

Thinking About Asbestos

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Scope and History

The cost of settling asbestos-related cases has risen as an increasing number of defendants have filed for bankruptcy protection, shifting much of the remaining liability to still solvent firms under current tort law. Actuarial firm, Tillinghast-Towers Perrin, estimates that the total U.S. asbestos liability will ultimately approach \$200 billion, with some 60% being absorbed by the global insurance industry. By scanning through plaintiff attorney Web sites and consulting with our analysts, we identified S&P SuperComposite firms with varying degrees of potential liability. Today's asbestos economics reflect a chess match played between plaintiffs and defendants over the past two decades.

Legislative Outlook in 2002 and Beyond

Although some bipartisan support exists for the "Fairness in Asbestos Compensation Act," which may be reintroduced in 2002, the outlook for passage this year is not favorable. The longer-term outlook for a legislative solution may improve after the fall elections, especially if the Republicans regain control of the Senate and if the Enron debacle occupies less public mind share.

Insurance Industry In-Depth Analysis

Asbestos is a well known never-ending drag on insurance company earnings. The related earnings drag differs for each company, but generally it is 8% to 12% of earnings for insurers with significant asbestos exposure. Any reform or a lessening of the claims inflation would be a positive for the insurers' future earnings. The insurers appear to have been increasing their asbestos-related reserves in a quiet, but significant way over recent years and, in particular, in 2001, when most of the estimates related to ultimate asbestos reserves were recalculated and projected to be higher than the amounts originally estimated. It is estimated that the U.S. property and casualty industry will ultimately pay between \$55 billion and \$70 billion in asbestos claims.

Nonlegislative Risk Management

Waiting for a legislative solution is like "Waiting for Godot." In the meanwhile, firms are deploying individual solutions combining insurance, corporate restructurings and more stringent injury requirements to reduce frivolous claims. In the future, capital market solutions may be employed, as well.

Industry and Company Analysis

Asbestos affects sectors and companies in different ways. Those grasping for a one-size-fits-all interpretation will find such an approach lacking. Investors really need to look at each company's specific situation, in addition to possessing a general understanding of the broader context. Ten industry analysts review the company-specific highlights in their space.

March 20, 2002

<http://www.lehman.com>

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Note: Special thanks to Scott Smith and Phil Buffa for their contributions.

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To Our Clients:

Many of you have been struggling to draw inferences and conclusions from the recent acceleration in asbestos-related Chapter 11 bankruptcy filings. In an era of class action lawsuits, mass settlements and environmental hazards, litigation risk that can materially alter the value of a multi-billion dollar company has become something to think about.

That is exactly what we asked our U.S. Equity Research department to do. The result of this effort, "Thinking About Asbestos," is intended to be a practical guide that will help you navigate through a complex issue.

The way we think about the topic of asbestos has evolved over time and remains in flux today. In this report, we will take you through the risk, history and scope of the issue, where exposure is known to exist based on our primary research, the outlook for a legislative solution, and examples of the nonlegislative risk mitigation strategies being deployed.

One issue that became clear to us as we put this research report together is that asbestos affects different sectors and companies in very different ways. Those grasping for a one-size-fits-all interpretation will find such an approach lacking. Successfully negotiating through this particular issue requires effort. Investors really need to look at each company's specific situation, in addition to possessing a general understanding of the broader context.

We hope you find this report useful, and we wish you success with your investments.



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U.S. INVESTMENT STRATEGY

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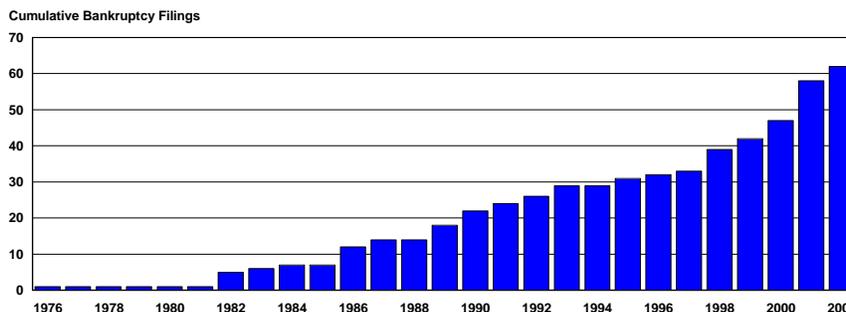
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Executive Summary

The way people think about asbestos has certainly changed over the years, from a useful fireproof substance, to a health hazard replete with litigation risk. The cost of settling asbestos-related cases has risen as an increasing number of defendants have filed for bankruptcy protection, shifting much of the remaining liability to still solvent firms under current tort law. The universe of firms with potential liability has broadened over the years to include the users of asbestos in products last made close to 30 years ago. Indeed, some of today's defendants never actually made any products with asbestos, but successor liability has resulted from mergers, acquisitions and consolidations involving past users. An actuarial firm, Tillinghast-Towers Perrin, estimates that the total U.S. asbestos liability will ultimately approach \$200 billion, with some 60% being absorbed by the global insurance industry. The insurance rating agency A.M. Best recently revised its ultimate cumulative cost estimate for U.S. insurers to \$65 billion, up from its prior estimate of \$40 billion made back in 1997. Asbestos litigation has proven to be an enormous challenge to the federal and state courts, demonstrating that the current tort system is ill-suited for settling mass asbestos class action suits. Although some bipartisan support exists for the "Fairness in Asbestos Compensation Act," which may be reintroduced in 2002, the outlook for passage this year is not favorable. The longer-term outlook for a legislative solution may improve after the fall elections, especially if the Republicans regain control of the Senate and if the Enron debacle occupies less public mind share. In the meanwhile, nonlegislative solutions such as insurance, corporate restructurings and more stringent injury requirements to reduce frivolous claims play a role in managing costs.

Asbestos is a complex issue that affects different sectors and companies in different ways. Investors struggling to reach conclusions really need to look at each company's specific situation, in addition to possessing a general understanding of the broader context.

Asbestos-Related Chapter 11 Bankruptcy Filings Have Nearly Doubled in the Last Five Years



Sources: Lehman Brothers, Plevin, Mark D. Kalish, Paul W. "Where Are They Now? A History of Companies That Have Sought Bankruptcy Protection Due to Asbestos Claims"; American Academy of Actuaries.

Scope and History

It is hard to think of asbestos in this light now, but there was once a time when asbestos was simply thought of as an indestructible and fireproof substance. As a result, asbestos was incorporated into a wide array of consumer and industrial products such as barbeque mittens, ironing board covers, floor tiles, ducts, electrical wiring insulation, plaster, wallboard, insulation for home heating and boiling systems, shingles, sidings and brake linings. The water from municipal supplies often came through concrete pipes reinforced with asbestos. Schools regularly used small asbestos squares in science labs to rest gas burners upon.

Today, asbestos is primarily associated with the health risks it can engender when asbestos fibers break apart and are inhaled. The inhalation of asbestos fibers can result in progressive diseases, such as asbestosis or mesothelioma. Asbestosis is an irritation of the lungs caused by very fine asbestos fibers being lodged deeply in the lungs, leading to breathing difficulty and sometimes cancer. Asbestos fibers can cause a severe thickening of the lung tissue and eventually choke those inflicted.

Mesothelioma is the most severe asbestos-related disease, and about 2500 cases are diagnosed each year in the United States. It is a malignancy of the membranes that separate the rib cage from the outer surface of the lungs (the pleura) or those that surround the abdominal cavity (the peritoneum). The latency period averages 40 years and can be as long as 60 years. It is fatal, and there is no treatment. Since millions of workers were exposed to asbestos on the job from the 1940s through the early 1970s, when legislation was passed prohibiting the use of asbestos in most products, Milliman USA, an actuarial and consulting firm, expects new cases to be diagnosed through 2015-2025.

The severity of mesothelioma and its association with asbestos make for meritorious claims that are very costly to settle. As a result, plaintiff attorneys often bundle a few mesothelioma claimants with an inventory of weaker claimants to negotiate more favorable mass settlements. The settlements typically award mesothelioma victims with less than they would have received if adjudicated individually, with larger awards going to the weaker claimants. Indeed, most of the claims filed today are by people with little physical impairment from asbestos exposure.

The recent acceleration of bankruptcy filings is further transforming the way people think about asbestos—it is now synonymous with litigation risk. Initially, most asbestos cases were filed on behalf of workers at asbestos mines and factories. The next round of litigation filed against shipyards, refineries, railroads and power plants involved the workers injured by exposure while installing asbestos-related products. After that came a series of lawsuits filed by workers in the construction industry who were exposed to products that contained asbestos. But as more firms filed for Chapter 11 bankruptcy protection, new defendants, such as contractors, distributors, owners of refineries and power plants, were named in suits. According to the Rand Institute for Civil Justice, the number of defendants today ranks in the thousands and consists mostly of long-ago users rather than the manufacturers of asbestos.

Sixty-Two and Climbing: Asbestos-Related Bankruptcies and Filing Dates

Number	Company	Date	Number	Company	Date
1	North American Asbestos Corp.	1976	32	Rock Wool Manufacturing	Nov-96
2	Forty-Eight Insulations	Apr-82	33	Todd Shipyard	Jun-97
3	UNR Industries	Jul-82	34	M.H. Detrick	Jan-98
4	Johns Manville	Aug-82	35	Raymark Industries	Mar-98
5	Amatex	Nov-82	36	Brunswick Fabricators, Inc.	Sep-98
6	Waterman Steamship Corp.	Dec-83	37	Atlas Corp.	Sep-98
7	Wallace & Gale Company	Apr-84	38	Fuller-Austin	Sep-98
8	Pacor	Jul-86	39	SGL Carbon	Dec-98
9	Standard Insulations Inc.	Aug-86	40	Joy Technologies	Jun-99
10	First Colony Farms ¹	Nov-86	41	Harnischfeger Corp.	Jun-99
11	McLean Industries ²	Nov-86	42	Rutland Fire & Clay	Oct-99
12	Prudential Lines	Nov-86	43	Babcock & Wilcox ⁸	Feb-00
13	Gatke Corp	Mar-87	44	Pittsburgh Corning	Apr-00
14	Nicolet/Keasby-Mattison	Jul-87	45	Owens Corning ⁹	Oct-00
15	Raytech ³	Mar-89	46	Armstrong World Industries Inc. ¹⁰	Dec-00
16	Delaware Insulations	May-89	47	Burns & Roe Enterprises	Dec-00
17	UNARCO	Jul-89	48	G-I Holdings Inc. ¹¹	Jan-01
18	Hilsgorough Holdings ⁴	Dec-89	49	Eastco Industrial Safety Corp.	Feb-01
19	Standard Asbestos Mfg. & Insulation	Jan-90	50	EJ Bartells	Apr-01
20	Carey Canada	Oct-90	51	Skinner Engine Company	Apr-01
21	Celotex ⁵	Oct-90	52	W R Grace	Apr-01
22	National Gypsum ⁶	Oct-90	53	Washington Group International	May-01
23	Eagle-Picher Industries	Jan-91	54	USG Corporation ¹²	Jun-01
24	H.K. Porter	Feb-91	55	United States Mineral Products	Jul-01
25	Cassiar Mines	1992	56	Bethlehem Steel	Oct-01
26	Kentile Floors	Dec-92	57	Federal Mogul Corp.	Oct-01
27	American Shipbuilding	Nov-93	58	Swan Transportation Co.	Dec-01
28	Baldwin Ehret Hill	Dec-93	59	North American Refractory Co.	Jan-02
29	Keene ⁷	Dec-93	60	A.P. Green Industries	Feb-02
30	Walter Industries	Mar-95	61	Harbison-Walker	Feb-02
31	Lykes Brothers Steamship	Dec-95	62	Kaiser Aluminum	Feb-02

Sources: Lehman Brothers, Plevin, Mark D. Kalish, Paul W. "Where Are They Now? A History of Companies That Have Sought Bankruptcy Protection Due to Asbestos Claims"; American Academy of Actuaries.

Notes: ¹Exposure from United States Lines (S.A.), ²Exposure from U.S. Lines, ³Formed from Raymark, the Raybestos Successor, ⁴Parent of Walter Industries, ⁵Formed from Philip Carey, ⁶Exposure from Ancor Holdings, ⁷Exposure mainly from Baldwin-Ehret Hill, ⁸Exposure from the following subsidiaries: Americon, B&W Construction Company and Diamond Power Int'l., ⁹Exposure from Fibreboard, Owen Corning Fibreglas Technology Corp. and CDC Corp., ¹⁰Exposure from Nitram Liquidators and Desseaux Corp., ¹¹Successor to GAF Group, ¹²Exposure from United States Gypsum Co., USG Interiors and L&W Supply Corp.

