. This conclusion brings you to some substantial differences in what kinds of things you may recommend.

As far as the insurance crisis goes, I analyze things in this way. I don't merely mean this to be assigning the blame, but I think I would like to call it "what kinds of factors contribute to the insurance crisis and how great are they."

I think that the most important contributing factor in its simplest form is the prime interest rate. A brief time ago the prime interest rate was 21%, and now it is 9%. The insurance companies earn more money from investment of income than they do as a result of their insurance sales. They have greater profits from the interest they can earn than they do from the business of insurance, and this factor totally dominates the insurance market and is the most important cause of the current crisis.

When times are good in the insurance industry, premiums are lowered. The companies sell many more lines of insurance than they sell otherwise. When the interest rate tightens up, they drop lines. They cut out customers thought less profitable.

Local governments are in the category of "less profitable customers" than many of the other kinds of clients insurance companies deal with. So whenever there is a major change in interest rates, you see a cyclical change in the types and amount of insurance available to local governments.

Second, we think the policies of the insurance industry generally are the next most important contributing factor to the current overall problem in the insurance industry. These policies relate to their reaction to the interest rate, to their reaction to legal suits, and to their way of doing business and their sense of what they owe to their customers. Although our primary concern is with local governments, the way insurance companies go about conducting their business is the second most important question. A lot of it is just pure economics.

The third problem is the litigious society we live in and the impression that local governments are more suable now for a variety of reasons. We have looked at the local liability question as a separate problem in addition to the insurance one. Some of the factors here have been mentioned earlier. The deep pocket syndrome is probably the most important aspect of liability. Local governments cannot go bankrupt. In our state for 50 years we have enacted numerous legislative bills that guarantee that no government in New Jersey will ever go bankrupt. But a party that can never go bankrupt is a lot different than others who might be sued. I also think local governments may prefer to settle with citizens in suits, and that also has some impact.

Another key issue is the question of joint liability. That has been discussed earlier and I count it as one of the major legal issues. I would like to briefly describe one case in New Jersey. This case may be one of the most important in the nation: *Ayers* v. *Jackson Township*. This was a suit involving a municipal land fill. The trial court levied a judgment of $15 million against the municipality. The Appellate Division has since cut the amount to $5 million, but the dollar amount is significant nevertheless. The case has gone to the New Jersey Supreme Court.

Perhaps more significant than the amount of the judgment is some of the reasoning relating to the case and the insurance industry's reaction to it. This case more or less eliminated what the insurance companies felt was an ironclad pollution exclusion clause in the insurance contract. Essentially the court overturned the basic exclusion language that the companies included in these contracts.

There also is no record of dollar settlements in this area, so you can't look at a past record and come up with a good determination of what the rates should be. It really makes the insurance business more speculative than normally.

On the insurance side of things, our Commission made several recommendations that address issues raised by this case. The Commission was dissatisfied with the operation of the insurance industry, and recommended that a statewide insurance fund be created for all local governments, similar to the one Lois described in Missouri. All local governments, but not the state, would be insured for a dollar amount, about $500,000 a year, by a single fund.

I didn't emphasize in my earlier remarks that in the insurance industry the reinsurance question is a much more acute aspect of the current problem than is normal insurance. Reinsurance is usually for $500,000 or $1 million on up, and that is the part of the market that has collapsed completely. Our recommendation offers an alternate method of providing insurance for those large dollar cases. We didn't emphasize the use of regional pools in the report, but they too should be utilized for smaller suits.

New Jersey deregulated property and casualty insurance in 1982, and the Commission has not been impressed with the results thus far. I don't know whether this opinion is shared by the members of the legislature, but the issue should be examined more closely.

We did not address federal regulation of the insurance industry, but my analysis of the market is that federal regulation might be more appropriate for the insurance industry than state regulation. There are 4,500 insurers involved in property and casualty insurance at the national level, and most of these insurance companies work across state lines. It is hard, I believe, for states to deal with this issue on an individual basis.

The insurance fund recommendation is not a controversial issue thus far. Insurance companies are not yet lobbying against it, but maybe they will, as apparently they are in Missouri. But what is controversial is a dollar cap on suits. Our recommendation is to cap local government liability at $1 million per occurrence. This proposal is very controversial already, and I don't know how various parties in our legislature are going to come down on the issue.

One of the basic questions is: should municipal and local governments be treated differently than other parties in tort liability questions? And our conclusion is yes, that they should and that a $1 million cap would be appropriate. Based on the record, it would not adversely affect the majority of settlements, and could have a tremendous positive impact on the insurance industry. We believe it would dissuade people from saying: "This insurance fund is something great; now we will sue municipalities even more because there is more insurance and our settlements will be larger than ever."

The Commission also recommended the elimination of joint liability for local government, and suggested several minor amendments to our "Tort Claims Act."

That is a brief summary of our recommendations in New Jersey and I thank you very much for allowing me this time to discuss them.

The Discussants

Ken Back
Washington Advisory Commission on
Intergovernmental Relations

David Coburn
Vermont Advisory Commission on
Intergovernmental Relations

Senator Ross Doyen
Kansas

Ken Kirkland
Multistate Tax Commission

George Goodman
Michigan Municipal League

Henry Guzman
Ohio State and Local Government Commission

Senator Jeanne Malchon
Florida Advisory Council; on
Intergovernmental Relations

Paul Moore
New York Legislative Commission on
State-Local Relations

The Discussion

Senator Jeanne Malchon: Do any of the provisions of U.S. Senate Bill 2129 or any of the other proposals preempt state regulations?

Mr. Bird: S 2129 preempts states which prohibit the formation of a risk protection group. In most states that jurisdiction would essentially no longer apply.

Senator Malchon: We don't have that kind of state prohibition.

Mr. Bird: Then it wouldn't affect you, but obviously, since most states do prohibit such formation, there is a preemption in those states per se.

