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DOCUMENT NO.	FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
001	Outline	Should the Federal Government...[3 PAGES RELEASED IN WHOLE ON PRA RE-REVIEW 09/02/2025 JLS]	3	N.D.	
002	Outline	Pricing, Incentives and Terrorism Insurance [2 PAGES RELEASED IN WHOLE ON PRA RE-REVIEW 09/02/2025 JLS]	2	N.D.	
003	Agenda	Agenda [2 PAGES RELEASED IN WHOLE ON PRA RE-REVIEW 09/02/2025 JLS]	2	N.D.	
004	Outline	Terrorism Insurance [3 PAGES RELEASED IN WHOLE ON PRA RE-REVIEW 09/02/2025 JLS]	3	10/09/2001	
005	Draft	[Draft] Insurance Industry [5 PAGES RELEASED IN WHOLE ON PRA RE-REVIEW 09/02/2025 JLS]	5	09/28/2001	

COLLECTION TITLE:
Counsel's Office, White House

SERIES:
Kavanaugh, Brett - Subject Files

FOLDER TITLE:
Terrorism Insurance Backup File [2]

FRC ID:
9800

RESTRICTION CODES

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006	Draft	[Draft] Insurance Industry [5 PAGES RELEASED IN WHOLE ON PRA RE-REVIEW 09/02/2025 JLS]	5	10/02/2001	
007	Outline	Terrorism Risk Insurance Approach [3 PAGES RELEASED IN WHOLE ON PRA RE-REVIEW 09/02/2025 JLS]	3	N.D.	
008	Memorandum	September 11 Tort Reform Legislation Now Being Drafted [with attachment] [5 PAGES RELEASED IN WHOLE ON PRA RE-REVIEW 09/02/2025 JLS] - To: Brad Berenson et al - From: Michael Horowitz	5	10/26/2001	
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This document was prepared on Tuesday, September 2, 2025

2017-0345-F
2018-0016-P
2018-0016-P 2

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FAX: (202) 463-5302

FACSIMILE TRANSMISSION COVER LETTER

To:	Brett Cavanaugh	**From:**	Jim Wootton
Fax:	(202) 456-1647	**Pages:**	14 (including cover)
Phone:		**Date:**	October 4, 2001
Re:	Airline Liability Bill Expansion	**CC:**	

☐ **Urgent** **X For Review** ☐ **Please Comment** ☐ **Please Reply** ☐ **Please Recycle**

• **Comments:**

Brett –

Attached is a draft copy of the revised airline liability bill that would provide additional liability protections to the other elements of the business community. We have also attached a summary of the draft. This is very much a work in progress and the coalition we have put together has not signed-off on this yet (we are meeting tomorrow afternoon). Just wanted you to see the direction in which we are heading.

THE INFORMATION IN THIS FACSIMILE IS INTENDED ONLY FOR THE USE OF THE INDIVIDUAL TO WHOM IT IS ADDRESSED AND MAY CONTAIN INFORMATION THAT IS PRIVILEGED AND CONFIDENTIAL. IF THE READER OF THIS MESSAGE IS NOT THE INTENDED RECIPIENT, YOU ARE HEREBY NOTIFIED THAT ANY DISSEMINATION, DISTRIBUTION OR COPYING OF THIS COMMUNICATION IS STRICTLY PROHIBITED. IF YOU HAVE RECEIVED THIS FACSIMILE IN ERROR, PLEASE NOTIFY THE ABOVE REFERENCED SENDER IMMEDIATELY AT (202) 463-5724.

DRAFT 10/4/2001

107TH CONGRESS
1ST SESSION

H.R. _____

IN THE HOUSE OF REPRESENTATIVES

A BILL

To ensure swift and fair compensation for the victims of the terrorist attacks of September 11, 2001, to hold the terrorists legally liable for their actions, to prevent further economic harm to innocent bystanders to these events, and for other purposes.

Be it enacted by the House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE

(a) SHORT TITLE. – This Act may be cited as the "September 11, 2001 Victim Compensation Act".