A Lehman Brothers search through several plaintiff attorney Web sites located hundreds of firms with possible asbestos litigation exposure. We augmented this with input from our analysts. The S&P SuperComposite (S&P 500, S&P MidCap 400 and S&P SmallCap 600) constituent subset of 48 firms is listed below. Understandably, firms with litigation exposure tend to be quite mindful that the information they disclose could potentially alter the course of pending or future settlements. Information not already released to the public is generally quite guarded. A succinct summary of the material information we were able to obtain, mainly via direct contact, is included in the table below; a more extensive look into firm-specific liabilities can be found in the industry analysis section of the report, prepared by our research analysts.

S&P SuperComposite Companies With Possible Asbestos Liabilities and Comments

Company Name	Comments
Alcoa*	Believes that between its reserves and insurance it is adequately covered for its known asbestos exposures. For the period from 1997 through the end of 2001, Alcoa's net out-of-pocket costs in payments on asbestos claims has averaged a little over \$1 million per year. For a company with over \$23 billion in annual revenue, asbestos is not believed to be a material issue.
Aliant Techsystems*	No expected liability or exposure.
ArvinMeritor*	Since 1996 paid \$40 million in asbestos-related settlements; currently has \$71million in liabilities booked with \$60 million in insurance recoverables. 46,000 cases pending at the end of 2001 of which 15,000 are awaiting final payment.
AT&T	No expected liability or exposure.
Boeing*	Has settled approximately 100 claims since the 1980s averaging \$4,000-\$6,000 each; currently has 108 claims; believes it has minimal liability.
Boise Cascades	Has 120 pending premises and product claims; are named with numerous other defendants and these claims have no legitimate connection to Boise Cascades, but they continue to defend 15-20 cases per year. Since 1984 they have spent a total of \$100,000 on all claims with most costs covered by insurance. An immaterial issue for them.
BorgWarner	Exposure is not material and they believe they have adequate insurance to cover any associated costs.
Con Edison	Accrued \$169.4 million for its utility subsidiaries' exposure to asbestos and other hazardous substances. Pending lawsuits are in the billions of dollars; but they believe these amounts to be greatly exaggerated. So far, lawsuits have generally been unsuccessful or settled for immaterial amounts.
Crane Company	Named as a codefendant in approximately 5,460 cases; should not have a material impact on its financial position.
Crown Cork and Seal*	Has paid out \$300 million-\$400 million, net of insurance proceeds, over the past ten years and may have well over \$1 billion of total liability remaining. The current run rate for payments is roughly \$100 million per annum with an average payout of \$2,500.
Dana	100,000 claims outstanding at the end of 2001, including 27,000 that were settled but are pending payment. \$102 million liability relating to claims with \$89 million in insurance recoverables. Contingent liabilities of \$44 million with \$39 million in insurance recoverables.
Dow Chemical	\$233 million in estimated liability at the end of 2001; expected to pay \$10 million after insurance. Liability stems from the acquisition of Union Carbide and AmChem.
Duke Energy*	Settling claims individually and not the subject of any class action suits.
DuPont	Primarily limited to premises liability; does not expect many asbestos lawsuits or material liability.
Eastman Kodak	No expected liability or exposure.
Ford Motor	Currently has 15,000-20,000 pending claims that they are trying to consolidate with GM. Declined official comment.
Foster Wheeler*	110,800 claims outstanding at end of 2001. Stringent criteria is used in paying claims, 55-58% are dismissed. Almost all costs covered by insurance.
General Electric	GE has never paid a penny out of pocket and does not expect to. GE Capital Insurance Group has \$585 million in Asbestos and Environmental reserves as of 2000, up 6% from 1999.
General Motors	Considers cases immaterial and believes lawsuits have little validity. Currently has 15,000-20,000 pending claims that they are trying to consolidate with Ford. Annual related expenses are \$10 million; this cost may increase due to a rising number of claims, it should not have a material adverse effect.
Georgia-Pacific	297,000 total claims filed; 235,000 claims settled or dismissed; 62,000 claims pending. Total exposure expected to be less than \$1 billion, mostly covered by insurance.
Goodrich	Paid \$74.8 million, \$36.4 million and \$19.3 million for the defense and disposition of the cases net of the amounts received from insurance, in 2001, 2000 and 1999, respectively.
Goodyear Tire	61,000 pending claims as of October 31, 2001.

S&P SuperComposite Companies With Possible Asbestos Liabilities and Comments(Continued)

Company Name	Comments
Halliburton	201,000 claims settled in the past with 274,000 claims pending. \$150 million paid on claims. Past settlements have averaged \$750 (\$200 after insurance) per claim. Plans to split its energy—services business from its Kellogg Brown & Root construction and engineering unit to help investors better understand its businesses and ease concern over asbestos-liability litigation.
Honeywell*	Did not manufacture asbestos related products; liability stems from relationship with Bendix and NARCO (owned from 1979-1986). Over the last 20 years, 53,000 Bendix cases have been resolved at \$1,000 per case with 74% of cases being dismissed without merit. Over the past 18 years, NARCO has settled 176,000 cases at \$2,200 per case where 43% of cases were dismissed without merit, according to management. In January 2002, NARCO filed for reorganization under Chapter 11, with Honeywell's consent, faced with a decline in the steel industry and increasing asbestos liability. At this point, all 116,000 claims outstanding against NARCO, of which 7% also name Honeywell, have been staid in Federal Bankruptcy Court.
International Business Machines	No claims outstanding; last case was settled years ago (amount undisclosed). No future cases are expected.
International Paper*	International Paper has very minimal exposure to asbestos. The exposure resides within a wood products distribution business that was wholly owned by Champion International. IP acquired Champion during 2000.
ITT Industries	Believes asbestos is not a material risk; never required to make payments for settlements or defense costs. Has substantial insurance protection. Have vendor agreements that shift product liability to the manufacturer.
L-3 Communications*	No current litigation or liability.
Lockheed Martin*	No current meaningful asbestos exposure.
McDermott International	As of February 2000 had 340,000 claims settled for \$1.6 billion (inclusive of insurance); additional 220,000 new claims in 2001. Has begun scanning new claims for validity. Under Babcock & Wilcox's plan of reorganization, the cost of claims is \$1.3 billion with \$1.15 billion covered by insurance. Exposure stems from Babcock & Wilcox, which filed for bankruptcy in February 2000.
Metropolitan Life	Has never manufactured, produced, distributed or sold asbestos or asbestos-containing products. Received approximately 54,500 asbestos-related claims in 2000. During the first nine months of 2001, Metropolitan Life received approximately 49,500 asbestos-related claims.
Minnesota Mining and Manufacturing	200,000 claims in the past with 80,000 claims outstanding; average settlement is less than \$1,000 per claim. Insurance recoverable is near 95%.
Navistar International	Consider exposure to be immaterial; significant percentage of claims have resulted in no awards being granted. Liability stems from brakes and clutches on trucks that contained asbestos; filed by mechanics who worked on their trucks.
Owens Illinois*	Disposed of 250,000 claims at an average cost of \$4,900 resulting in total payments well over a billion dollars. Projected to spend \$240 million in 2002.
Phillips Petroleum	Number of past claims is undisclosed, but the cost was deemed immaterial. Asbestos was used as an insulator in refineries, which may have led to exposure.
Phelps Dodge	"No settlement" policy has resulted in just \$520,000 paid out in last 10 years; 15,000-20,000 claims pending.
Pfizer	170,000 claims pending against Pfizer (Quigley) and 59,000 against American Optical. Believes most cases are spurious and therefore insignificant. The number and amount of past settlements was not disclosed.
Procter & Gamble	Although they have appeared on trial lawyer Web sites, they have no asbestos exposure.
PPG Industries	115,000 claims outstanding but have gone to trial only a few times. Litigation stems from premises claims (undisclosed amount paid in past) and from a venture with Pittsburgh Corning in the 1930s for which they have never paid associated claims.
Raytheon*	No litigation or liability.
Sears Roebuck & Company	Have no material exposure and therefore no reserves for asbestos-related claims. Undisclosed number of cases in the past, but very few in number. Liability stems from products sold in stores (e.g. brake pads, floor tiles, iron board covers) and have fought all cases; exposure is minimal.
Sealed Air	Have faced very few claims and costs have been on legal services only. Liability stems from the structure of the contract with VWR Grace to acquire Cyrovac in 1998-99.
TRW*	Liability linked to Kelsey-Hayes Wheel Co. brake business acquired in 1999. Roughly 20 cases filed. Average annual settlement costs over the past five years is under \$10,000.
United Defense*	No litigation or liability.
United Technologies*	Small number of cases; insubstantial costs.
Verizon Communications	Insignificant number of cases; believed to have no material exposure.
Wyeth (formerly American Home Products)	Believes they have minimal exposure. Have had very few claims; estimate \$100,000 spent (including legal fees) to settle all cases. Liability stems from Cytec—a former subsidiary of a company they acquired.
York International	Immaterial exposure. Have had a few hundred claims. Roughly 10 settlements averaging less than \$1,000. Exposure results from encapsulated gaskets.

Sources: Lehman Brothers, The Law Offices of Christopher E. Grell, The Murad Law Firm, Mesothelioma Legal Information Center – Law offices of David A. Shaw, L.L.C. and Baron & Budd, P.C., Early, Ludwick, Sweeney, Strauss.

Note: *These companies were not mentioned on the trial lawyer Web sites cited, but are discussed by our analysts in the following sections.

How much will the U.S. asbestos tab run? The actuarial firm Tillinghast-Towers Perrin estimates the total U.S. asbestos liability to be \$200 billion, with the global insurance industry absorbing \$122 billion of that amount. But, the true cost will not be known for years due to the long-term nature of the issue and its moving parts. The U.S. insurance industry estimates that it has already paid more than \$20 billion to settle asbestos-related claims. The insurance company rating agency A.M. Best expects the ultimate cumulative cost to be another \$65 billion in the United States, a considerable increase from its 1997 estimate of \$40 billion; by extension, it argues that the U.S. insurance industry will need to boost reserves by \$33 billion over time to cover its costs.

The economics of today's asbestos liabilities reflect a legal chess match that has been played out over the decades between plaintiffs and defendants; in and out of a tort system that most agree is ill-suited for handling mass class action asbestos cases. The early victims of asbestos-related illnesses confronted state laws that prevented workers from suing their employers for occupational disease. As a result, many seriously debilitated workers never received anything beyond modest workman compensation benefits for their injuries. To maneuver around this hardship, plaintiff attorneys crafted product-liability suits against asbestos manufacturers. In 1973, a jury award in connection with an asbestos claim was upheld for the first time by the U.S. Court of Appeals for the Fifth Circuit. By the mid-1970s, the race to the courthouse was under way.

The seeds were planted for a major shift in the playing field against the asbestos firms in 1978 when a Johns-Manville Corp. plant manager admitted to a company policy of suppressing knowledge regarding the hazards of asbestos. Subsequent document findings proved fraud and conspiracy. Asbestos caseloads accelerated as punitive-damage verdicts were awarded. To slow down the onslaught, asbestos firms deployed a statute-of-limitations defense. But plaintiffs counteracted by filing cases for employees who had been exposed to asbestos, even if they did not show any signs of illness, and most judges permitted these cases.

In 1981, the California Supreme Court ruled that workers could sue their employers for occupational diseases under circumstances where the employers had engaged in fraud and conspiracy. This enabled workers to proceed with cases against their employers in civil court. In February 1982, a Johns-Manville Corp. employee was awarded a verdict of \$150,000. Thousands of additional cases were brought against the company, and by August 1982, Johns-Manville Corp., a Fortune 500 firm, opted to leave the tort system by filing for bankruptcy in what is arguably the most complex Chapter 11 case in history.

Johns-Manville Corp. had taken advantage of an obscure bankruptcy law change that allowed liable companies to discharge personal injury claims that had not been reduced to a sum certain via a jury verdict, the prior requirement. The company was split into two halves, a reorganized company—sans its asbestos operations and liabilities—and a trust funded to pay awards to current and future claimants based upon their asbestos-related

medical conditions. The basic bankruptcy model would become codified into U.S. bankruptcy law and followed by other asbestos defendants.

The complexity of the Johns-Manville Corp. case showed that the U.S. tort system was ill-suited for asbestos class action suits due to conflicts of law that cannot be disposed of without a federal statute. The *Erie* doctrine, which has been extended by the Supreme Court to nationwide class actions, requires federal courts to apply the substantive laws of the states. Asbestos class-action suits typically involve claimants from all 50 states with differing tort laws. Although rare exceptions to the *Erie* doctrine do exist, the U.S. Court of Appeals for the Fifth Circuit held that in the absence of congressional action in connection with asbestos, federal courts remained constrained by the substantive laws of the states—putting the ball into the congressional court.

The most cogent argument for a federal asbestos statute rests on conflicts over limited resources, the interstate nature of the asbestos dilemma and that federal conflict also exists with state law when it comes to asbestos. Each state involved in asbestos litigation has an interest in promoting the full recovery of its citizens to reduce the resources it will eventually deploy in caring for the injured parties. In asbestos cases, states are competing for a finite resource where the adjudication of a case in one state can potentially affect the litigants in every other state in the United States: now and in the future. Furthermore, differing substantive state laws in place lead to varying costs and unequal recoveries among identically injured victims, making it possible that some asbestos victims can go completely uncompensated for their injuries. The absence of a federal statute creates high transaction costs, wholesale state-by-state forum shopping by plaintiffs for the best location to bring a suit, and contributes to excessive court delays.