Paul Moore: The question of joint and several liability is the heart of the issue and there are no data that we can put our hands on that can begin to show to what extent local governments really are at risk. How much is it really costing localities to defend themselves in these kinds of actions, even though it never comes to court and is settled outside of court?

Don Jones: I'll take a crack at that one. We have been plagued, I think, by a shortage of good data, but there is in California a draft study done by the League of California Cities, I believe, that has tracked a number of deep pocket cases that have been filed, and has examined the potential exposure of the cities involved. I believe the study shows some $230 million worth of suits against California cities just for deep pocket cases, not for the cases in which the city has primary liability. The study also documents the amount of legal costs in defending those cases. Hopefully, more studies of this type will be done in the future.

Senator Ross Doyen: I have two questions. First, has any research been done to determine whether rate setting is different under an elected commission than under an appointed commission?

And second, do you think insurance companies are too eager to settle out of court rather than to go to the courthouse?

Mr. Bird: To my knowledge, no one has looked at the question of rate raising differentials between elected and nonelected commissions. Most studies look at a state's ability to collect and analyze data in order to set rates rather than at the outcome of those decisions.

On the second question, two recent reports I've seen look at the eagerness to settle out of court or not. And essentially, it's hard to say. A Michigan study, and one in Iowa, analyzed such things as the time between the actual filing of the initial claim and the settlement or jury verdict in some cases, and tried to see at what point a claim actually went to settlement as opposed to the time of going to court. It would appear that local governments, in particular, are much more inclined to settle because of the court costs, or because they may not have the staff to handle the claim. In some cases, settling a claim is less expensive than actually employing legal staff.

From an insurance company perspective, the size of the company seemed to be a determining factor according to the two reports. Some of the larger, internationally based companies tend to have more wherewithal to draw upon in order not to settle and thereby take on a case and go all the way through the civil justice system.

There is another aspect here. A few states require pretrial screening or encourage a pretrial judgment, so it's hard to isolate whether or not the insurance company really wanted to settle or whether or not there was a "judicial incentive" applied to both parties to say "let's get this thing settled right now."

It's a very sticky issue. Also, a number of states are trying to apply award caps, and trying to limit noneconomic pain and suffering awards. I think there is a body of information that brings you to just about any conclusion that you want. If you cap at a certain level, will people with smaller claims raise their sights toward the cap? Do we have enough case histories concerning suits for settlements above the cap that indicate that a cap will significantly reduce ultimate losses for the insurer?

Then there's another mystical area: do any of these things relate to the ultimate price of insurance? I have probably not helped anybody here, because it gets more and more confusing as you get deeper and deeper into the insurance morass. The Rand Institute has certainly tried very hard to identify a linkage between the caps, settlements and the actual price paid, even though they would admit the information still is very flimsy.

Mr. Moore: In 1980, when I wore a different institutional hat as a staff member of the New York Assembly Ways and Means Committee, NCSL funded us to do a study of municipal insurance pools.

One of the pools we looked at, in a fair amount of detail, was the Texas Municipal League's workmen's compensation pool. League staff and the pool managers told us that one reason why the pool had been so successful was because the rates were 25%-50% below what the prevailing market conditions were over a period of time, and not just at any one point in time. They said the main reason for this is that the pool managers are very effective in fighting frivolous claims; they will contest a claim all the way through the court process, even though initially it is more expensive. Yet, in the long term, they feel it saves a significant amount of money.

Senator Malchon: I served for six years on our county commission. We fought every claim and kept our losses to a minimum. Now, several of the panelists have suggested that the issue here is not just insurance costs, but rather a matter of public policy overall. I agree with that assessment, and as a state legislator, I want to ask if anybody has any information about better mechanisms for state and local governments, either by pooling or other alternatives, to deal with their problems, and what effects, direct or indirect, they have on the private sector?

Let me explain what I am getting at here. If we make it possible by legislation or other ways for local governments to pool and therefore take themselves, so to speak, out of the insurance market as customers, what is the relative risk factor of the public sector as opposed to the private sector? Does the public sector present a greater risk factor, therefore leaving the insurance companies a pool of better customers, or are we taking their better customers away from them?

I think this is something we ought to examine. If governments' risk factors are lower overall than the private sector, then we may be creating another problem for the private sector which we as legislators are going to have to address.

Last year, our legislature created a program that requires arbitration, with a sliding scale on contingency fees. The earlier the settlement, the lower the contingency fee paid; therefore, there is an incentive to the plaintiff to settle. It is not completely satisfactory, although I think eventually it will prove to be a very strong program if we give it a chance. But we, too, have pressures to completely abolish joint and several liability, or to limit it somehow, and to put a dollar cap on judgments or eliminate noneconomic damages. Has anybody looked at how you can do this and still protect the potential legitimate victim out there? This is of very great concern to me.

David Mattek: In my former life, I worked on environmental legislation for many years, and I advocated that the concept of joint and several liability should be applied to chemical and oil companies with respect to pollution and the like. Many chemical and oil companies are bankrupt, but the industry itself should pay for itself.

I don't believe that I would change that position, but I have concluded that local governments should not be part of that process and that joint and several liability should be left in place in pollution laws for chemical and oil companies. It should be made clear that local governments are responsible for only 1% of the pollution, and to that extent it should not be liable to be charged 100% of the cost if other parties are bankrupt.

Senator Malchon: Yes, I would tend to agree in a narrow sense, but I am thinking about other kinds of claims as well. There are legitimate individual as well as group victims that I think we have to look at protecting.

George Goodman: I think if you deal with the whole question of joint and several liability and put it into perspective, you establish structured opportunities and you really pass some of the other pieces of the puzzle. I am not sure that the whole cap question, for example, ends up being a top priority from the standpoint of our interests.

