

Testimony of  
**Charles Bates, Ph.D.**

Chairman  
Bates White LLC  
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Good afternoon Mr. Chairman and members of the committee. I am Dr. Charles Bates, President and CEO of Bates White, LLC, a private consulting firm of 130 people specializing in quantitative research of economic and financial issues. I have a Ph.D. in economics from the University of Rochester where I embarked on my career as an expert in quantitative methods. I served on the faculty of Johns Hopkins University for seven years. I then left my academic career in 1991 to join KPMG where I worked on developing appropriate methods for forecasting asbestos personal injury and property damage claims and their related expenditures. Since then I have maintained an ongoing research program to improve the methods used for this purpose. In particular, over the last six years I have dedicated significant resources at my firm for enhancing the methods of forecasting asbestos claims.

The team I have assembled to perform this research includes highly trained Ph.D.s with years of experience in the physical sciences, labor economics, health economics, data analysis, and computer simulation modeling. We have codified our research on asbestos-related methodologies into a series of proprietary, state-of-the-art computer models and databases that we use in a wide variety of commercial contexts, including financial reporting services, due diligence evaluations, insurance valuations, and commercial litigation. I have served as an expert in litigation and business contexts for over 15 years. Given the depth and focus of our research, my firm and I are ideally qualified to analyze the FAIR Act. Thank you for inviting me to discuss our research.

The information I present to you today is based on our report sponsored by the American Legislative Exchange Council. We were asked to assess the financial viability of the National Asbestos Trust Fund proposed in the FAIR Act, assuming it would be funded to \$140 billion. No one at any time has specified a desired outcome or suggested a direction of our research. The analyses we performed are of our own design and the conclusions we reached are the result of our own analyses and experience.

In this report, we conclude that the proposed Trust Fund is under funded. The reason is that the FAIR Act establishes an entitlement for compensation to large numbers of lung and other cancer patients who currently do not have a valid tort claim. Whereas lung cancer tort claimants face the prospect of jury trials where they need to establish asbestos as the likely cause of their cancer, the FAIR Act replaces this with a contributing factor standard of proof. The tort requirement is much harder to establish because although asbestos contributes to the risk of lung cancer, it is rarely the principal cause.

The FAIR Act proposes to compensate pending and future claimants who fall into one of the specified disease categories. These categories are mesothelioma, lung cancer with asbestosis, lung cancer with pleural markers, other cancers, and impaired nonmalignant diseases. There is relatively little controversy about the number of claims for mesothelioma, lung cancer with asbestosis, and impaired nonmalignant disease. Our estimates are comparable to the Congressional Budget Office's estimate of approximately \$130 billion. This is because most of these claimants already have incentives to file in the tort environment and hence extrapolating from historical filing behavior, as CBO has done, is fairly accurate.

However, our estimate differs from CBO's estimate for the two remaining disease categories: Level VII lung cancers with pleural markers and Level VI other cancers. These two disease categories pose the greatest threat to the Fund's financial viability.

Historically, claims corresponding to Level VII lung cancer and Level VI other cancer categories were rarely compensated in the tort environment. For example, payments to other cancer claimants amount to less than two percent of total compensation paid to asbestos-related claims. The tort environment requires claimants to show that asbestos was the cause of their disease. These cases are hard to win since lung and other cancers lack the strong link to asbestos that mesothelioma has. If someone has mesothelioma, it was most likely caused by asbestos exposure. In contrast, if someone has lung cancer, it was most likely caused by smoking. The FAIR Act weakens the tort criteria. It only requires claimants to show that asbestos was a "significant contributing factor." Many researchers, including Dr. Nicholson, state that asbestos exposure increases the incidence of lung and other cancers. We believe doctors will interpret this finding to mean that asbestos was a significant contributing factor for lung and other cancers.

Given that lung and other cancer claimants will meet the "significant contributing factor" criteria under the FAIR Act, the question is how many such claims will be compensated by the Fund. The answer depends on the size of the asbestos-exposed population, how many people in this population will have lung and other cancers, and how many of them will also demonstrate pleural changes. Our research indicates that over 20 million people alive today have worked in occupations that will qualify under the FAIR Act. Millions of these individuals will develop lung and other cancers, mostly from causes other than asbestos. Hundreds of thousands of them will also have pleural changes.

It is not possible to reliably know how many of these qualifying lung and other cancer claimants will file with the Fund. However, the FAIR Act greatly increases the incentive for these individuals to file for compensation. Depending on their smoking history, these claims could receive between \$200,000 and \$800,000 from the Fund. The Fund not only offers substantial compensation to these claimants but it also allows them to bypass the tort system and qualify for payment as long as they satisfy FAIR Act's exposure and medical criteria. For the Trust Fund to be viable, the vast majority of future eligible lung and other cancer claimants would have to decide not to collect their entitlement. As an economist who has been trained to pay attention to incentives, I believe this is unlikely.

We estimate that the Fund will create a total entitlement of at least \$300 billion. This represents a potential shortfall of \$160 billion. If the Level VI other cancer category is eliminated from the FAIR Act, the shortfall decreases by \$55 billion to about \$100 billion.

This morning I had the opportunity to review the written testimony of several members on the panel today who are critical of our study. I would like to thank these members for bringing to light several issues that clarify our analysis. Their criticisms are essentially three points. First, they argue that we do not account for differences in the exposure levels within the population we study. This is incorrect. All of our models explicitly account for each individual's amount of exposure. Of the 27 million people in our study population alive in 2000, 18 million have low exposure levels and account for only a small fraction to the qualifying claimants.

Second, our critics assert that we overstate the number of individuals from low exposure occupations who will qualify for compensation under the FAIR Act. Specifically, they assert we overstate the number of people who will satisfy the occupational criteria and we overstate the prevalence of pleural conditions for this group. The detailed level of our analysis makes it straightforward to assess the impact of this group on our conclusions. This group is not the source of the shortfall. These 18 million individuals account for only \$30 billion of our \$300 billion entitlement estimate. In contrast, the nine million individuals with medium to high exposure account for \$270 billion, 90 percent of our low-end estimate. Even entirely excluding the low exposure group, the Trust Fund remains insolvent.

Third, our critics assert that we assume that 100 percent of qualifying claimants would file with the Fund. This grossly mischaracterizes our report. We explicitly address the difference between the entitlement created and the realized claiming rate. It is correct that we do not offer an opinion about the fraction of the entitled individuals who would claim. Instead, we quantify the claiming rate under which the Fund would be solvent, ranging from 14 to 41 percent. If all disease Levels other than the Level VI and Level VII file at their historical tort rates, then the Trust only has sufficient funds to compensate at most 13 percent of qualified other cancers and non-asbestotic lung cancers. Given the financial incentive created by the FAIR Act for these cancers, I believe it is very unlikely that such a large fraction of these qualifying individuals would not file for their entitlement.

Thank you again for the invitation to appear today. I hope this summary has been useful. I would be happy to address any questions.