Although some bipartisan support exists for the "Fairness in Asbestos Compensation Act," which may be reintroduced in 2002, our Washington Research team does not think passage is likely this year. Longer term, the outlook may improve, especially if the Republicans retake control of the Senate and if the Enron debacle occupies less public mind share.

In the absence of a federal statute, litigation since the early 1980s has centered on mass settlements as the most logical way of addressing an enormous caseload dilemma. In a mass settlement, an attorney representing many plaintiffs reaches an agreement with a defendant on an award schedule for different illnesses and levels of severity. In utilizing this approach, companies reduce their transaction costs in defending asbestos cases but give up the ability to closely evaluate the merits of each claim. It has been alleged over the years that this arrangement has encouraged the settlement of numerous frivolous claims as a quid pro quo for settling the more meritorious ones out of court.

In the mid-1980s, the Asbestos Claims Facility (ACF) was formed by several of the larger asbestos defendants and their insurance companies. The aim was to achieve bargaining leverage and lower transaction costs by pooling their resources and litigating as a group. Internal disputes inevitably took place, leading some key members to splinter

away. The ACF formally dissolved; some founding members opted to reorganize as the Center for Claims Resolution (CCR) with the same mission in mind. The CCR would settle some 350,000 claims at a cost of \$5 billion before it stopped brokering bulk settlements for its members in February 2001.

The next twist in asbestos litigation took place in the procedural realm in 1990 when a group of federal judges known as the Judicial Panel on Multidistrict Litigation (MDL) stayed, or froze, all personal injury asbestos cases in the federal courts and transferred them to a single judge in Philadelphia for pretrial procedures. The MDL transfer effectively halted asbestos litigation in federal courts; suits filed in state courts were not directly affected by the MDL action, at least initially. However, plaintiffs responded by moving their suits to the state courts, where the MDL had no jurisdiction, adding to an existing state court case backlog that would take years to overcome, as an infrastructure to handle the case loads was lacking.

Faced with long delays, in 1993, the CCR members and a cadre of resolute plaintiff attorneys crafted an involuntary "class action" outside of the court system, using an injury award schedule similar to those deployed in mass settlements. The case was known as the "Georgine" class-action settlement. Under Georgine, plaintiffs agreed to a system for processing future claims, but frivolous cases were not to receive awards until showing signs of asbestos-related illness. Georgine was opposed by most plaintiff attorneys and raised constitutional issues because it attempted to circumvent the substantive tort laws of the 50 states.

The Supreme Court struck down Georgine in June 1997, putting the claims back into the court system. In July 1999, the Supreme Court rejected a second proposed settlement by a 7-2 vote, declaring at that time that only the Congress could sort out an asbestos solution because the plaintiffs came in two classes with irreconcilable interests: those with asbestos-related illnesses today and those exposed to asbestos but not yet showing symptoms of disease. To wit, no universal settlement of all claims could be equitable to both groups.

Given the rise in bankruptcies and the concern over funding for legitimately injured parties, nonlegislative solutions have increasingly focused on reducing the costs borne by frivolous claims. For example, since the CCR ceased brokering bulk settlements for its members, the defendants have begun to work individually or with their insurance companies to craft solutions for managing their asbestos litigation costs. Many of these defendants and their insurance firms have vowed to resist settling with claimants that have been exposed to asbestos but have yet to exhibit asbestos-related illnesses. Other steps have also been taken, such as using insurance in conjunction with corporate restructuring to transfer catastrophic risk. In the future, capital market solutions might also be a possibility.

In January 2002, the federal judge presiding over the pretrial proceedings of all federal asbestos cases in the United States ordered that nonmalignant cases initiated through

mass screenings be dismissed unless corroborated with independent evidence of asbestos exposure and illness. Indeed, there appears to be some movement by multiple parties towards reducing frivolous cases to preserve funding for current and future meritorious cases.

Is this the beginning of a solution that might change the way we think about asbestos for a final time? Do not get too excited. If the last two decades of asbestos litigation have revealed a single bromide, it is that "it's not over until it's over."

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Legislative Solutions

There was, both on Wall Street and in Washington, a fairly persistent rumor that George W. Bush, celebrated Texas "tort reformer," would address the topic of asbestos litigation reform in his State of the Union speech, delivered on January 29. The rumor, of course, turned out to be just that, nothing more. Despite the advance speculation, President Bush neither said the word "asbestos" nor addressed the more general issue of tort reform in that speech.

This, we think, should be taken as a prelude of things to come. While the Street and, perhaps, much of Washington will buzz with concern about asbestos litigation and the hope of legislative relief, those whose voices really matter (e.g., the Administration, the Senate majority) will remain silent, at least for the remainder of this, an election year. As on January 29, the word asbestos will scarcely merit a mention. Though the asbestos issue may scream out for a legislative solution, the atmosphere in Washington will, we think, preclude such.

There is little doubt that the issues raised by asbestos litigation can and likely should be addressed with legislation. Most reasonable people, on both the political right and left, acknowledge that there is, in this case, a set of problems the solutions to which should come from Washington. In the now famous Supreme Court decision that threw out the Amchem (Georgine) comprehensive settlement, Justice Ruth Bader Ginsburg wrote in her opinion for the court, "The argument is sensibly made that a nationwide administrative claims processing regime would provide the most secure, fair, and efficient means of compensating victims of asbestos exposure." The problem, she continued, is that "Congress . . . has not adopted such a solution."

According to *The Wall Street Journal*, her colleague on the bench, Justice Souter, "pleaded with Congress to shed its lethargy and resolve an 'elephantine mass' of claims that 'defies customary judicial administration.'"

On the other side of the political aisle, in a series of recent editorials, the *Journal's* editorial staff, likely the ideological polar opposite of Justices Ginsburg and Souter, has nevertheless echoed their sentiments, exhorting both Congress and the Bush administration to contain the economic damage done by "the asbestos Blob."

We note that Congress has, in fact, made several attempts to address this issue, most recently in the wake of the court's Amchem ruling. In the 106th Congress (1999-2000), then-House Judiciary Committee Chairman Henry Hyde (R-IL) introduced two pieces of legislation: H.R. 1283, The Asbestos Compensation Act of 2000, and H.R. 4543, a proposed amendment to the 1986 Internal Revenue Code, providing tax relief for funds set up to pay asbestos-related claims. The Fairness in Asbestos Compensation Act of 1999 (S. 758), the Senate's version of Hyde's bill, was introduced by then-Senator John Ashcroft (R-MO).

Both principal bills (the Asbestos Compensation Act, and the Fairness in Asbestos Compensation Act) proposed providing relief from the crushing weight of asbestos claims through the creation of a new Office of Asbestos Compensation, which was to be part of the Justice Department. Key components of the legislation included the creation of an Asbestos Compensation Fund, the details of which were unclear; the preclusion of court action prior to participation in the federal compensation procedure; and the establishment of rules of medical eligibility. The latter two provisions were considered by many observers to be the most important, as they were designed to eliminate the most egregious abuses of the tort system: venue shopping and the collection of substantial settlements for plaintiffs with no medical impairment.

And while the Hyde legislation was considered by many observers to provide a palatable solution, it was not perfect. The Asbestos Compensation Fund, for example, was to be funded initially by a loan from the Office of Asbestos Compensation. This loan was to be drawn from an appropriation of, according to the bill, up to \$100 million. In this sense, Hyde's bill followed the format of previous mass liability legislation (in this case, the most practical example is the Superfund legislation), removing some of the financial burden from the industry and placing it instead on the federal treasury, otherwise known as the taxpayers.

In any case, none of the bills made it very far. H.R. 1283 was narrowly reported out of Hyde's Judiciary Committee on March 16, 2000, but was never brought to the House floor. Hyde's tax bill fared even worse, never even receiving a hearing in the Ways and Means Committee. Ashcroft's bill was essentially shelved by then-Majority Leader Trent Lott (R-MS), who announced early in the session that the Senate simply would not have time to address the issue. Though he co-sponsored the bill, Lott clearly showed no desire to push too aggressively.

In the nearly two years since this previous attempt to establish a legislative solution failed, much has changed. Most notably, several more companies, including Babcock & Wilcox, Owens Corning, G-I Holdings, and W.R. Grace, have been forced into bankruptcy protection because of their exposure to asbestos liability. Several others, including Georgia-Pacific, 3M, and Halliburton, are considered by some to be on shaky footing because of asbestos.

That said, we urge interested parties not to hold their breath waiting for Washington to address the problem, for several reasons.

The first is that this is an election year. It is unlikely that anyone, either in the administration or on Capitol Hill, will have either the time or the energy to push such potentially contentious legislation during an election year. This is especially so, given the historically tight margins in both houses. The loss of a few House seats and one Senate seat would alter the balance of power, shifting the majority. It is unlikely that either party will be willing to risk the loss of that one seat that could flip the majority.

The second reason (actually an extension of the first) can be summed up in five letters: E-N-R-O-N. The Bush administration and its allies on Capitol Hill should be ideological proponents of any sort of tort reform. This year, however, they can hardly afford the luxury of appearing too industry-friendly, given the heat they are already taking for being too close to Ken Lay and the rest of the folks at Enron. Any attempt by the Bush administration or congressional Republicans to provide relief for companies with asbestos-related liability would undoubtedly be met with gleeful choruses of "there they go again."

This problem is, of course, exacerbated by the fact that one of the companies most desperately seeking redress, the aforementioned Halliburton, was once run by Vice President Cheney. In a February 6, *Wall Street Journal* piece, lobbyist Victor Schwartz, who now represents a group called the Coalition for Asbestos Justice, summed up the problem his clients face, noting, "No matter what [the White House] does, you would see the headline, 'Bailout for Halliburton.'"

A third reason not to expect Washington to take action this year is that the balance of power on Capitol Hill has shifted since legislation was last introduced. Specifically, the Democrats now control the Senate. In 2000, Republican Trent Lott could not find the time to tackle asbestos legislation, and he was undoubtedly far more motivated to do so than current Majority Leader Tom Daschle (D-SD) is likely to be.

Democrats have ideological and practical reasons to oppose a legislative solution at this point. First, as the self-described champions of the "common man," Democrats have little motivation to be perceived as taking the side of big industry over the thousands of individual plaintiffs who may eventually die from asbestos-related diseases. It can be argued that a legislative settlement might actually help said plaintiffs by preventing asbestos-connected companies from filing for bankruptcy before they pay out claims, but such an explanation is not likely to carry much weight, particularly because, as we noted above, this is an election year.

In more practical terms, congressional Democrats have a vested financial interest in the current status quo. The current asbestos tort system has been a financial boon to trial lawyers, who contribute heavily and overwhelmingly to Democratic political candidates. In supporting asbestos legislation, Democrats would run the risk of crossing one of their most generous and most consistent constituencies.

Again, this is unlikely in an election year.

A final reason not to expect Washington to move too terribly far or too quickly toward resolution of the asbestos issue is that those who pushed the legislation previously no longer occupy the positions they once did. Hyde, for example, is no longer chairman of the Judiciary Committee. And while he could request that his successor, James Sensenbrenner (R-WI) schedule hearings, he does not have control over the committee's agenda, as he did in 2000. Additionally, the author of the Senate bill is now the current

Attorney General of the United States. This is arguably a more powerful position, but it does not exactly help in the push for legislation.

Now, given all these factors stacked against the passage of a sweeping asbestos bill, the National Association of Manufacturers (NAM), which is leading the lobbying charge on behalf of industry, has indicated that it would be satisfied with the enactment of less comprehensive legislation. The Asbestos Alliance (of which NAM is a part) has developed prototype legislation proposing a narrower fix. According to an article in the March 4, 2002, issue of *Fortune* magazine, the Alliance would be willing to settle for establishment of standard medical criteria and restrictions on venue shopping.

This proposal seems reasonable enough, given the current political environment, but we still think it is unlikely to be accepted. The Bush administration is fighting with one hand tied behind its back (and depending on how bad Enron gets, it could be both hands), and Tom Daschle could manage the Senate agenda well enough to keep legislation off the table for this year. House Republicans can possibly make some noise, but the bottom line is this: without Daschle or Bush on board, nothing will likely happen.

Our assessment could, of course, change, depending on the outcome of November's election. Given the current margins, though, there is no way to know right now whether any post-election reassessment will be positive or negative for those seeking a legislative remedy.

If the Republicans can manage to hold the House this November (which is expected by most observers) and can wrestle control of the Senate back from the Democrats (a proposition that is a "toss-up," at this point), prospects for a legislative solution will increase, though by how much it is hard to say.