In the Michigan Municipal League, we have supported caps because we have seen some of the abuses that occurred as a result of not having other built-in protections. Local road commissions are a prime example, since road-related claims are the top local problem as a source of suits.

I think the problem a local government has in working with the state and the federal government that it is often are viewed as just one more private interest out there. The fact of the matter is all levels of government get elected by the same people, and they get paid from the same taxpayers' pocketbooks, and so there has got to be a better way of coordinating some of these issues.

And that is the reason I think the role of the federal government and the state government is absolutely essential in terms of resolving some of the liability questions, because we are still talking about potentially spending taxpayers' money to pay disproportionately for the results of an accident. For example, the reality can be that a private citizen may simply have been drunk and speeding, and it wouldn't have mattered what anybody would have done to try to and protect that citizen. If you're drunk and you drive, you're likely to kill your fool self.

We have had cases in Michigan where a drunk driver ran into a bridge abutment and sued, and the county road commission was held liable because it had not put barricades up around the bottom ends of the bridge.

Mr. Moore: I think George Goodman's example is indicative of the fact that the pattern of risk exposure for government entities is fundamentally different from that of private entities. And risk exposure is a factor that affects the price of insurance.

For example, we don't have too many public buildings burn down, and we've found that our fire insurance rates are really subsidizing commercial interests. On the other hand, risk exposure for certain public employees, notably police officers, clearly is much greater so we would expect the exposure factor to be reflected in our rate structure.

Ken Kirkland: There also is another issue known in the insurance industry as adverse selection. An example here is when all the "good risks" get together and pool to lower insurance costs, and exclude the "bad risks." This isn't necessarily a bad thing. It forces a certain amount of self-discipline. For example, if you had, say, 100 cities that got together to create a pool and left out the 101st city with a particularly bad exposure record, that means the 101st city probably would find it difficult to obtain coverage at any price. It also becomes a useful means of discipline for that 101st city to do something about the practices that led up to its bad exposure record.

However, in the health insurance field, adverse selection is not considered a good approach because you would create health insurance pools composed of only well people and the sick people couldn't get insurance.

But again, public entities are not the same as private individuals and corporations. They need to be treated differently.

Senator Doyen: I think as legislators we also need to provide the tools for various occupations to police their own professions, whether it be medical doctors, local governments, or what have you. We need to emphasize professional standards and responsibilities.

David Coburn: Another issue that should be studied is whether insurance companies are offering the same lines of coverage in all the states where they do business. In other words, if you are going to sell any type of insurance in Vermont, and you offer liability insurance in another state, then you have to offer it in Vermont. The reaction of some of the insurance companies, particularly the larger carriers, who have terminated their coverage of local governments has been "that is fine, see you around; and we will take our business elsewhere." Unfortunately, Vermont really isn't large enough, with half a million people, to insist that any insurance company do business in the State of Vermont.

The question is this: can a state require, as a condition of obtaining a license to do business in that state to sell any kind of insurance, that the insurance company offer a uniform line of coverage?

Has anyone tried this approach?

Mr. Moore: I think that is the spirit of what a governor's task force in New York had in mind; if a company offers 18 lines of insurance, henceforth it will not be able to selectively offer only eight in New York because those eight lines are profitable in New York, and the remainder are not.

Mr. Bird: California has very similar legislation under review that requires any insurer providing a line of coverage in another state to make sure that that line also is offered in California.

West Virginia is involved in a lawsuit challenging state legislation specifying the kind of information that must be submitted by insurance companies, and giving the insurance commissioner authority to set up a joint underwriting association. Three of the larger insurance providers in that state have threatened to leave.

Ken Back: Is this the kind of issue that might be better dealt with at the federal level: provide some uniformity across the country so that all states are treated equally?

Mr. Bird: It is quite possible that if New York and California are able to act on this point, that it might just settle the issue for the other states. I don't really think the federal government wants to legislate in this area.

Henry Guzman: I have a question on the issue of reinsurance. There was a series of ten bills introduced in Ohio recently, and one of them allows state chartered banks and building and loan associations to own all or part of the stock of domestic life, property and casualty insurance companies for the purpose of doing business and reinsuring risk. I wonder if that type of situation is being looked at as a means of reinsuring risk in other states—by using savings and loans, state chartered banks and savings and loans.

Mr. Bird: I believe that about a dozen states now allow banks and thrifts to engage in various kinds of insurance activities, and one or two states permit their banks and thrifts to engage in vesting activities such as reinsurance. I think the insurance crisis is driving initiatives like this, but I don't see anyone moving very, very quickly on these fronts at the present time.

Mr. Goodman: Three quick points. First, aside from just the question of tort reform and the availability of liability insurance, I think that in the government sector there needs to be an understanding that if you are going to be in the pool business, or whatever sort of risk management business from the local government standpoint, then it ought to be a serious effort. As Don Jones mentioned, risk management is a relatively new concept in local government, and we should approach it in the best professional and technical way possible. There are a lot of issues I think that local governments—and certainly the general purpose units of government—need to take a look at in order to maintain a lower threshold of risk. A lot of local governments right now are doing an excellent job in terms of risk management, but they are simply not able to get next year's coverage because it's not offered or the rates are too high.

On a second point, I have advocated for a long time that in view of the fact that a local government usually does have the capacity to raise revenues through its millage and so forth, we might just encourage local government to not have any insurance. You get a lot of claims that end up going through the judicial process because the general public knows that you are heavily insured. You end up escalating claims in a trip and fall case, or some minor infraction that hurts not much more than one's feelings. They become major civil suits. I was in local government for 14 years, and I used to fight, to my own detriment politically, some of the more stupid cases that arose. The word got out that the city was an easy touch. You could just have people falling and tripping in city property and sidewalks and all they had to do was to go to the city manager's office and say: "By gosh, I sprained my wrist on the way home from a fire one night, and I'm going to sue you for a $3,000 settlement." The city was scared to death that if it ever went it court it was going to cost $10,000.