(b) REFERENCE. – Whenever in this Act, reference is made to a section or other provision, the reference shall be considered to be made to a section of the Air Transportation Safety and System Stabilization Act (P.L. 107-42).

SECTION 2. FINDINGS AND PURPOSES

(a) FINDINGS. – The Congress finds as follows:

(1) In the wake of the tragic terrorist attacks of September 11, 2001, we as a Nation must give the highest priority to providing full, fair and swift compensation to those individuals, family members, and businesses who were most seriously harmed.

(2) Virtually every individual and business in the country suffered as a result of the terrorist attacks of September 11, 2001 – many citizens were put out of work, countless businesses were closed or otherwise disrupted, and the lives of all Americans were disrupted in countless ways.

(3) At a time when national unity should be our paramount concern, it is important to minimize court battles amongst our citizens related to the terrorist attacks of September 11, 2001, and to minimize the damage that these attacks have wrought on our nation's economy.

(4) Although numerous programs are being implemented by the Federal Emergency Management Administration, the Small Business Administration and various state and local agencies to assist small businesses that were affected by the terrorist attacks, Congress recognizes that additional help is necessary for those small businesses that were directly and most severely affected by the terrorist attacks and their aftermath.

(b) PURPOSES – The purposes of this Act are:

(1) To ensure swift, full and fair compensation for those who suffered personal injury, death, or property damage as a result of the terrorist attacks.

(2) To ensure that our civil justice system does not punish Americans for the evil acts of terrorists or further their goal of crippling the U.S. economy.

(3) To assist all victims of the terrorist attacks in their efforts to seek recovery from anyone who knowingly participated in a conspiracy to perpetrate the attacks.

(4) To preserve the ability of all insured individuals and entities to recover under their insurance policies for business interruption and other damages they may have sustained as a result of the attacks.

(5) To assist small businesses that were most directly and severely affected by the terrorist attacks.

SECTION 3. REGISTRATION AND RECORDATION OF AIRCRAFT

Section 201 is amended by inserting the following at the end:

"(f) LIMITATION ON LIABILITY. – Section 44112(b) of such title is amended by inserting at the beginning "Notwithstanding any federal or state statute, regulation, or judicial interpretation to the contrary,".

SECTION 4. DEFINITIONS

Section 402 is amended –

(a) By redesignating subsection (8) as subsection (9); and

(b) By inserting after subsection (7) the following:

"(8) PROPERTY DAMAGE. – The term "property damage" means physical injury to or destruction of tangible or intangible property, or loss of tangible or intangible property that has not been physically injured or destroyed but has been evacuated,

withdrawn from use or rendered inaccessible as a direct result of the terrorist attacks of September 11, 2001".

SECTION 5. PURPOSE

Section 403 is amended by inserting the following after "2001":

"and to provide for a fair, orderly and expeditious process for the resolution of all claims arising out of those crashes".

SECTION 6. LIMITATION ON CIVIL ACTION

Section 405(c)(3)(B)(i) is amended by striking "Federal or State".

SECTION 7. FEDERAL CAUSE OF ACTION FOR DAMAGES

(a) Section 408 is amended –

(1) by striking "(a)" and "IN GENERAL".

(2) by redesignating the heading of subsection (b) as "Sec. 409. – FEDERAL CAUSE OF ACTION FOR DAMAGES".

(3) by redesignating paragraphs (1), (2) and (3) as subsections (a), (b) and (c) respectively.

(4) by redesignating subsection (c) as subsection "(b)".

(b) The new Section 409 is amended –

(1) by striking subsection (2) and inserting the following:

"(2) SUBSTANTIVE LAW. – The substantive law for decision in any such suit shall be as follows:

(A) For a breach of contract claim, the substantive law for decision shall be derived in accordance with the choice of law principles of the State of New York.

(B) For a negligence claim, the substantive law for decision shall be derived exclusively from the law of negligence of the State in which the crash occurred, unless such law is inconsistent with or preempted by Federal law"; and

(2) by striking subsection (3) and redesignating subsection (2) as subsection (3);

(3) by inserting after subsection (1) the following:

"(2) COGNIZABLE CLAIMS. – This cause of action shall be limited to –

(A) claims for breach of contract;

(B) claims for negligence alleging physical injury or death; and

(C) claims for negligence alleging property damage.