If the Democrats hold the Senate, regardless of what happens in the House, we believe that the long-term prospects for a legislative remedy to the asbestos problem will be little different from the short-range prospects, in a word, unlikely. In the absence of an unforeseen occurrence, Democrats will, we think, remain unlikely to alienate their ideological and financial backers by signing on to legislation that *could* be construed as industry friendly and potentially damaging to average Americans.

Beyond Congress, the Bush administration's position is unlikely to change, even after November. It will remain a bit gun-shy with regard to overtly industry-friendly legislation. Yes, George W. Bush is a noted tort reformer, and yes, he would like to push tort legislation (particularly in the case of unified GOP rule). That said, he has his own reelection to think about, and many of the same factors preventing his administration from taking on this issue now ("Halliburton bail out bill") will still be around, regardless of the results of the midterm. This problem could be exacerbated or ameliorated to an extent by the emergence of a front-runner for the Democratic nomination. If it is someone like Daschle, Bush will not touch asbestos with a ten foot pole. If its Lieberman, Bush may

rightly assume that tort reform benefiting insurance companies is something that his opponent will not bash.

Additionally, all of this must be considered in light of the Enron mess. Anyone's ability to do anything with regard to asbestos may well be affected by the length, breadth, and depth of the Enron investigation(s). A long, broad, and deep investigation would, we think, portend ill for those hoping for industry-friendly reform.

Yet another factor that may affect the long-term likelihood of asbestos legislation; financial considerations and the outcome of the asbestos-related issues at Ground Zero in New York. Although most of the funding for a federally-overseen asbestos settlement would come from the companies involved, some of the costs would be borne by the U.S. treasury and, by extension, American taxpayers. In the current political atmosphere, charged as it is with concern about the reemergence of budget deficits, new federal obligations seem unlikely. Similarly, the possible emergence of asbestos-related illness associated with the clean up of Ground Zero will also, we think, compound the problems associated with reform. Who, after all, would want to sponsor, much less vote for, a bill that can be painted as "anti fire fighter," in the sense that precludes individual law suits prior to participation in the federal settlement procedure?

All things considered, then, even after November's election, the prospects for enactment of asbestos legislation appear fairly slim. Under certain conditions (e.g. unified GOP control) that could change, though how much change is possible is rather uncertain at this point.

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Insurance: A Well Known Never-Ending Drag on Earnings

Asbestos losses represent the property/casualty (P/C) industry's largest single claim exposure. In the mid-1990s the industry felt that its losses to asbestos had stabilized, but with the recent surge in claims the issue has come to the forefront of the industry. The increased number of claims, typically by individuals that have been exposed to asbestos but are often uninjured, and the reopening of claims by more active asbestos litigators have caused the insurance industry to reexamine its total exposure.

Investors should first recognize that this is a very old issue for the insurers and their indirect liability with many policyholders gives them a unique position to assess their risk. The real asbestos liability experts are the insurers' lawyers and actuaries that have been dealing with the issue for the last 20 years. Unfortunately, these individuals tend to be closed mouthed about the issue for fear of jeopardizing their litigation strategy.

Insurance analysts (including ourselves) generally have an ongoing increase in asbestos reserves built into their earnings estimates. The related earnings drag differs for each company, but generally it is 8%-12% of earnings for insurers with significant asbestos exposure. Any reform or a lessening in the claims inflation rate would be a positive for the insurer's future earnings.

The insurers appear to have been increasing their asbestos-related reserves in a quiet, but significant way in recent years. In 2001, in particular, most of the estimates related to ultimate asbestos reserves were recalculated and projected to be higher than originally estimated; and we have identified an additional \$2.5 billion added in 2001. Based on estimates by A.M. Best and others, we believe there could be roughly \$5 billion in asbestos reserve additions—a good dent in the \$23 billion-\$38 billion in estimated additional needed reserves.

In our view, no public insurer will need to increase significantly its asbestos reserves in 2002. The first step for investors trying to create a list of insurers they think will likely need to greatly increase asbestos reserves is to compare the company's three-year survival ratio to A.M. Best's view that the survival ratio should be roughly 12x. It is important to note that some companies have been aggressively settling claims in the last year, which artificially lowers the survival ratio.

It is estimated that the U.S. P/C industry will ultimately pay between \$55 billion-\$70 billion in asbestos claims. As points of reference, this is equal to 1.4x-1.8x the estimated losses expected from the P/C industry's largest man-made catastrophe, the September 11 events, and 3.0x-3.9x its largest weather-related catastrophe, Hurricane Andrew.

What Will Asbestos Cost the U.S. P/C industry?
(\$ In Billions)

	<u>A.M. Best</u>	<u>Tillinghast</u>	<u>Milliman</u>
Ultimate Asbestos Cost for U.S. P/C Industry	\$65	\$55 - \$65	\$70
Less: Incurred Asbestos Losses To Date	\$32	\$32	\$32
Reserve Shortfall	\$33	\$23 - \$33	\$38
Combined Ratio Impact			

Source: A.M. Best, Tillinghast, Milliman

There are several different reliable industry loss estimates. We have concentrated on A.M. Best whose estimates have considerable creditability with the insurers, as well as the well regarded actuarial consulting firms of Tillinghast-Towers Perrin and Milliman & Robertson.

The results from the studies suggest that the U.S. P/C industry's asbestos reserves were deficient by \$23 billion-\$38 billion at year-end 2000. According to A.M. Best in their special report on asbestos published last year, the U.S. P/C industry will have to ultimately pay an additional \$43.4 billion on top of the \$21.6 billion it has already paid for asbestos-related claims as of year end 2000, bringing the total ultimate asbestos price tag to \$65 billion. According to a recent study released by Tillinghast-Towers Perrin, settlements to individuals exposed to asbestos in the United States and related expenses will reach \$200 billion. Of the \$200 billion, the P/C insurance industry will pay \$110 billion (55%) to \$130 billion (65%) of the costs, split between both the United States and foreign insurers and reinsurers. Based on Milliman's study, also released last year, their estimated ultimate cost of asbestos claims including legal expenses of \$275 billion is 37.5% higher than the Tillinghast estimate. Milliman expects that \$175 billion (64.5% of the \$275 billion), will be uninsured (paid by non-insurance companies), but the U.S. insurers could shell out \$70 billion, while the non-U.S. insurers pay \$30 billion of their worldwide insured loss estimate of \$100 billion.

While virtually all P/C insurers will pay some part of the asbestos-related costs, the lion's share of the costs will be borne by the 30 most exposed insurers commonly referred to as the "dirty thirty". On the list of the dirty thirty are companies in our universe including ACE, AIG, Hartford Financial, Allstate, Safeco, St. Paul, Everest Re and Chubb. The publicly traded companies that we do not cover include Berkshire Hathaway, Citigroup and CNA. In our universe, Allmerica Financial is affected, but did not make the list of the top 30, and Cincinnati Financial, HCC Insurance Holdings, Progressive, and XL Capital are relatively untouched.

P/C Companies/Groups Ranked by Total Asbestos and Environmental Reserves

Top-30 Property/Casualty Groups Ranked by Total Asbestos and Environmental Reserves

Net A&E Reserve Rank	Group	Net A&E Reserve Share	2000 Net A&E Reserve Composition					2000 Net A&E Paid Losses			Survival Ratios		Earnings Drag (pts)	
			Net A&E Loss Reserves (\$ millions)	Net Reserve Growth (%)	Asbestos Mix (%)	Environmental Mix (%)	A&E Reserve Retention (%)	Net A&E Paid Loss (\$ millions)	Asbestos Mix (%)	Environmental Mix (%)	1-Yr	3-Yr	1-Yr	3-Yr
			1	Berkshire Hathaway	6.7%	\$1,500	6%	42%	58%	51%	\$82	26%	74%	18.3
2	Nationwide Group	6.6%	\$1,469	-1%	51%	49%	100%	\$117	66%	34%	12.6	51.1	0.8	1.6
3	Travelers P&C	6.1%	\$1,362	-9%	59%	41%	82%	\$253	28%	72%	5.4	3.1	1.2	1.7
4	Brandywine (ACE INA Group)	6.1%	\$1,359	14%	46%	54%	62%	\$244	31%	69%	5.6	5.3	26.0	13.6
5	Hartford Ins. Group	5.6%	\$1,261	-7%	34%	66%	46%	\$109	41%	59%	11.6	9.0	0.1	0.1
6	Liberty Mut Ins Cos	5.4%	\$1,215	-11%	62%	38%	55%	\$229	62%	38%	5.3	2.9	1.0	1.0
7	Allstate	4.8%	\$1,066	-15%	60%	40%	75%	\$227	68%	32%	4.7	7.7	0.2	0.6
8	Allianz of America	4.4%	\$996	12%	31%	69%	54%	\$199	25%	75%	5.0	5.3	8.9	3.1
9	AIG	3.8%	\$855	-2%	40%	60%	35%	\$71	67%	33%	12.1	7.7	0.5	1.2
10	CNA Ins Companies*	3.8%	\$851	-15%	71%	29%	72%	\$275	58%	42%	3.1	2.9	1.6	3.6
11	St. Paul	3.8%	\$851	-4%	35%	65%	91%	\$82	39%	61%	10.4	11.1	1.0	0.9
12	American Re (Munich Re)	3.7%	\$837	-11%	49%	51%	67%	\$162	51%	49%	5.2	5.8	1.9	9.0
13	OneBeacon Group	3.6%	\$796	-17%	20%	80%	73%	\$163	30%	70%	4.9	7.2	NM	4.8
14	Swiss Re Group	3.4%	\$765	0%	43%	57%	85%	\$5	NM	NM	166.0	13.8	0.4	0.3
15	Fairfax Fin (C&F; Int'l Ins. Co.)	2.8%	\$632	-6%	50%	50%	36%	\$89	45%	55%	7.1	9.2	2.2	3.4
16	Zurich/Farmers Group	2.6%	\$589	-2%	31%	69%	80%	\$24	6%	94%	24.3	17.3	0.1	NM
17	GE Capital Ins Group	2.6%	\$585	6%	67%	33%	73%	\$57	61%	39%	10.3	4.9	1.9	2.3
18	Home Ins Companies (Run-Off)	2.3%	\$506	-1%	48%	52%	53%	\$74	41%	59%	6.9	5.8	NM	NM
19	Chubb Grp of Ins Cos*	2.0%	\$443	-15%	46%	54%	98%	\$106	33%	67%	4.2	5.5	0.5	1.3
20	Royal & SunAlliance	1.6%	\$369	-13%	37%	62%	84%	\$62	41%	59%	5.9	6.1	0.2	0.4
21	Great American	1.6%	\$351	-12%	40%	60%	77%	\$46	15%	85%	7.7	10.1	NM	2.5
22	FM Global Group	1.4%	\$321	-7%	65%	35%	48%	\$24	72%	28%	13.3	19.8	NM	1.0
23	Everest Reins Group**	1.4%	\$317	-54%	68%	32%	33%	\$68	75%	25%	4.7	9.4	NM	NM
24	SAFECO	1.3%	\$287	-5%	32%	68%	91%	\$24	25%	75%	11.7	13.5	0.2	0.2
25	Kemper	0.8%	\$179	-26%	57%	43%	87%	\$89	52%	48%	2.0	2.8	1.1	NM
26	Duke's Place Hldg (Seaton; Stonewall)	0.8%	\$176	5%	47%	53%	43%	\$8	51%	49%	21.2	13.8	NM	NM
27	Reliance (In Liquidation)***	0.8%	\$175	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
28	Phila Reins Corp (Run-Off)	0.8%	\$173	4%	69%	31%	67%	-\$7	NM	NM	NM	0.0	0.0	NM
29	Argonaut	0.7%	\$155	-7%	52%	48%	79%	\$22	63%	37%	7.2	9.8	7.7	0.8
30	Gerling Global	0.7%	\$152	2%	30%	70%	36%	\$9	35%	65%	17.8	12.1	1.3	NM
	Top 30*	92.0%	\$20,593	-6%	47%	53%	61%	\$2,912	45%	55%	7.0	6.6	1.0	1.6
	All Others	8.0%	\$1,790	-1%	42%	51%	56%	\$207	42%	58%	9.6	9.3	0.2	0.2
	Total P/C Industry *	100.0%	\$22,383	-6%	47%	53%	61%	\$3,119	44%	55%	7.2	6.7	0.6	1.0

Source: A.M. Best

We compiled a list (primarily composed of the dirty thirty) of U.S. P/C insurers that notably (and not surprisingly) increased their asbestos reserves in 2001. The collective total asbestos reserves incurred by these companies totaled \$1.6 billion in 2001.

Which Companies Have Recently Strengthened their Asbestos Reserves?