The final point that I want to make relates to the business of insurance. We got into the insurance business in the municipal league because the market was closed to us. I suspect that one of the reasons that we are in this situation now is not so much that local government wanted to jump into pooling, but that we were forced into the business as the result of the inability of the rest of the system to work accurately and adequately. I think what we are going to see—and it is going to take a while, I am sure, to measure it—but if we are able to get some of these reforms in place, then I think it is going to certainly take away a good deal of the argument that the private insurance companies use to justify their treatment of local governments.

One of the advantages we have found that a pool provides is that if you stay in business long enough, then you have your own protection and don't have to be beholden to the reinsurance industry in order to provide coverage. You have got enough reserves to cover your losses; if you do have a big loss in one year, you have enough money coming in to maintain a self-sustaining operation. We are close to that point in one of our pool programs in Michigan, but our other pool is so new we just need a little more time in the business to make it really work effectively.

Suggested State Legislation for Insurance Pools

Appendix A

As a result of the most recent liability insurance crisis, several innovative approaches to providing liability and other insurance to state and local governments have been developed to maximize the use of the tax dollar in insurance management, particularly for smaller local governments. There are two excellent sources of information about these efforts and innovations: the Public Risk and Insurance Management Association (PRIMA), 1120 G Street, NW, Suite 400, Washington, DC 20005, (202) 626-4650; and the National Conference of State Legislatures (NCSL), 1050-17th Street, Suite 2100, Denver, Colorado 80265, (303) 623-7800.

Insurance management is part of a broader function—risk management—that is directed toward guarding an organization's assets by various forms of protection of which insurance against financial loss is only one. Other protective measures include safety programs, avoidance of hazardous materials and conditions, and improved security.

Major elements of a risk management program at the state or local level are: (1) a clearly enunciated policy on the extent to which property damage, personal liability, and other risks will be protected against, and the relative reliance on self-insurance or purchased insurance; (2) an analysis of insurable risks, claims and loss history, and premium payments; (3) a safety program encompassing risk reduction or removal, fire and accident prevention, worker and work place safety, etc; (4) a method of determining insurable values of property; (5) a method of insurance placement (negotiated by individual or committee, competitive bidding, etc; (6) the use of deductibles or co-insurance; (7) the cancellation or nonrenewal of insurance; (8) machinery for claims administration; (9) provision for legal defense against claims; and (10) a review and evaluation of the program at periodic intervals.

In 1975, the Advisory Commission on Intergovernmental Relations published suggested state legislation designed to provide a system of pooled insurance coverages to be sponsored and administered by the state for the benefit of all state and local agencies. In 1979, the measure was expanded to authorize local units of government to contract with one another to form insurance pools.

The 1979 measure is reproduced here as one alternative that state and local officials can explore in their efforts to formulate policies to respond to liability insurance problems in their jurisdictions.

Section 1 states the title of the act.

Section 2 sets out the purposes of the act.

Section 3 creates a risk management division in the state, enumerating its powers and duties.

Section 4 establishes an insurance risk management trust fund to provide insurance to all state departments and agencies, unless specifically excluded, and any local government, on request.

Section 5 sets forth the major elements of the risk management program, including claims administration and defense, and premiums to be charged to state agencies and local units of government for their insurance coverages.

Section 6 authorizes local units of government to contract with one another to form joint entities for purposes of insurance pooling.

Section 7 authorizes and directs the risk management division to render assistance to local units of government, including technical assistance in forming interlocal insurance pools and other aspects of risk management; working with insurance carriers to provide commercial coverages to those units desiring such coverage and unable to obtain it in the open market; and providing state loans to interlocal insurance pools.

Section 8 establishes the elements of any joint underwriting plan formed under the act.

Section 9 requires the division submit an annual report to the governor and legislature covering the status of the trust and loan funds and other items.

Section 10 provides an appropriation to the insurance risk management trust fund, to the interlocal insurance loan fund, and to the division for administrative expenses.

Section 11 and *12* provide for separability and effective date clauses, respectively.

[AN ACT PROVIDING FOR A POOLED INSURANCE PROGRAM FOR STATE AGENCIES AND UNITS OF LOCAL GOVERNMENT AND FOR INTERLOCAL INSURANCE POOLS, INCLUDING STATE ASSISTANCE THERETO]

(Be it enacted, etc.)

SECTION 1. *Short Title.* This act may be cited as the "[*State*] Risk Management Act."

SECTION 2. *Purpose.* The purpose of this act is to:

(a) establish a state-administered insurance trust fund to provide insurance coverage for state agencies, and upon request, for local units of government;

(b) assist local units of government unable to obtain appropriate casualty and other insurance coverage in the commercial market to obtain such coverage;

(c) authorize local units of government to cooperate, through contract, joint enterprise, and other means, in pooling insurance coverage and conducting other aspects of risk management;

(d) provide state technical assistance in risk management to local units of government, especially smaller units; and

(e) establish an interlocal insurance loan fund to provide state loans to interlocal insurance pools.

SECTION 3. *Risk Management Division: Creation, Powers, and Duties.*

(a) There is hereby created within the [*appropriate state agency*][1] a [*risk management division*], hereinafter referred to as the "[*division*]," to establish and administer an insurance [*trust fund*] for state agencies [and units of local government] and to provide technical and financial assistance to interlocal insurance pools created by local governments, as set forth in this act.