(4) by inserting after subsection (3) the following:

"(4) REMEDIES. –

(A) The remedies for breach of contract claims shall be governed by applicable state law.

(B) The remedies for negligence claims shall be as follows:

(i) Any individual or entity asserting negligence claims for physical injury or death shall be entitled to seek only economic and noneconomic losses (as defined in Section 402).

(ii) The liability of each defendant for economic losses shall be joint and several among defendants.

(iii) The liability of each defendant for noneconomic losses shall be several only and shall not be joint. Each defendant shall be liable only for the amount of noneconomic losses allocated to the defendant in direct proportion to the percentage of responsibility of the defendant for the harm to the claimant.

(iv) Any individual or entity asserting negligence claims for property damage (as defined in Section 402) shall be entitled to seek only the replacement cost of such property.

(v) The liability of each defendant for property damage losses shall be several only and shall not be joint. Each defendant shall be liable only for the amount of property damage losses allocated to the defendant in direct proportion to the percentage of responsibility of the defendant for the harm to the claimant.

(vi) Neither punitive damages nor any other form of relief not specified in this subsection shall be recoverable under this cause of action.

(vii) Any judgment awarded to an individual or entity under this subsection shall not include interest prior to judgment.

(viii) Any judgment awarded to an individual or entity under this subsection shall be reduced by the amount of collateral source compensation the individual or entity has received or is entitled to receive as a result of the terrorist attacks of September 11, 2001.

(5) REASONABLE ATTORNEYS' FEES. – In no event shall any attorney charge, demand, receive or collect contingency fees in connection with the assertion of a claim under this section that exceed:

(A) the amount of costs and reasonable expert witness fees incurred in prosecuting the claim; and

(B) a reasonable attorney's fee.

In this subsection, a reasonable attorney's fee shall be a fee based on the actual time spent and the reasonable expenses of an attorney incurred in providing legal services in connection with the prosecution of a claim under this section.

(6) REPORT TO CONGRESS. – Within eighteen months after the enactment of the "September 11, 2001 Victim Compensation Act," the United States District Court for the Southern District of New York shall provide Congress with a report describing the number and nature of the claims brought under this section and the aggregate amount of compensation being sought by all claimants. On the basis of that report, Congress shall promptly take whatever action is determined to be necessary (including approval of appropriate compensation plans and appropriation of funds) to ensure that individuals and entities receive full compensation for legitimate claims and to ensure that the liability regarding such claims is not borne primarily by persons not involved in the perpetration of terrorist attacks.

(7) LIMITATIONS PERIOD. – No claim for negligence may be filed under this section after the date that is one year after the date of enactment of the "September 11, 2001 Victim Compensation Act".

(5) by striking subsection (b) and inserting the following:

"(b) EXCLUSION FOR RECOVERY AGAINST TERRORISTS. – Nothing in this section shall in any way limit the ability of any individual or entity to seek any form of recovery from any person alleged to be a knowing participant in any conspiracy to hijack any aircraft or commit any terrorist act, or to limit the liability of such a person".

(c) Section 409 is amended by redesignating it as Section 410.

SECTION 8. JURISDICTION

(a) Title IV is amended by inserting the following at the end of Section 410:

"Sec. 411. ORIGINAL AND EXCLUSIVE JURISDICTION FOR ALL CIVIL ACTIONS.

The United States District Court for the Southern District of New York shall have original and exclusive jurisdiction over all actions brought for any claim (including any claim for loss of property, personal injury, or death) resulting from or relating to the terrorist-related aircraft crashes of September 11, 2001. For purposes of personal jurisdiction, the United States District Court for the Southern District of New York shall be deemed to sit in all judicial districts in the United States".

SECTION 9. SMALL BUSINESS RELIEF

(a) IN GENERAL. – There is hereby authorized to be appropriated $500,000,000 to the Small Business Administration to establish a September 11th Small Business Relief Fund. The purpose of the fund is to provide direct relief to small businesses,

as defined in 15 U.S.C. § 632(a)(1), that have been directly affected by the terrorist attacks of September 11, 2001.