(In Millions)	Pre-Tax Charges
U.S. Companies (subsidiaries):	
C.N.A.	\$1,000.0
Royal & Sun Alliance (U.S.)	\$241.0
American Financial (Great American)	\$136.0
GE Global	\$99.0
Safeco	\$70.0
Allmerica Financial	\$33.0
Markel	\$20.0
Everest Re	\$10.0
Ohio Casualty	<u>\$9.2</u>
Total U.S. Companies (subsidiaries)	<u>\$1,618.2</u>

Source: Lehman Brothers

We also were alerted in 2001 to an unexpected asbestos-related charge from an old voluntary excess and reinsurance pool, known as the Excess Casualty Reinsurance Association (ECRA). This came about after Allmerica Financial announced that it would be taking a \$33 million asbestos-related charge in the fourth quarter as a result of its modest 3% participation in the ECRA pool.

According to Allmerica, a recent reserve study (conducted by the actuarial consulting firm, Milliman and Robertson), suggests that asbestos and environmental (A&E) reserves set aside for ECRA are inadequate. In February, we learned that the reserve study has not been acted upon or approved yet by the pool's board of directors and, therefore, many insurers may have not strengthened their reserves due to the study's results. According to A.M. Best reports, Aetna (Travelers), Eagle Star (W.R. Berkley), Great American (American Financial) and St. Paul are among the pool participants in this run-off reinsurance pool in 1982. We also understand Cincinnati Financial has some exposure to the pool. The pool has been in existence since the 1930s and pool participants do not often change. We do not know the extent that the individual insurers participated in the pool nor the level of A&E reserves previously set aside for such liabilities (actually reserve assumptions vary by company), so it is not clear just how much a financial impact this will have on the individual companies. But some insurers will need to increase A&E reserves if the Milliman and Robertson report is accepted by the reinsurance pool's board.

Excess and Casualty Reinsurance Association

Companies participating in the pool in 1982:

Abeille-Paix General Ins. Co. (U.S. Branch)	Liberty Mutual Ins. Co.
Aetna Ins. Co. (Travelers)	Liberty National Fire Ins. Co.
Alabama Farm Bureau Mutual Ins. Co.	Merchants and Business Men's Mutual Ins. Co.
American Agricultural Ins. Co.	Merrimack Mutual Fire Ins. Co.
Atlas Assurance Co. of America	Metropolitan Reinsurance Co.
Continental Casualty Co. (C.N.A.)	Mutual Fire, Marine, and Inland Ins. Co.
Copenhagen Reinsurance Co. of America	National Reinsurance Corp.
Dorinco Reinsurance Co.	New England Reinsurance Corp.
Eagle Star Ins. Co. of America (W.R. Berkley)	Nippon Fire Y Marine Ins. Co., Ltd. (U.S. Branch)
Employers Ins. Of Wausau A Mutual Co.	Northeastern Ins. Co. of Hartford
Excess and Treaty Reinsurance Corp.	Philadelphia Manufacturers Mutual Ins. Co.
Farmers Home Mutual Ins. Co.	Providence Washington Ins. Co.
Farmers Mutual Hail Ins. Co. of Iowa	Provident General Ins. Co.
Folksamerica Reinsurance Co.	Republic Ins. Co.
General Accident Ins. Co. of America	Royal Ins. Co. of America (Royal and Sun)
Great American Ins. Co. (American Financial)	St. Paul Fire & Marine Ins. Co. (St. Paul)
Guarantee Ins. Co.	Security Ins. Co. of Hartford
Hanover Ins. Co. (Allmerica)	Shelby Mutual Ins. Co.
Hansecos Ins. Co.	Taisho Marine and Fire Ins. Co., Ltd. (U.S. Branch)
Hastings Mutual Ins. Co.	Tokio Marine and Fire Ins. Co. Ltd. (U.S. Branch)
Highlands Ins. Co.	United Fire & Casualty Co.
Home Ins. Co.	Winterthur Swiss Ins. Co. (U.S. Branch)
Inland Ins. Co.	Zurich Ins. Co. (U.S. Branch)
Insurance Corp. of Hannover	

Source: A.M. Best

If we gross up Allmerica's 3% participation in the pool, the reserve charge related to the ECRA pool has the potential of costing the P/C industry in excess of \$1 billion. This would bring the total potential asbestos reserve strengthening for the U.S. P/C industry to at least \$2.5 billion in 2001.

Total Potential Reserve Strengthening

(In Millions)	Pre-Tax Charges
Total U.S. Companies (subsidiaries)	\$1,618.2
ECRA (estimate)	<u>\$967.0</u>
Total U.S. Companies (Subs) and ECRA	<u>\$2,585.2</u>

Source: Lehman Brothers

The \$2.5 billion is likely a low number even with the ECRA estimate (which may or may not be \$1 billion), since we expect that there are plenty other P/C insurers that increased their asbestos reserves in 2001, as well.

We will not know the amount of reserve strengthening nor who contributed to the increase in 2001 until a review of 2001 year-end statutory annual reports are filed.

A.M. Best estimates that the U.S. P/C industry incurred \$4.6 billion in losses related to asbestos claims (or approximately 1.4 percentage points on the combined ratio) in 2001. Standard and Poor's also expects that the P/C industry has increased asbestos-related reserves \$5 billion-\$10 billion in 2001. Our guess is that the S&P estimate is for both domestic and foreign companies. Regardless, the reserve charge for 2001 will likely represent the biggest hit that the P/C industry has taken to shore up asbestos reserves (the entire 1.4 percentage point A&E impact on the 2001 estimated combined ratio—the P/C industry's measure of underwriting profitability) in any given year.

Below, we illustrate A.M. Best's estimates for the industry's asbestos-related earnings drag.

Combined Ratio Impact (1997-2002E) – Pretax Earnings Drag

(%)	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001E</u>	<u>2002E</u>
Combined Ratio (Reported)	101.6	105.6	107.8	110.1	117.0	107.5
Less: Catastrophe Losses	<u>1.0</u>	<u>3.6</u>	<u>2.9</u>	<u>1.5</u>	<u>8.8</u>	<u>3.0</u>
Combined Ratio (x Cat Losses)	100.6	102.0	104.9	108.6	108.2	104.5
Less:						
Asbestos Losses	0.4	0.6	0.8	0.5	NA	NA
Environmental Losses	<u>0.4</u>	<u>0.4</u>	<u>0.2</u>	<u>0.1</u>	<u>NA</u>	<u>NA</u>
Total A&E	<u>0.7</u>	<u>1.0</u>	<u>1.0</u>	<u>0.6</u>	<u>1.4</u>	<u>1.5</u>
Combined Ratio (Normalized)	99.9	101.0	103.9	108.1	106.8	103.1

Note: Represents the net point impact on the p/c industry's combined ratio.

Source: A.M. Best

If we apply the estimated asbestos losses incurred totaling \$4.6 billion in 2001, the reserve shortfall for the U.S. P/C industry at year-end 2001 would be \$11 billion-\$33 billion. On an after-tax basis for the same period, we are looking at an asbestos reserve deficiency that represents 3.9%-7.7% of the U.S. P/C industry's estimated statutory surplus. However, since the majority of the asbestos claims will be paid by the top 30 most exposed companies, the hit to their individual and/or combined surplus would be more significant. However, looking at the P/C industry's net ultimate asbestos exposure as a percentage of surplus tends to be a worse-case scenario considering that the P/C industry will likely be funding asbestos claims over many years to come.

Building Estimated Net Asbestos Reserve Shortfall and Impact on Statutory Surplus at Year-End 2001

(\$ In Billions)

	<u>A.M. Best</u>	<u>Tillinghast</u>	<u>Milliman</u>
Ultimate Asbestos Cost for U.S. P/C Industry	\$65	\$55 - \$65	\$70
Less: Incurred Asbestos Losses To Date*	\$37	\$37	\$37
Reserve Shortfall (pre-tax)	\$28	\$18 - \$28	\$33
Reserve Shortfall (after-tax)	\$18	\$12 - \$18	\$21
% of Best's est. statutory surplus at y-e 2001	6.5%	3.9% - 6.5%	7.7%

Source: A.M. Best, Lehman Brothers estimates, Tillinghast, and Milliman

While we saw many P/C insurers increase their reserves for the such potential future asbestos-related claims this past year, the amount was not as much as we would have considered likely as the P/C industry was unexpectedly hard hit by September 11 and other adverse events (i.e. prior year reserve deficiencies from pricing wars of the 1990s and Tropical Storm Allison) during 2001. As a result, the funding of asbestos claims will

likely continue to be an ongoing earnings drag for the P/C industry for quite sometime. However, we believe that the asbestos issue has been a long running problem that is largely baked into earnings estimates and valuation for publicly traded P/C insurers.

The impact to earnings on P/C insurers varies from one company to the next but, for the most part, we expect to see asbestos exposures being offset somewhat by a couple of things over the next couple of years. The increased need for asbestos reserves is just one more reason to justify continued price increases to customers. It is also believed that the reserves that were set aside for environmental (pollution) claims years ago when such exposures were the hot issue for the P/C industry are, for some companies, becoming superfluous. In addition, there are some legislative solutions being pursued by insurers to reduce asbestos exposures. We will not hold our breath but, asbestos reform of some sort would mean earnings would increase significantly by virtually every publicly traded insurer.

Asbestos incurred losses as a percent of net premiums earned has averaged 0.6 percentage points on the P/C industry's combined ratio from 1997 to 2000. We and A.M. Best believe the impact on future earnings from asbestos losses will get much worse, as incurred losses are estimated to be roughly \$5 billion in 2001 or about 1.4 percentage points on the P/C industry's combined ratio.

For 2002, if we assume that the P/C industry has a projected earnings drag of 1 percentage point, we estimate a net asbestos incurred loss of \$3.5 billion. If we assume that the P/C industry has a projected earnings drag of 1.5% points (splitting the difference with A.M. Best's estimate of 1%-2%), it would record a net asbestos incurred loss of approximately \$5.3 billion.

Top-30 Property/Casualty Groups Ranked by Total 2000 Asbestos Reserves & Estimated Net Asbestos Incurred Losses for 2002 Based on Market Share

(\$ millions)

Net A&E Reserve Rank	Group	Net A&E Loss			2000 Net Asbestos		2002 Net Asbestos Estimated Incurred Losses	
		Reserve Share	Reserves (\$ millions)	Asbestos Mix (%)	Net Asbestos Loss Reserves	Net Asbestos Reserve Share	Assumes 1% point impact on combined ratio	Assumes 1.5% point impact on combined ratio
1	Travelers P&C	6.1%	1,362	59%	\$804	8%	\$267	\$405
2	Liberty Mut Ins Cos	5.4%	1,215	62%	753	7%	251	380
3	Nationwide Group	6.6%	1,469	51%	749	7%	249	377
4	Allstate	4.8%	1,066	60%	640	6%	213	322
5	Berkshire Hathaway	6.7%	\$1,500	42%	630	6%	210	317
6	Brandywine (ACE INA Group)	6.1%	1,359	46%	625	6%	208	315
7	CNA Ins Companies	3.8%	851	71%	604	6%	201	304
8	Hartford Ins. Group	5.6%	1,261	34%	429	4%	143	216
9	American Re (Munich Re)	3.7%	837	49%	410	4%	136	207
10	GE Capital Ins Group	2.6%	585	67%	392	4%	130	197
11	AIG	3.8%	855	40%	342	3%	114	172
12	Swiss Re Group	3.4%	765	43%	329	3%	109	166
13	Fairfax Fin (C&F; Int'l Ins. Co.)	2.8%	632	50%	316	3%	105	159
14	Allianz of America	4.4%	996	31%	309	3%	103	156
15	St. Paul	3.8%	851	35%	298	3%	99	150
16	Home Ins Companies (Run-Off)	2.3%	506	48%	243	2%	81	122
17	Everest Reins Group	1.4%	317	68%	216	2%	72	109
18	FM Global Group	1.4%	321	65%	209	2%	69	105
19	Chubb Grp of Ins Cos	2.0%	443	46%	204	2%	68	103
20	Zurich/Farmers Group	2.6%	589	31%	183	2%	61	92
21	OneBeacon Group	3.6%	796	20%	159	2%	53	80
22	Great American	1.6%	351	40%	140	1%	47	71
23	Royal & SunAlliance	1.6%	369	37%	137	1%	45	69
24	Phila Reins Corp (Run-Off)	0.8%	173	69%	119	1%	40	60
25	Kemper	0.8%	179	57%	102	1%	34	51
26	SAFECO	1.3%	287	32%	92	1%	31	46
27	Duke's Place Hldg (Seaton; Stonewall)	0.8%	176	47%	83	1%	28	42
28	Argonaut	0.7%	155	52%	81	1%	27	41
29	Gerling Gillobal	0.7%	152	30%	46	0%	15	23
30	Reliance (In Liquidation)*	0.8%	175	NA	NA	NA	NA	NA
	Top 30	91%	20,593	47%	\$9,679	92%	\$3,220	\$4,876
	All Others	8%	1790	42%	752	7%	250	379
	Total P/C Industry	99%	22,383	47%	\$10,520	100%	\$3,500	\$5,300

* Reliance did not file 2000 statutory statements

Source: A.M. Best and Lehman Brothers

Impact on Individual Companies

We estimate the 2002 cost per company by allocating the net asbestos incurred losses for the P/C industry (assuming both the 1% earnings drag or \$3.5 billion and 1.5% earnings drag or \$5.3 billion) to the most exposed commercial lines insurers based on their proportionate net asbestos loss reserve market share at year-end 2000.