(b) The [*division*] shall have the following powers and duties in addition to such other powers and duties as are conferred in this act:

(1) as provided in Sections 4 and 5 of this act, to consolidate and combine all insurance coverages into one insurance program consisting of commercial insurance and self-insurance in any combination or separately as is in the best interest of the state and local governments;

(2) consistent with market availability, to provide self-insurance, specific excess insurance, aggregate excess insurance through the [*state purchasing agency*], and such other insurance as is nec-

[1] The insurance risk management program probably should be administered outside, but in close cooperation with the agency or official charged with insurance regulation in the state, because of possible confusion or even conflict among the financial interests of the state government, of which the insurance commissioner is a part, the economic interest of the industry, which the commissioner regulates, and the purchasers of commercial insurance among the general public, which the commissioner is required to protect. Some states may prefer to have an interagency board advise on the management of the fund (e.g., the secretaries or commissioners of administration and insurance and the state comptroller or chief fiscal officer) with an administrator appointed by the Governor.

essary to provide the insurance coverages authorized by this act, to purchase such risk management services as may be required, and pay claims as may arise under any self-insurance provisions;

(3) in cooperation with the [*department of insurance or other agency responsible for regulating the casualty insurance industry within the state*], to develop a plan for providing casualty and other insurance coverage to local units of government which are unable to obtain such coverage in the commercial market, such plans being directed toward an equitable apportionment of coverage and risk as prescribed in Section 8 of this act;

(4) in the development of self-insurance, joint underwriting, and other plans, to maximize the use of competitive bidding when insurance from carriers is sought;

(5) in accordance with [*the state personnel act*] and current budget and personnel requirements, to employ administrative, technical, and clerical personnel and actuarial consultants necessary to maintain, operate, and administer the [*insurance risk management trust fund*] and to conduct other activities authorized in this act, provided that all salaries and expenses of administration and operation of the [*trust fund*] shall be paid from the [*trust fund*];

(6) to provide technical assistance and services in insurance risk management to any unit of local government, upon request; and

(7) to provide loans to interlocal insurance pools established pursuant to this act.

SECTION 4. [*Insurance Risk Management Trust Fund.*]

(a) There is hereby created within the [*division*], an [*Insurance Risk Management Trust Fund*], hereinafter referred to as the "[*trust fund*]," to provide insurance as authorized by Section 5 of this act for workmen's compensation, general and professional liability, fidelity and faithful performance, fleet automotive liability, fire, and extended [and additional areas of] insurance coverages. The [*division*] is authorized to promulgate rules and regulations in accordance with [*administrative procedures act*] for the proper management and maintenance of the [*trust fund*].

(b) The [*trust fund*] shall, unless specifically excluded [herein] [by the [*division*]] provide insurance for all departments of the state government and shall provide separate accounts for workmen's compensation, general liability, professional liability, fidelity bond, fleet automotive liability, fire, and extended, [and additional areas of] insurance coverages.

(c) Any unit of local government of this state may apply for participation in the [*trust fund*] and, upon acceptance by the [*division*], shall participate upon such terms and conditions as may be provided by rule, pursuant to [*administrative procedures act*]. [Such rules may provide for an initial differentiation of risks and premiums among participating local governments in terms of

(1) high, medium, low, or other risk categories of entire governmental jurisdictions; or

(2) risk categories of local government activities, such as transit and airport authorities, hospitals, warehousing, and parks.

The [*division*] may also establish, by rule, subsequent differentiation of risks and premiums, based on prior loss and claims experience].[2]

[*Optional*] [(d) In the event sovereign immunity is waived in whole or in part, the insurance programs developed herein shall provide coverage only to the extent of such waiver of sovereign immunity.]

SECTION 5. *Insurance Risk Management and Self-Insurance.*

(a) In consultation with [*administrative services, safety, health, and other appropriate agencies*], the [*division*] shall initiate appropriate programs and procedures for the major aspects of risk management, including but not limited to:

(1) identification of major hazards to persons and property attendant to the programs and operations of participating state agencies [and local units of government], and the formulation or enhancement of safety, educational, and other procedures to eliminate or reduce such hazards;

(2) initiation of steps for the valuation of real and personal property subject to risk and for which commercial insurance or self-insurance protection is to be extended, including adequate inventory appraisal, and accounting records and procedures and periodic up-dating of such records and procedures to reflect changes in prices, construction and replacement costs, and other market factors; and

(3) analysis of the extent to which sovereign immunity has been waived and resultant impacts upon needs for liability protection, including identification of areas of needed clarifying legislative or administrative action.

(b) The [*division*] [*chief legal officer of the division or agency in which it is located*] [*attorney general*] shall provide defense for claims against any participating agency [or any participating unit of local government] and shall consult with, and advise counsel for, such participating agency [or local unit] as to the status of each claim. Legal counsel for the participating agency [or local unit] may elect to enter into the defense of any claims against it, but such participation shall not be financed from the [*trust fund*] unless authorized by [*division*] [*division or agency counsel*], [*attorney general*].[3]

(c) [Primary responsibility for defense of claims against local units of government shall rest with

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[2] In some states, the range of activities conducted by local governments is so broad that wide risk variations arise. If local units of government joining the trust fund would be pooling risks as well as reserves, a problem could be created by jurisdictions with low risks being forced to share the higher premiums charged to the jurisdictions with high risk (e.g., beaches, transit systems, hospitals, etc.). This could discourage low risk jurisdictions from joining and thus reduce the potential size and resulting economies of scale of the pool. The issue can become political, regardless of the practical merits of local government participation in the state pool.

Under a risk differentiation approach, at least one local pooling arrangement has been set up in California in which members pool only reserves and not risks. Each local member's premiums are calculated separately, based on their individual risk profile in the same way that a private carrier would rate the jurisdiction if it were to purchase private insurance. The member's premium can then be based on the level of risk and amount of coverage.

As noted subsequently, the principle of risk differentiation may also be both feasible and desirable with regard to certain state agencies which, by the nature of their operations, entail higher risks of losses than others.