(1) Within 30 days of the date when this Act shall take effect, the Administrator shall publish eligibility guidelines consistent with this Act and the procedures under which the relief fund shall be administered.

(2) In establishing eligibility requirements and administrative procedures, the Administrator shall give priority to businesses located in close proximity of the site of the terrorist attacks which occurred on September 11, 2001.

(3) The Administrator shall begin accepting applications for the relief fund immediately upon publication of the eligibility guidelines and administrative procedures.

(4) Not later than 21 days after the date on which an application is filed, the Administrator shall complete a review, make a determination and provide written notice to the applicant with respect to the application Such a determination shall be final and not subject to judicial review.

SECTION 10. EFFECTIVE DATE.

(a) EFFECTIVE DATE. – This Act and the amendments made by this Act shall take effect on the date of the enactment of this Act, and shall apply to any claim (or cause of action) resulting from or relating to the terrorist attacks of September 11, 2001.

Thursday, October 04, 2001 (5:45 pm)

Summary Of "September 11, 2001 Victim Compensation Act"

The recently enacted Air Transportation Safety and System Stabilization Act (the "ATSSSA") was a first step toward addressing the economic ramifications of the September 11 tragedy, focusing primarily on the airline industry. The proposed September 11, 2001 Victim Compensation Act (the "Victim Compensation Act") would complete that effort by amending the ATSSSA to add provisions that would ensure swift and fair compensation for the victims of the terrorist attacks of September 11, 2001 and prevent further economic injury to innocent bystanders to those events.

I. Principal Provisions

The ATSSSA established a federally funded September 11th Victim Compensation Fund (the "Victim Fund") from which persons physically injured or killed in the events in New York, Pennsylvania, and Virginia (or their representatives) may obtain compensation. Persons who seek compensation from the Victim Fund waive their right to pursue claims through litigation. However, persons eligible to make claims to the Victim Fund are free to pursue their claims through traditional litigation. Further, any person who sustained personal or economic injuries resulting from the September 11th events (*i.e.*, claims not presently compensable by the Victim Fund) also is free to litigate.

The proposed Victim Compensation Act would set ground rules for the tidal wave of litigation that is now likely to ensue. Thousands of injured parties should be expected to sue hundreds of non-terrorist defendants (*e.g.*, airlines, aircraft manufacturers, aircraft component manufacturers, airport authorities, security companies, building owners, building managers, architects, building contractors, building components manufacturers and suppliers, employers). The guiding principles of the Act are (a) to ensure an orderly, equitable process for providing swift compensation for persons who present legitimate claims and (b) to protect innocent bystanders from being further victimized by the specter of misguided or excessive claims.

The bill would not restrict or otherwise affect the type and scope of claims that may be asserted against the September 11 terrorists or any person or entity that aided or abetted their activity. However, the bill would:

- Confirm the intent of the ATSSSA that all court claims arising out of the events of September 11 must be filed in the U.S. District Court for the Southern District of New York.

- Confirm that the sole cause of action by which a person may seek compensation from non-terrorists for injuries/damages sustained in the September 11 attacks is the new federal cause of action established by the ATSSSA.

- Establish that under the new federal cause of action for asserting claims against non-terrorists, a claimant may sue for breach of contract (with the substantive law derived from the jurisdiction designated by the choice of law principles normally applied by the New York court) or for negligence (applying the same elements and other governing

substantive law as a negligence claim under the law of the jurisdiction where the relevant aircrash occurred (either New York, Pennsylvania, or Virginia)). (Thus, other causes of action (*e.g.*, fraud-based claims) would not be available.)

- Establish that this new federal cause of action will be available only to persons who allegedly have sustained personal injury (including death) or property damage. (Thus, for example, the cause of action would not be available to persons who arguably have claims only for lost profits (without any property damage) or emotional distress (unaccompanied by physical injury).)