If we assume that reform eliminates the need to add to current reserves, the 1.0% point or 1.5% pretax earnings drag is eliminated in 2002. The companies most affected are principally commercial insurers like Chubb (\$0.31 to \$0.51 per share estimated 2002 EPS upside, St. Paul (\$0.31 to \$0.47), ACE (\$0.61 to \$0.92) and Hartford Financial (\$0.38 to \$0.58). But there are a few personal lines companies that once wrote commercial lines like Allstate that are also affected (\$0.22 to \$0.32).

Potential Earnings Upside – 1% Impact on P/C Industry's Combined Ratio

Assumes 1% point impact on the p/c industry's combined ratio or net asbestos incurred losses for the industry of \$3.5 billion for 2002 and allocate the loss proportionately based on companies net asbestos reserve market share at year end 2000:

(\$ millions)

Company	2000		Net		Pt. Impact on Combined Ratio (%)	2002E		
	Net Asbestos Loss Reserves	Asbestos Reserve Share	Net Asbestos Incurred Losses	Net Premiums Earned		Published EPS	Adjusted EPS	Upside Earnings
Hartford Financial	\$429	4.08%	\$143	\$7,826	1.8%	\$4.93	\$5.31	\$0.38
St. Paul Companies	\$298	2.83%	\$99	\$6,160	1.6%	\$3.02	\$3.33	\$0.31
Allstate	\$640	6.08%	\$213	\$23,874	0.9%	\$2.60	\$2.82	\$0.22
Everest Re	\$216	2.05%	\$72	\$1,821	3.9%	\$5.70	\$6.71	\$1.01
American International Group	\$342	3.25%	\$114	\$22,906	0.5%	\$3.50	\$3.53	\$0.03
ACE Ltd.	\$625	5.94%	\$208	\$6,986	3.0%	\$3.54	\$4.15	\$0.61
Safeco Corp.	\$92	0.87%	\$31	\$4,614	0.7%	\$1.65	\$1.81	\$0.16
Chubb	\$204	1.94%	\$68	\$7,215	0.9%	\$4.61	\$4.92	\$0.31
Cincinnati Financial	\$28	0.27%	\$9	\$2,258	0.4%	\$1.66	\$1.69	\$0.03
Total Industry	\$10,520		\$3,500	\$351,976	1.0%			

Source: Lehman Brothers

Potential Earnings Upside – 1.5% Impact on P/C Industry's Combined Ratio

Assumes 1.5% point impact on the p/c industry's combined ratio or net asbestos incurred losses for the industry of \$5.3 billion for 2002 and allocate the loss proportionately based on companies net asbestos reserve market share at year end 2000:

(\$ millions)

Company	2000		Net		Pt. Impact on Combined Ratio (%)	2002E		
	Net Asbestos Loss Reserves	Asbestos Reserve Share	Net Asbestos Incurred Losses	Net Premiums Earned		Published EPS	Adjusted EPS	Upside Earnings
Hartford Financial	\$429	4.08%	\$216	\$7,826	2.8%	\$4.93	\$5.51	\$0.58
St. Paul Companies	\$298	2.83%	\$150	\$6,160	2.4%	\$3.02	\$3.49	\$0.47
Allstate	\$640	6.08%	\$322	\$23,874	1.3%	\$2.60	\$2.92	\$0.32
Everest Re	\$216	2.05%	\$109	\$1,821	6.0%	\$5.70	\$7.26	\$1.56
American International Group	\$342	3.25%	\$172	\$22,906	0.8%	\$3.50	\$3.55	\$0.05
ACE Ltd.	\$625	5.94%	\$315	\$6,986	4.5%	\$3.54	\$4.46	\$0.92
Safeco Corp.	\$92	0.87%	\$46	\$4,614	1.0%	\$1.65	\$1.88	\$0.23
Chubb	\$204	1.94%	\$103	\$7,215	1.4%	\$4.61	\$5.12	\$0.51
Cincinnati Financial	\$28	0.27%	\$14	\$2,258	0.6%	\$1.66	\$1.71	\$0.05
Total Industry	\$10,520		\$5,300	\$351,976	1.5%			

Source: Lehman Brothers

Throughout our analysis we assume that if there is reform, the asbestos reform would limit the extent of any future exposures to asbestos settlement. This could mean that the industry may already have adequate reserves set aside to settle their existing asbestos claims.

We also assume that if legislation passes, that the P/C industry reserves should be sufficient to fund asbestos-related claims and litigation, and that companies will no longer need to set aside future reserves for unfunded liabilities. The exact amount of earnings benefit, however, will ultimately depend on the reform and the companies' reserve position.

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Nonlegislative Risk Mitigation Strategies

Asbestos begs for a legislative solution. While much has been written about the public health toll from asbestos, the flood of claims in recent years also has led to a surge in corporate fatalities—there have now been 62 corporate bankruptcies producing a different type of human suffering in the form of lost jobs and decimated 401k plans. With 2,000 defendants facing an estimated 1,000,000 claims still to come, the havoc will continue unless Congress acts.

Whether Congressional action is something that can be counted upon is a different story. As Lehman's Washington-based political analysts noted earlier, tort reform is unlikely even under the most optimistic scenarios. Companies who base their asbestos strategy on imminent legislation may find themselves like the characters in Samuel Beckett's absurd classic, "Waiting for Godot"—endlessly waiting for salvation, which often appears tantalizingly close but never actually arrives.

Some forward-looking companies have chosen a different path for dealing with the asbestos scourge: hoping for the best, but planning for the worst by adopting various strategies to mitigate risk.

One strategy has been to transfer varying degrees of risk to large insurance or reinsurance counterparties. There have been several such transactions—some widely publicized, some not. One example is T&N PLC, formerly the United Kingdom's largest asbestos manufacturer. In 1996, T&N arranged for an insurance policy with three insurers, which provided \$835 million of coverage excess of the first \$469 million of loss, paying the insurers a premium of \$154 million. T&N's stock price jumped 30% on the news that it had purchased the policy.

Insurance has been particularly useful in conjunction with corporate restructurings, mergers and acquisitions. By transferring catastrophic risk, crystallizing the liability for buyers, and helping sellers avoid long-term indemnities, insurance removes an impediment to deals. For example, in the September 2000 sale of the U.S. subsidiary of British insurer CGNU, the buyer, White Mountains, was concerned about exposure to the U.S. company's asbestos and environmental liabilities (notwithstanding a \$1 billion reserve on the U.S. company's books). A \$2.5 billion "stop loss" reinsurance policy was purchased for the \$1 billion reserve, plus a \$250 million premium.

Similarly, in the July 1999 purchase of Cigna's property and casualty division by ACE, a reinsurer stepped up to provide ACE significant coverage to protect against adverse development of Cigna's asbestos and environmental liabilities. More recently, Winterthur Swiss successfully used reinsurance in conjunction with its sale of troubled subsidiary Republic Insurance. Republic, like other insurers, faced significant asbestos and environmental exposure from business written years ago. For a \$220 million premium, Winterthur secured a \$700 million policy. Partly on the strength of this policy, the Texas

insurance regulators cancelled Winterthur's surplus maintenance agreement with Republic, giving Winterthur a complete exit.

Although no deals have yet been completed, insurance may enable bankrupt asbestos defendants to discharge their liabilities and emerge from bankruptcy or sell their operations cleansed of the liability. The Federal Bankruptcy Code now provides for the creation of a special trust to which existing and future claims are "channeled" through a court ordered injunction. What has prevented the widespread use of this vehicle has been disagreement among plaintiff attorneys, commercial creditors and corporate management over the valuation of future asbestos claims (75% of the class of asbestos claimants must approve the trust, which must hold at least a majority of the company's voting stock). By transferring the risk of future claim valuation to an Insurer or Reinsurer, insurance may facilitate deals among clashing creditor classes and accomplish the asbestos trust's worthy goal.

Apart from insurance, it has been suggested that capital markets tools such as catastrophe bonds, swaps or contingent capital may be applied to asbestos risk. For example, it may be possible to establish a liquidity facility which provides capital at precisely the time when companies need it the most: When asbestos claims have overwhelmed the company's existing sources of liquidity.

Unfortunately, there is no panacea that can make asbestos liability vanish, but depending on the company's particular situation, there are strategies to mitigate risk—not magic elixirs, but better than waiting for Congress.

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BASIC INDUSTRIES

Paper & Forest Products

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Asbestos Exposure: Paper & Forest Product Companies

Few paper and forest product companies have exposure to asbestos. However, Georgia-Pacific manufactured a product that contained asbestos and International Paper acquired a company that distributed a product containing asbestos.

Georgia-Pacific

The most significant exposure resides with Georgia-Pacific, which manufactured asbestos-containing "joint systems compound" (similar to spackle compound), used in construction. The product was manufactured by GP's gypsum wallboard business starting in the mid-1960s through 1977.

G-P recently provided clarity on their asbestos exposure. Using analysis performed by National Economic Research Associates and Peterson Consulting, G-P's estimated asbestos exposure for the 10-year period through 2011 is expected to be less than \$1 billion and most of its liability will be covered by insurance. Given "gaps in coverage" resulting from insolvency of some of G-P's previous insurers, GP booked a \$350 million (\$0.96 per share after-tax) charge during the fourth quarter of 2001. We would summarize additional key points as follows:

- To date, approximately 297,000 asbestos claims have been filed against GP, of which 235,000 have been settled or dismissed. At the end of 2001, approximately 62,000 claims were pending.
- To date, substantially all of the asbestos settlements have been covered by GP's insurance.
- The number of new claims filed decreased last year to less than 40,000. A third-party analysis expects the number of new claims to continue to fall over the next decade.

International Paper

International Paper has minimal exposure to asbestos. The exposure resides within a wood products distribution business that was wholly owned by Champion International. IP acquired Champion during 2000. Champion's distribution business did not manufacture any asbestos-containing products but they did distribute "countertops" that contained asbestos and were delivered to shipyards. Shipyards have proven to be an easy target for lawyers as various asbestos products were used to build the ships. However, the good news is that the exposure is confined. We do not believe IP's exposure presents any material financial risk to the company.

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BASIC INDUSTRIES

Metals & Mining

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Asbestos Exposure: Metals & Mining Companies**The Phelps Dodge Corporation**

The Phelps Dodge Corporation is facing ongoing litigation related to its past production of asbestos-containing products. Phelps Dodge management does not believe that this litigation represents a material risk to the firm. Phelps Dodge holds litigation insurance, which management believes is sufficient to protect the company against the risks related to this litigation.

Phelps Dodge manufactured asbestos-insulated wire and cable for approximately 30 years until the early 1960s. The asbestos-bearing wire and cable was produced by Phelps Dodge subsidiaries. The subsidiaries involved in manufacturing these products were sold during the 1980s.

Phelps Dodge management believes that the pending asbestos litigation is not a material threat based, in part, on studies that have shown that the wire and cable insulation is stable and is not friable, even after extended periods of time. To date, over 48,000 claims have been filed against Phelps Dodge, most in the form of mass-tort litigation. Of these claims, over 33,000 have been disposed of without a legal defeat. The "no settlement" policy employed by Phelps Dodge has resulted in the firm paying out only \$520,000 for claims over the last 10 years, amounting to \$16 per claim. There are currently about 15,000 unresolved asbestos claims against Phelps Dodge. This number has remained fairly constant over the past few years, with new claims approximating disposals. Furthermore, Phelps Dodge management believes the number of total claims outstanding will remain on the order of 15,000 for the next few years.

Legal defense costs are approximately \$1 million to \$2 million per year. Phelps Dodge's litigation insurance policies cover a substantial portion of these costs, but the company declined comment on the exact proportion. Importantly, this insurance will also mitigate the cost of adverse decisions against Phelps Dodge. In the opinion of management, this insurance would be sufficient to cover any adverse rulings, although they would not divulge the actual dollar amount of coverage. Again, according to management, Phelps Dodge has yet to lose a case in court over the current asbestos litigation. Furthermore, management does not believe the pending claims to be a material threat to the ongoing viability of the firm. However, the legal costs that are not covered by insurance will likely represent an ongoing expense.

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BASIC INDUSTRIES

Major Chemicals

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Asbestos Exposure: Major Chemical Companies**Dow Chemical Company**

Dow Chemical itself never sold any asbestos products, and all cases came with Union Carbide, which Dow bought in February 2001. Union Carbide had \$230 million in asbestos liability in 2001, with asbestos insurance coverage of \$220 million, as disclosed on Dow's 4Q01 conference call.