[3] It is essential that responsibility be specified for the preparation and conduct of legal defense against claims; this subsection naturally needs to take into account state law and practice in other interagency and state-local problems of a legal nature.

the respective local unit, with the [*division, agency, attorney general*] free to enter the defense at any time. Reimbursements to the [*trust fund*] and credits against premium charges in such instances shall be provided under rules issued by the [*division*].][4]

(d) Premiums as calculated on all coverages shall be billed and charged to each state agency [and participating unit of local government] according to coverages obtained by the [*trust fund*] for [its] [their] benefit, and such premiums shall be paid promptly by each agency from its operating budget [or by each participating unit of local government] upon presentation of a bill therefor.[5] After the first year of operation, premiums to be charged to all departments of the state [and participating local units] shall be computed as provided by rule of the [*division*] promulgated pursuant to [*statutory citation of state administrative procedures act*], and shall take into account reasonable expectation of loss, the maintenance and stability of the [*trust fund*], [the risk, loss, and claims experience of the agency,][6] and the cost of insurance. Initial premiums for units participating in the [*trust fund*] after the first year of operation shall be paid on an estimated basis.

(e) All premiums paid into the [*trust fund*], investment income, and other revenue of the [*trust fund*] shall be held by the [*division*] and used for the purpose of paying losses, premiums for insurance, the costs of risk and claims management services, refunds for excess premium payments, and the expenses of operating the [*trust fund*].

(f) The [*agency*] [*state treasurer or other appropriate official*] shall invest assets of the [*trust fund*] in accordance with [*cite state law governing investment of idle funds*].

SECTION 6. *Interlocal Cooperation for Self-Insurance Pooling.*

(a) Any two or more units of local government in this state are hereby authorized to enter into agreements with one another for joint or cooperative action to pool financial and administrative resources for the purpose of providing to the participating units insurance, self-insurance, or any combination thereof for [fire and extended coverage,] [workmen's compensation,] [general and professional liability,] [fidelity and faithful performance,] [fleet automotive liability,] and [*additional areas*] insurance, pursuant to the provisions of [*cite general statutory authority for interlocal cooperation, contracting, and joint enterprise establishment*].[7] Appropriate action by ordinance, resolution, or otherwise, pursuant to law of the governing bodies of these participating local units, shall be necessary before any such agreement may enter into force.

(b) Any such agreement shall specify the following:

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[4] Some states and participating local governments may find this optional provision more economical. In any event, participating local units should be encouraged to assist in every feasible way in claims defense.

[5] See optional language and accompanying footnote for *Section 3(c)* above. In some instances it may be found desirable to isolate one or more high risk categories among state agencies and to adjust premium charges accordingly. However, each such categorization of state or local coverage diminishes somewhat the breadth of the self-insurance pooling concept.

[6] *Ibid.*

[7] If such general statutory authority is not provided, see ACIR, *State Legislative Program, 2. Local Government Modernization,* "2.204, Interlocal Cooperation and Joint Enterprises," Washington, DC, U.S. Government Printing Office, November 1975, pp. 88-96.

(1) its duration;

(2) the precise organization, composition, and nature of the separate legal or administrative entity created thereby, together with the powers delegated thereto, which may be created with its governing body composed solely of local elected officials ex officio unless otherwise provided;

(3) the nature and scope of insurance coverages to be provided;

(4) the manner of financing the enterprise, of establishing and maintaining a budget therefor, and of accounting and keeping records thereof;

(5) the permissible method or methods to be employed in accomplishing the partial or complete termination of the agreement and for disposing of property upon such partial or complete termination;

(6) the methods by which coverages are to be extended, premiums or assessments levied and paid, claims administered and defended against, and financial reserves established and maintained;

(7) responsibilities for claims defense and expenses of such defense between the entity established and individual participating units;

(8) annual or other periodic financial and operating reports to the participating units and to the general public; and

(9) any other necessary and proper matters.

(c) If the agreement entered into under this section does not establish a separate legal entity to conduct such pooled insurance undertaking, it shall, in addition to all items except (2) enumerated in subsection (b) of this section, contain the following:

(1) designation of an [*administrator or a joint board*] responsible for administering the interlocal insurance pool, provided that if a [*joint board*] is designated, the local units of government party to the agreement shall be represented appropriately; and

(2) the manner of acquiring, holding, and disposing of financial reserves and any other assets, including real and personal property, used in the establishment and administration of the interlocal pool.

(d) In addition to information required in subsections (b) and (c) of this section, the agreement and subsidiary arrangements thereunder [shall] [may] [among other things,][8] provide for:

(1) types of coverage available;

(2) a pooling of reserves, or of both reserves and risks;[9]

(3) extent of choice among participating units of local government as to the coverages or combinations of coverage in which each unit desires to participate;

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[8]Some states may find it desirable merely to provide that details as to levels of coverage and similar matters are to be handled by rules and regulations adopted by the interlocal pool entity, subject to public hearing and any governing statutes as to local administrative procedures.

[9]See footnotes to *Sections 3(c)* and *4(c)* above regarding variations in risks among and within local units of government, depending upon the variety of services rendered and activities conducted.

(4) level, by type of coverage, of required self-insurance or deductible, and maximum levels or excess coverage obtainable for the pool;

(5) premium reductions, rebates, or other financial incentives for achieving loss, claim, and risk reduction by participating units;

(6) procedures for reporting losses and the administrative processing and settlement of claims; and

(7) any other provisions necessary for the proper administration of the interlocal insurance pool.[10]

(e) Any unit of local government entering into an agreement pursuant to this section may appropriate funds, pay premiums and assessments, and may sell, lease, give, or otherwise supply the [*joint board*] [*or other legal or administrative entity created to operate an interlocal insurance pool*] with such personnel or services therefor as it may be within its legal power to furnish.

(f) Prior to its entry into force, an agreement made pursuant to this section shall be submitted to the [*division*]. Within [60] days of receipt of the text of the agreement and other materials associated therewith, the [*division*], after consultation with [*the state insurance regulatory agency*] shall review the agreement, for [technical sufficiency] [and conflict or inconsistency with any provisions of this act and operations being conducted thereunder].[11] Failure by the [*division*] to disapprove an agreement within the [60] days of receipt shall constitute a finding of no objection to such agreement.[12]

(g) Prior to its entry into force, an agreement made pursuant to this section shall be filed with [*the keeper of public records in each participating local jurisdiction and in the county in which such unit, other than a county, is located*] and with the [*secretary of state or other appropriate state records or archival agency*].

SECTION 7. *Assistance to Local Governments; Interlocal Insurance Pool Loan Fund.*

(a) The [*division*] is authorized and directed to render technical and other assistance to local governments in the areas of risk management covered by this act, including, but not limited to, insurance coverage through the [*trust fund*] as provided in Sections 4 and 5 of this act, establishing interlocal inusrance pools as provided in Section 6 of this act, establishing arrangements for providing casualty, [liability] [other] insurance coverage through the commercial market to units unable to ob-

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[10]Local units of government in California have been especially active in establishing arrangements for interlocal pooling of insurance coverage and other aspects of risk management. For example, (1) at least six cities have joined the Orange County Cities Risk Management Agency, formally established in 1978; (2) 30 smaller cities in Los Angeles County, serviced by the County under the "Lakewood Plan," have formed an insurance pool; and (3) other California interlocal pools formed under the general authority of the *California Joint Powers Act*, include 14 cities in Contra Costa County and several school districts in Sacramento County.

[11]Some statutes governing interlocal agreements require agreements of certain types to be reviewed by the attorney general for legal sufficiency.

[12]Some states' statutes governing interlocal agreements require agreements of certain types to be reviewed by the attorney general for legal sufficiency.

tain such coverage, and making loans to interlocal insurance pools as provided in subsection (b) of this section. Such assistance shall be provided without charge except in instances where the estimated scope and duration of the requested assistance is in excess of the staff and other resources that could be allocated equitably without reimbursement. In such cases, the [*division*] is authorized to enter into contractual arrangements with the requesting local unit or units for the provision of such assistance on a partially or wholly reimbursable basis.

(b) There is hereby created within the [*division*], a revolving, self-supporting fund to be known as the [*Interlocal Insurance Loan Fund*], hereinafter referred to as "the [*loan fund*]." The [*division*] is authorized to make loans from the [*fund*] to interlocal insurance pools created pursuant to Section 6 of this act for the sole purpose of assisting an interlocal pool in dealing with one or more large losses occurring in the formative, first five years, of the pool prior to the accumulation of adequate reserves to finance such losses. Any such loan shall be approved by the [*administrator*] of the [*division*] only following a finding of actuarial and fiscal adequacy of the time schedule adopted by the pool for achieving a specified level of reserves during the term of the loan. Administrative expenses incurred by the [*division*] in reviewing loan applications and servicing the loans shall be charged against the [*loan fund*]. Loans from the [*loan fund*] shall be subject to the following terms and conditions:

(1) The amount of the loan may not exceed that determined by the [*division*] [as necessary to maintain the liquidity of the interlocal pool for the remainder of the formative period and in no event more than $200,000] [as arranged in accordance with the terms established between the [*division*] and the interlocal pool at the time the time schedule for achieving an adequate level of reserves was established pursuant to Section 6(b)(6) and the maximum amount of credit obtainable from the [*division*] in meeting major losses and claims during the intervening period].[13]

(2) The conditions of any loan shall provide for repayment of principal at the end of [five] years, with interest at an annual rate of [six] [seven] [*other percent*] [at the cost of state borrowing at the time of the loan application approval plus [one-half of one] percent] [equal to the rate being received by the state on investments of its idle cash balances for periods of [one year] or less].

SECTION 8. *Joint Underwriting Plans.* If a joint underwriting plan or other plan for pooling risks and coverages for local governments with two or more commercial insurance carriers is established, it shall include, but not be limited to, the following features:

(a) equitable apportionment of any profits realized or of losses and expenses incurred among participating insurers;

(b) rules for the classification of risks and rates that reflect the past and prospective loss experience in different geographic areas;

[13]Such an understanding should be a part of the agreement establishing the interlocal pool as specified in section 6(a) of the act.

(c) a rating plan that reasonably reflects the prior claims experience of those insured;

(d) excess coverage by insurers if the [*division*], in its discretion, requires such coverage by insurers participating in the plan;

(e) if an underwriting deficit exists at the end of any year the plan is in effect, each policyholder shall pay to the plan a premium contingency assessment not to exceed one-third of premium payments paid by such policyholder for that year. The plan shall pay no further claims on any policy for which the policyholder fails to pay the premium contingency assessment;

(f) any deficit sustained under the plan shall first be recovered through a premium contingency assessment. Concurrently, the rates for insureds shall be adjusted for the new year so as to be actuarially sound in conformance with rules of the [*division*].

(g) If there is any remaining deficit under the plan after collection of the maximum premium contingency assessment, such deficit shall be recovered from the companies participating in the plan in the proportion that the net direct premiums of each member written during the preceding calendar year bears to the aggregate net direct premiums written in the state by all members of the plan.