Two Sources of Asbestos Liability

- Carbide owned a mine in King City, California, and an asbestos mill (making short-length fibers), which it ran from 1963-1986. Union Carbide sold actual asbestos pellets made from the mine to other companies in order to make ceiling and floor tiles. The mine was sold to King City Asbestos in 1986, and it continues to operate today.
- The other case is from AmChem. Products, an acquisition made by Union Carbide in 1977 from HB Fuller. AmChem was later sold to Rhone-Poulenc. AmChem did not sell any asbestos products when under Carbide's control, but had sold adhesives that contained small amounts of asbestos before the 1977 acquisition. When Carbide acquired AmChem., the asbestos liability came with it. After the 1986 sale of the unit to Rhone-Poulenc, Carbide retained the asbestos liability.

Dow's insurance policy is very large for both cases, and supported by several strongly solvent insurers, not just with one company. Insurance companies are readily paying for clients' liability to asbestos. Dow is reluctant to disclose the total value of their insurance coverage because it is concerned that it will lead plaintiffs to seek total claims of that amount.

A recent lawsuit in Beumont, TX, was settled for an undisclosed amount on January 9, and Dow's insurance policy seems large enough to pay the settlement. The full value of the coverage from the policies is not known. There are several other cases in the pipeline, but we do not know how many. Moreover, the timing and the actual outcome of these cases are difficult to predict.

There are also other companies mentioned in the Texas lawsuit. In a pending case in California, the plaintiff still needs to prove that the asbestos in the products they were exposed to was the same asbestos sold by Carbide from its asbestos mine.

PPG Industries, Inc.

PPG's involvement in asbestos is related to "premises" liability from using asbestos products as insulation, which every chemical, energy, refining company has done, due to asbestos being a good insulator of hot pipes in chemical processes. The exposure is due to 50% ownership in a joint venture (JV) called Pittsburgh-Corning (PC), where PPG claims to have been involved only at "arms-length" as a financial partner. This is similar to

that of Dow Chem in the Dow Corning JV breast implants bankruptcy, which did not impact Dow Chem due to the corporate veil concept. PPG's involvement in PC was as limited as Dow's in Dow Corning; thus, we believe the corporate veil concept should also apply to PPG.

PC filed for bankruptcy on April 16, 2000. The bankruptcy judge stayed all cases against PC, until the lawyers, creditors, and suppliers could fathom the division of PC's assets. The stay has been extended many times, but it will be lifted when the parties either come to a decision or to a complete dead end. The next time the stay is to be reviewed is on or about April 15. This stay order freezes consideration of all cases against PC; although lawyers can file new claims, they will not go to court until after the stay is lifted.

Over the past 30 years, PPG has been a defendant in many cases, and was successful in getting them dismissed. The total amount of settlements has been immaterial. PPG is one of the defendants in cases involving 115,000 plaintiffs, this number has been stable over the past two years.

So far, PPG has been found partially liable in only one lawsuit (10% of the \$15 million judgment for five plaintiffs in Beaumont, TX, in January 2000). PPG plans to appeal it, but can not proceed until after the stay is lifted. The appeal could take 12-18 months.

The bottom line, in our view, is that PPG's asbestos "cloud" seems to be much less serious than for many others, including Dow, but we will be watching it closely.

DuPont

DuPont's exposure to asbestos litigation is primarily limited to "premises" liability, which most chemical companies encounter since asbestos products are commonly used in chemical plants, as it is a good insulator of hot pipes in chemical processes. We believe DuPont will not have many asbestos lawsuits brought against it and that the claims will be for relatively small amounts. Thus, we do not expect DuPont's earnings or operations to be materially affected by asbestos litigation.

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Asbestos Exposure: Major Pharmaceuticals

Pfizer, Inc.

There has been some concern over Pfizer's potential liability as a defendant in a number of asbestos-related lawsuits. These claims seem to come from three (historical) sources:

- Pfizer itself (via the sale of asbestos-containing talc);
- Quigley (a wholly-owned subsidiary of PFE that sold "construction products;" and
- American Optical (which was owned by WLA, which sold safety equipment (such as gloves) that contained asbestos).

The reason for some heightened concern is that the Center for Claims Resolution (CCR), a joint defense organization of several defendants that has been defending these claims, has been dissolved. Thus, Pfizer will defend its remaining claims itself and could be seen as having deep pockets. Pfizer claims to have sufficient insurance to cover all claims, although the company has not provided specific coverage amounts. At this point, we regard this not as a serious cause for alarm, but as something to monitor.

The number of asbestos cases is increasing and the body to distribute them, the CCR, has disbanded (this occurred some time ago). Grace and Owens Corning have filed for chapter 11, and, therefore, some litigants are seeking deep pockets like Pfizer. Pfizer, because the CCR disbanded, will litigate some of these cases. At the December 2001 analyst meeting, Pfizer CEO Hank McKinnel claimed that there are many issues that pose a risk to Pfizer, but this is not one of them. CFO David Shedlarz claimed that while this issue is an administrative nightmare, they will work through these issues and that there are sufficient reserves and cash flow for litigation.

Asbestos Excerpt from Form: 10-Q (Filing Date: 11/13/2001)

Through the early 1970s, Pfizer Inc. (Minerals Division) and Quigley Company, Inc. ("Quigley"), a wholly owned subsidiary, sold a minimal amount of one construction product and several refractory products containing some asbestos. These sales were discontinued thereafter. Although these sales represented a minor market share, the Company has been named as one of a number of defendants in numerous lawsuits. These actions, and actions related to the Company's sale of talc products in the past, claim personal injury resulting from exposure to asbestos-containing products, and nearly all seek general and punitive damages. In these actions, the Company or Quigley is typically one of a number of defendants, and both have been members of the Center for Claims Resolution (the "CCR"), a joint defense organization of several defendants that has been defending these claims. The Company and Quigley have been responsible for varying percentages of defense and liability payments for all members of the CCR. With the reformation and/or dissolution of CCR, the Company and Quigley will defend the litigation separately from other CCR members. A number of cases alleging property damage from asbestos-containing products installed in buildings have also been brought against the Company, but most have been resolved and none are active.

As of September 30, 2001, there were 90,227 personal injury claims pending against Quigley and 59,071 such claims against the Company (excluding those that are inactive or have been settled in principle), and 74 talc cases against the Company.

The Company believes that its costs incurred in defending and ultimately disposing of the asbestos personal injury claims, as well as the property damage and talc claims, will be largely covered by insurance policies issued by several primary insurance carriers and a number of excess carriers that have agreed to provide coverage, subject to deductibles, exclusions, retentions and policy limits. Litigation against excess insurance carriers seeking damages and/or declaratory relief to secure their coverage obligations has been largely resolved.

From 1967 to 1982, a Warner-Lambert subsidiary owned American Optical Company, which at certain times manufactured a line of personal protective clothing and respirators for use in general industrial settings. Certain of the protective clothing items (e.g., certain gloves) contained asbestos. American Optical discontinued production of protective clothing in 1976, and sold its protective clothing business in its entirety in 1977. In May 1982, Warner-Lambert sold American Optical. As part of that sale, the Warner-Lambert subsidiary agreed to indemnify the purchaser against product liability claims arising out of alleged use or exposure to American Optical products up to the date of closing.

As of September 30, 2001, American Optical was named a defendant in lawsuits involving approximately 64,046 individual plaintiffs. Approximately two-thirds of these lawsuits involve claims for asbestos-related disease developed as a result of exposure to asbestos-containing protective clothing allegedly manufactured by American Optical. The remaining one-third consists of claims for silica-related disease developed as a result of exposure to silica while using allegedly defective respirators manufactured by American Optical.

Based on the Company's experience in defending the claims to date and considering its insurance and reserves, the Company is of the opinion that the actions should not have a material adverse effect on the financial position or results of the Company.

Source: Pfizer

INDUSTRIAL

Packaging

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jtiss@lehman.com**Asbestos Exposure: Packaging Companies****Owens-Illinois**

Owens-Illinois made insulation products between 1948 and 1958 with annual average sales of \$4 million. The company sold the business in 1958 and has been receiving lawsuits since the mid 1980s. The average age of the plaintiff is now 74 years and based on demographics, there is a 12-year tail on the liability after which most plaintiffs will expire from either asbestos or natural causes. Since its first claim, the company has disposed of 250,000 claims at an average cost of \$4900 resulting in total payments well north of a billion dollars. Nobody outside of the population of workers that would have been of working age and exposed to OI's products during this time has successfully sued the company. Lawyers are now working on families of potentially exposed workers that could have been exposed to fibers through the workers' clothing, but there have been no successful cases to date. Owens' average cost per case five years ago was below \$5000 and has since risen toward \$10,000, partly because as the suing population ages, the incidence of actual sickness is amplified, and the cases have become more costly. That said, however, the vast majority of the cases (over 95%) are still without merit and settled at minimal cost. Owens is projected to spend some \$240 million in 2002, roughly flat with 2001 levels. As of September 2001, the liability reserve on the balance sheet had declined to roughly \$140 million, which will most likely be increased as management forecasts asbestos payments in 2002 running in excess of \$200 million. During 2000, 20,000 cases were filed with 18,000 being disposed at an average cost of roughly \$10,000 per case.

Crown Cork and Seal

Crown Cork and Seal acquired Mundet Cork Company in 1963 and closed down the small division three months later. Unfortunately, this investment made a product that contained asbestos. Crown has paid out \$300 million-\$400 million, net of insurance proceeds, over the past 10 years and may have well over \$1 billion of total liability left. The current run rate for payments is roughly \$100 million per annum with an average payout of roughly \$2500. During 2000, roughly 44,000 claims were filed with 40,000 being disposed; not to mention an additional 30,000 or so that are pending as management believes they are without merit. As of September 2001, the reserve was roughly \$330 million with management assessing whether or not to adjust it. For now, the reserve appears reasonable, but in all likelihood it will be revisited on an annual basis. Crown has won a landmark agreement with the state of Pennsylvania that potentially shields the company from any further liability, however that ruling has yet to be court tested. While we believe that the amounts that Crown has paid out and the potential for further payouts ignore the past business profits or contribution to the overall issue, the company's tremendous debt burden makes the asbestos liability somewhat more important than otherwise.

Sealed Air Corp

Sealed Air is a special case in that it is uncertain whether they will end up with asbestos exposure or not. In 1999, Sealed Air borrowed some \$5 billion and was acquired by then WR Grace. Grace took the proceeds and spun out their chemical and other divisions leaving behind the old Sealed Air and their Cryovac division. The remaining company was renamed Sealed Air and was shielded from any potential asbestos liability by WR Grace. Then Grace went bankrupt reducing the potential for them to honor their agreement, longer term. The current lawsuits claim that Sealed Air and Grace coconspired to favor shareholders (who were given the spinouts) over the asbestos claimants, which because the two companies were combined, even if for a short period, may have some validity.

INDUSTRIALElectrical Equipment
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For the February 2002 quarter, the company reported total new claims of approximately 9,600. Roughly one-third of the new claims are related to a single lawsuit, which the company believes is without merit and expects to dismiss without payment. The 9,600 new claims compares with 11,100 from 2Q01, and 20,700 from 3Q01 and shows a pattern of new claims on the decline. The company resolved 17,200 cases in the quarter, compared to 6,100 claims resolved in 4Q00 and 5,700 resolved claims in 3Q01. Over the last two years, the rate of claims dismissed without payment has increased to 55%-58% and looks to be continuing upward. The number of outstanding claims at the end of 2001 stood at 110,800 versus 92,100 at the end of 2000 and 118,400 at the end of 3Q01. Management believes Foster Wheeler's asbestos strategy has, so far, been effective in conserving insurance assets and avoiding high risk situations. Claims are settled only when the cases meet stringent criteria. Foster Wheeler notes that almost all indemnity and defense costs have been paid by insurance and anticipates substantially all disbursements related to asbestos claims would be reimbursed by insurance coverage going forward.

Honeywell

During Honeywell's January analyst meeting, the management summarized the company's asbestos situation. There are two businesses that have or had some peripheral connection with asbestos (Honeywell did not mine or manufacture asbestos but installed products that contained asbestos): 1) Bendix – a business currently part of Honeywell that sold encapsulated brake pads containing small amounts of asbestos; and 2) North American Refractory Company (NARCO) – a business that Honeywell owned between 1979-1986, but is now owned by RHI AG (an Austrian company). The company noted that Honeywell was named in lawsuits along with other companies in the auto industry, but it is difficult to establish that a claimant, usually an auto mechanic, was exposed to a Bendix product. Over the last 20 years, management resolved 53,000 cases at \$1,000 per case with 74% of cases being dismissed without merit, and it won 116 out of 119 cases that went to court. Honeywell stated that it has not made asbestos related pay outs for a number of years since satisfying the insurance deductible. Even under conservative estimates, management believes the company is sufficiently covered by the existing \$2 billion insurance coverage for Bendix, and does not expect outlays going forward.