SECTION 9. *Reports*. The [*division*] shall submit to the Governor and [*legislature*] annually a report and analysis of the activities conducted pursuant to this act, which shall include, but not be limited to, the following:

(a) the funds allocated to the [*trust fund*], premiums paid for insurance through the market, and final balances, including all reserves;

(b) the balance and status of the [*loan fund*] including a list of loans extended, by borrower, amount, term, repayments, and unpaid balances;

(c) a list of local units of government participating in the programs open to them under this act, including all requests, approved or not, for program participation and technical assistance;

(d) complete underwriting information as to the values of property protected, the nature of the risk accepted for self-insurance, and those risks transferred to the insurance market;

(e) the extent and nature of interlocal insurance pools established under this act;

(f) the method of handling legal matters and the allocation of costs;

(g) the method and cost of handling inspection and engineering aspects of risk management services provided;

(h) the cost of risk management services purchased;

(i) the administrative costs of the [*division*] in managing the respective activities authorized by this act;

(j) a complete history of claims, including descriptions of loss, claims paid and reserved, and the cost of all claims handled by the [*division*];

(k) a discussion of progress made in identifying and reducing hazards to life and property subject to protection under this act; and

(l) recommendations, if any, for improving the economy, effectiveness, and equity of insurance programs and other risk management activities conducted pursuant to this act;

SECTION 10. *Appropriations.* In order to carry out the provisions of this act, there is hereby appropriated:

(a) from the state general fund to the [*Insurance Risk Management Trust Fund*], as a special reserve fund thereof, the sum of [*insert amount*]for the [*insert dates*] fiscal years. Such appropriation shall be repayable, in installments, as the [*fund*] and its reserves becomes self-sufficient.

(b) from the state general fund to the [*Interlocal Insurance Loan Fund*], as a continuing, self-replenishing reserve therefor, the sum of [five million] dollars.

(c) from the state general fund to the [*division*] [*or agency administrative account*] to provide for those administrative expenses of the [*division*] not properly chargeable to the [*trust fund*] or the [*loan fund*] as provided in Section 3(f) and 7(b), respectively.

SECTION 11. *Separability.* [*Insert separability clause.*]

SECTION 12. *Effective Date.* [*Insert effective date.*]

State ACIR Conference Attendees
April 1986, Washington, DC — Appendix B

Ken Back
Washington Advisory Commission on Intergovernmental Relations

Gilbert Barrett
Chairman, Dougherty County Commission, Georgia
Member, U.S. Advisory Commission on Intergovernmental Relations

Allen Barron
Tennessee Advisory Commission on Intergovernmental Relations

William Beach
Tennessee Advisory Commission on Intergovernmental Relations

Susannah Calkins
U.S. Advisory Commission on Intergovernmental Relations

David Coburn
Vermont Advisory Commission on Intergovernmental Relations

Senator Ross Doyen
Kansas
Member, U.S. Advisory Commission on Intergovernmental Relations

Orin Durey
Maryland Joint Committee on Federal Relations

Philip Elfstrom
Kane County Commissioner, Illinois
Member, U.S. Advisory Commission on Intergovernmental Relations

Robert Gleason
U.S. Advisory Commission on Intergovernmental Relations

Steven Gold
National Conference of State Legislatures

George Goodman
Michigan Advisory Council on Intergovernmental Relations

Harry Green
Tennessee Advisory Commission on Intergovernmental Relations

Gwen Gregory
National School Boards Association

Charles Griffiths
Pennsylvania Intergovernmental Council

Henry Guzman
Ohio State and Local Government Commission

Katharine Herber
National School Boards Association

Douglas Hill
Pennsylvania Intergovernmental Council

Lawrence Hunter
U.S. Advisory Commission on Intergovernmental Relations

Don Jones
National League of Cities

Nolan Jones
National Governors' Association

John Kamensky
General Accounting Office

Robert Kirby
Virginia Local Government Advisory Council

Ken Kirkland
Multistate Tax Commission

Denise Lord
Maine Governor's Municipal Advisory Council

Dan Mackey
South Carolina Advisory Commission on Intergovernmental Relations

Senator Jeanne Malchon
Florida Advisory Council on
Intergovernmental Relations

David Mattek
New Jersey Commission on
County and Municipal Government

Pauline Mengebier
Michigan Advisory Council on
Intergovernmental Relations

Paul Moore
New York Legislative Commission on
State-Local Relations

Kim Newman
Executive Office of the President
Office of Management and Budget

Kathy Nixon
Florida Advisory Council on
Intergovernmental Relations

Doug Peterson
National League of Cities

Fred Pfeiffer
Texas Advisory Commission on
Intergovernmental Relations

Lois Pohl
Missouri Commission on
Local Government Cooperation

Sally Potter
National Education Association

Jane Roberts
U.S. Advisory Commission on
Intergovernmental Relations

Elaine Young
Delaware House of Representatives

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(December 1987)

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The Commission is composed of 26 members—nine representing the federal government, 14 representing state and local government, and three representing the public. The President appoints 20—three private citizens and three federal executive officials directly and four governors, three state legislators, four mayors, and three elected county officials from slates nominated by the National Governors' Conference, the Council of State Governments, the National League of Cities/U.S. Conference of Mayors, and the National Association of Counties. The three Senators are chosen by the President of the Senate and the three Representatives by the Speaker of the House.

Each Commission member serves a two-year term and may be reappointed.

As a continuing body, the Commission approaches its work by addressing itself to specific issues and problems, the resolution of which would produce improved cooperation among the levels of government and more effective functioning of the federal system. In addition to dealing with the all-important functional and structural relationships among the various governments, the Commission has also extensively studied critical stresses currently be placed on traditional governmental taxing practices. One of the long-range efforts of the Commission has been to seek ways to improve federal, state, and local governmental taxing practices and policies to achieve equitable allocation of resources, increased efficiency in collection and administration and reduced compliance burdens upon the taxpayers.

Studies undertaken by the Commission have dealt with subjects as diverse as transportation and as specific as state taxation of out-of-state depositories; as wide ranging as substate regionalism to the more specialized issue of local revenue diversification. In selecting items for the work program, the Commission considers the relative importance and urgency of the problem, its manageability from the point of view of finances and staff available to ACIR and the extent to which the Commission can make a fruitful contribution toward the solution of the problem.

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