NARCO is the other business with a connection with asbestos and Honeywell. This company manufactures bricks and cement for high temperature applications mostly in the steel industry with approximately 2% of products containing asbestos. Upon the sale of NARCO in 1986, Honeywell indemnified NARCO for discontinued products prior to 1986 and NARCO, in turn, indemnified Honeywell for products after 1986. Over the past 18 years, NARCO has settled 176,000 cases at \$2200 per case where 43% of

cases were dismissed without merit, according to management. In January 2002, NARCO filed for reorganization under Chapter 11, with Honeywell's consent, faced with a decline in the steel industry and increasing asbestos liability. At this point, all 116,000 claims outstanding against NARCO, of which 7% also name Honeywell, have been staid in Federal Bankruptcy Court. The court has curtailed claims against Honeywell until the bankruptcy case has been resolved. If the reorganization plan is approved, an injunction would become effective such that all future claims would be taken care of by the court. Honeywell holds a \$1.3 billion insurance policy, which combined with the assets of NARCO, would be used to fund a trust that the company estimates would be sufficient in covering any claims. Bottom line, Honeywell does not expect any expenditures related to NARCO's asbestos issue for at least three years or until the reorganization is resolved, and the company could make a similar case for subsequent periods.

INDUSTRIAL

Aerospace & Defense Electronics

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Asbestos Exposure: Aerospace and Defense Electronics**United Technologies**

United Technologies does have a small number of asbestos cases, but according to the company, they do not amount to anything meaningful and the company has insurance policies in place. In other words, its exposure does not have any material financial impact. The company is not aware of any customers filing asbestos suits.

Aliant Techsystems

All public companies are required to disclose all material exposure or litigation in their 10-K filings. In review of ATK's 10-K filings, there is no reference to any asbestos exposure or litigation.

Lockheed Martin

No current meaningful asbestos exposure. Lockheed takes pride in the diligence of disclosing their legal contingencies in their SEC filings, and there is no mention of material asbestos exposure in these filings outside of an immaterial \$315,000 civil penalty in the first quarter of 2000 related to the mishandling of asbestos-containing demolition debris in Lockheed's former aircraft manufacturing facilities in Burbank, CA.

Boeing

Asbestos was used in the past in certain components of aerospace products. In the late 1970s Boeing began to identify the components and materials that contained asbestos, and to introduce substitute materials. Nearly all use of asbestos in Boeing products had been eliminated by the early 1990s. Claims for asbestos-related damages against Boeing have typically been dismissed or settled for a nominal amount. Most of the claims have been insured. Boeing has no basis to believe that asbestos-related claims are, or will be, a material factor in the company's financial performance.

L-3 Communications

No current litigation or liability.

Raytheon

No litigation or liability.

United Defense

No litigation or liability.

Goodrich

The only aerospace and defense electronics company in our universe that has meaningful asbestos exposure is Goodrich. Although asbestos exposure is an important element of Goodrich's investment thesis, we do not currently cover this company, therefore we do

not feel comfortable singling it out. We can, however, provide some factual information regarding its exposure. The asbestos exposure associated with its industrial subsidiary, Coltec, is discussed in Goodrich's most recent 10-K. More specifically, Coltec's historical subsidiary operations of Garlock Sealing Technologies LLC and the Anchor Packing Company, which made and/or distributed industrial-sealing products, primarily gaskets, have resulted in a substantial volume of asbestos litigation. The company believes that pending actions are not likely to have a material adverse effect on its financial condition, but could, at some point, harm its profitability or cash flows.

Garlock believes its exposure is well managed and it is currently covered by insurance. At this time, Goodrich is in the process of spinning off its industrial unit (EnPro) to its shareholders. It believes this will separate the parent company from the asbestos liability contained in the industrial unit. The company believes that EnPro is viable, has a strong capital structure, healthy cash flows and that it can manage all of its liabilities, including asbestos. It has hired external experts to evaluate EnPro and it is the experts' opinion that EnPro satisfies all legal requirements to remove future asbestos liability from Goodrich and that it is both liquid and solvent with respects to its liabilities.

Since 1999, Garlock has implemented a short-term aggressive settlement strategy, with the goal of achieving a permanent reduction in the number of overall asbestos claims at current settlement rates. When a settlement demand is not reasonable given the totality of the circumstances, Garlock generally will try the case and has been successful in winning a substantial majority of the cases it has tried to verdict and has paid roughly \$7 million in compensatory damages in cases that have gone to verdict in 1999, 2000, and 2001.

Anchor is an inactive and insolvent subsidiary of Coltec. The insurance coverage available to it is fully committed. Anchor continues to pay settlement covered by its insurance, but has not committed to settle any further actions since 1998. As cases reach the trial stage, Anchor is typically dismissed without payment.

From a cash standpoint, Garlock has about \$1.0 billion of insurance coverage. The amount of insurance receivable to the company in any given year was limited to \$80 million per year in 2001 and 2000. This limit automatically increases by 8% every three years. As a result, Garlock has to pay out its own cash to settle the claims in excess of the annual limit and collect these amounts from its insurance carriers in subsequent years.

At the end of 2001, Goodrich had 95,400 pending cases. It paid \$74.8 million, \$36.4 million, and \$19.3 million for the defense and disposition of the cases net of the amounts received from insurance, in 2001, 2000, and 1999, respectively.

INDUSTRIAL

Multi-Industry

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Asbestos Exposure: Multi-Industry Companies**Minnesota Mining & Manufacturing Co.**

According to 3M's 10-Q filing for 3Q01, the jury in the Circuit Court of Holmes County, Mississippi, ruled against the company that its respirator and masks did not protect the plaintiffs against contracting claimed asbestos-related diseases. Consequently, the jury awarded \$25 million in compensatory damages to each of four plaintiffs. 3M estimated its share of the total liability to be \$22.5 million, but had limited visibility as to whether its liability would increase if any of the codefendants were unable to pay its share of damages.

3M said it never had a negative asbestos award of this magnitude in the past. Also, only two other cases ever went to trial. Those cases, in Texas, were awarded in 3M's favor. The Mississippi case is almost identical, according to 3M, and it is the first trial case to go against the company.

As of September 30, 2001, 3M had approximately 20,000 asbestos lawsuits and claims remaining (as a defendant with multiple codefendants), representing approximately 85,000 individuals. 3M had about \$122 million in estimated accrued liabilities related to asbestos claims, and about \$184 million in receivables for expected insurance recoveries, with the difference between the two items relating to time delay between payment of claims, and receipt of insurance reimbursement.

3M noted that the asbestos issue is not likely to have a material impact on its financial position, but future unfavorable rulings or developments could lead to material negative impact on its financial position. However, 3M expects to challenge the jury's verdict, and believes that it will ultimately be overturned. In the past 20 years, 3M noted that it had successfully defended and resolved about 200,000 similar claims and lawsuits, with an average settlement of less than \$1,000.

On the asbestos issue, 3M recently commented that it has not witnessed any acceleration in claims and that there are no pending trials. At the end of December 2001, 3M had about 80,000 claims outstanding, down from about 85,000 at the end of 3Q01. The number of claims filed in 4Q01 was fewer than those filed during the same period last year. Further, 3M noted that insurance recovery has been around 95% and that its top five insurance companies have strong credit ratings.

Crane Co.

Crane Co. has disclosed its asbestos litigation in its annual reports since 1995. According to Crane's annual report for 2000, the company was a codefendant (along with 15-40 other companies) in approximately 5,460 asbestos-related cases. The plaintiffs have alleged injury or death due to exposure to asbestos in products allegedly manufactured or sold by Crane.

Our understanding is that most of Crane's exposure to asbestos came from gaskets and packing used in the company's valves between 1957-86. Crane claims that it was never involved in the manufacturing of asbestos products per se, and in the early 1980s, the company refrained from using any asbestos-related product in its manufacturing. Crane has indicated that the asbestos issue is not expected to have a material impact on its financial position.

ITT Industries

ITT is involved in asbestos litigation, but the company believes that it is not a material risk. ITT noted that it has never been required to make any payments for settlements or defense costs with respect to asbestos litigation. Further, the company believes that it has substantial insurance coverage and that this issue would not have any material effect on its financial position.

INDUSTRIAL

Auto & Auto Parts

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Asbestos Exposure; Auto and Auto Parts Companies**Dana Corporation**

Dana had about 100,000 claims outstanding at the end of 2001, including about 27,000 claims that were settled and pending payment. The company has accrued a \$102 million liability relating to these claims as well as an \$89 million insurance recoverable asset, indicating that the vast majority of the claims are covered by insurance policies. The net liability has not increased significantly, having risen only \$2 million since 2000.

Dana also has contingent liabilities of \$44 million (offset by a \$39 million insurance recoverable) related to shared settlements among former CCR members who have defaulted over the past year.

ArvinMeritor

ArvinMeritor has paid out a total of \$40 million in asbestos-related settlements since 1996, almost all of which have been covered by insurance. The company currently has a \$71 million liability booked, mostly offset by a \$60 million insurance recoverable. ArvinMeritor had about 46,000 cases pending at the end of 2001, 15,000 of which are awaiting final payment.

Bottom Line on Dana and ArvinMeritor

Given what we know right now, we do not believe asbestos liabilities will have a material impact on Dana's or ArvinMeritor's financial condition. The disclosures to date do not indicate a material risk. However, we are not in a position to predict the outcome of future litigation either in terms of claim activity or magnitude of settlements. In particular, both companies have been left to fight claims on their own following the dissolution of the CCR.

Our biggest concern related to asbestos is related to the caps on the companies' insurance policies. Because neither company has disclosed the terms of its insurance coverage, we do not know if they are adequately covered. While both companies have expressed a reasonable level of confidence that they are adequately insured, we would feel more comfortable if we had greater transparency on the terms of coverage.

Ford and General Motors

Although asbestos liability has always been an issue for the automakers, it has only recently come to the forefront subsequent to the Federal-Mogul bankruptcy filing. Both Ford and General Motors (and numerous other automakers) have been named as codefendants, as plaintiffs are now looking for deep pockets. Although Ford and GM are named as codefendants, there are many other automakers named, including DaimlerChrysler, BMW and Volkswagen.

While Ford declines to comment officially, in its 10-K, it states that these claims have arisen as a result of plaintiffs "alleged contact with certain Ford parts and other products containing asbestos". GM-related claims are primarily auto/brake pad related, although some stem from GM locomotives (railroad workers exposed to asbestos used in brake linings) and some older GM buildings (and contractors who worked on them).

Ford and GM had requested that roughly 15,000 to 20,000 brake-related asbestos claims to be consolidated into the bankruptcy proceedings of auto parts maker Federal Mogul Corp. These claims represent the majority of asbestos-related lawsuits against the automakers. Had this occurred, they were prepared to argue that the claims be dismissed as a group, on grounds that the claims lacked scientific evidence linking products to asbestos-related illnesses.

However, on February 2, 2002, a U.S. District Court Judge ruled that he did not have jurisdiction to make such a move, that it would hurt Federal Mogul's bankruptcy case and it would disrupt many asbestos claims in state courts that are nearing trial. The decision was a defeat for the automakers, which sought to limit legal costs and avoid litigating the cases in state courts across the country.

Recently, \$53 million was awarded to a claimant, the highest amount ever for an asbestos case. GM, Ford and five other defendants settled out of court for an undisclosed amount before the ruling was issued.

GM will not comment on financial exposure, except to say that it is not material to its financial results. Further, GM would not comment on whether or not it had established legal reserves or had insurance coverage for its asbestos liability.

Ford stated in its 10-K that as of December 31, 2001, plaintiffs sought both actual and punitive damages of approximately \$1.7 billion. Like GM, it would not comment on whether or not it had established legal reserves or had insurance coverage for its asbestos liability.

ENERGY/POWER

Power

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Asbestos Exposure: Power Companies**Con Edison**

Con Edison has accrued \$169.4 million for its utility subsidiaries' exposure to asbestos and other hazardous substances including polychlorinated biphenyls (PCBs) and coal tar based on cases where they have received process as of September 30, 2001. This includes \$130.9 million at the Con Edison of New York subsidiary and \$38.5 million at Orange & Rockland. Also, under current rate plans, ED is able to defer for potential recovery site investigation and remediation costs with respect to hazardous waste. At the end of September, this amount totaled \$100.7 million (\$60.6 million for Con Ed NY and \$40.1 million for O&R). Amounts specified in pending lawsuits are in the billions of dollars, however ED believes that these amounts are greatly exaggerated and notes that, so far, lawsuits have generally been unsuccessful or settled for immaterial amounts.

Duke Energy Corp

Duke Energy's asbestos exposure stems from construction and maintenance activities conducted by the company on its electric generation plants during the 1960s and 1970s. During the late 1990s Duke Energy experienced a significant increase in the number of these claims, which prompted the company to record an \$800 million accrual in 4Q99 to reflect the purchase of a third-party insurance policy as well as estimated amounts for future claims not recoverable under such policy. The insurance policy, combined with amounts covered by self-insurance reserves, provides for claims paid up to an aggregate of \$1.6 billion.

We believe that Duke's asbestos exposure is unique because it has an identified finite population (i.e. confined to current and former employees) and it is settling claims on an individual basis and not in a class action lawsuit.

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