- Establish that as to remedies from non-terrorists, persons who assert personal injury/death claims may obtain through litigation the same remedies as are available from the ATSSSA-created Victim Fund. As to such claims, the liability of each defendant for economic losses would be joint and several, but as to noneconomic losses, each defendant shall be liable only in direct proportion to its responsibility for the alleged harm. Persons who assert property damage claims may recover the replacement cost of such loss. As to such claims, the liability of each defendant shall also be proportional.

- Preclude the award of any punitive damages against non-terrorists.

- Limit any attorney contingency fees to lodestar fees, costs, reasonable expert witness fees, and reasonable expenses.

- Require that all negligence claims against non-terrorists be filed within one year; breach of contract claims would be governed by normal rules.

- Require that within 18 months, the court handling the claims shall report to Congress on the number and nature of the claims and the total amount of the claims asserted to that point.

- Declare that upon receiving the court's report regarding the claims filed, Congress "will take whatever action is determined to be necessary (including approval of appropriate compensation plans and appropriation of funds) to ensure that individuals and entities receive full compensation for legitimate claims and to ensure that the liability regarding such claims is not borne primarily by persons not involved in the perpetration of terrorist attacks."

- Provide a $500 million appropriation to the Small Business Administration to establish a September 11th Small Business Relief Fund to provide immediate relief to small businesses that have been directly affected by the terrorist attacks.

II. Rationale

The core dual rationale for the legislation is (a) to ensure that parties injured by the events of September 11 may obtain swift and fair compensation and (b) also to ensure that

such compensation burdens are not visited primarily on parties that played no role in the primary causative act – the terrorists' hijacking and crashing of four commercial aircraft. The bill achieves those fundamental purposes in several ways:

- ***First,*** the bill will establish a process by which litigation claims will be filed and by which the court will report to Congress the nature and aggregate amount of such claims. In the bill, Congress will commit to take the necessary steps (including appropriations) to ensure that legitimate claims will be reasonably compensated without placing that burden on persons and entities not involved in the terrorist activity that was the primary cause of the injurious events on September 11. Hopefully, any necessary federal appropriations can be financed from assets seized essentially as war reparations from the terrorists and any governments or other entities that in any way aided and abetted their heinous acts.

- ***Second,*** every American family and business was affected by the September 11th attacks – Americans nationwide were glued to their television sets, mourning for the victims and worrying about the safety of their families. People stayed home, many businesses closed, and numerous trips and conventions were cancelled. If each and every individual or business affected in any way by the terrorist attacks were allowed to bring a lawsuit to seek recovery for economic losses related to the attacks with no cap on total liability, it would delay justice for those who were most injured – and it could devastate the American economy. For that reason, the bill would focus the litigation process on the claims that are most deserving of compensation – claims for personal injury and property damage. Further, the bill would prohibit the award of punitive damages based on the view that the judicial system should not punish Americans for the acts of terrorists and thereby help the terrorists achieve their evil ends by wreaking further havoc on the U.S. economy.

- ***Third,*** the bill would simplify the litigation process by establishing two causes of actions – a breach of contract action (tracking traditional state law principles) and a negligence action (derived wholly from state negligence law of the three jurisdictions where the primary injuries occurred). The bill requires that all tort claims be filed within one year, so that the court will be able to determine rapidly the full array of defendants and tort claims that must be resolved and proceed to do so as quickly as possible. Since the Victims Fund will be open to receiving claims for two years, claimants who become disenchanted with the litigation process will still have an opportunity to seek recovery through the Victims Fund. (Breach of contract claims will be governed by normal limitations rules, since many of those claims will be insurance coverage matters that may not ripen within a shorter period.)

- ***Fourth,*** in enacting the ATSSSA, Congress intended that the Victim Fund would be the primary source of payments for personal injury and wrongful death claims. However, it is now apparent that because of the absence of any restraints on the litigation process, the incentives will push most eligible claimants toward filing litigation and away from the Victim Fund. The bill would impose some restrictions on the litigation process, a step that would make the Victim Fund more attractive.

- ***Fifth,*** the bill would not affect the prosecution of any claims against the terrorists or their co-conspirators. Further, the bill would not in any way affect the ability of persons with insurance coverage – such as business interruption coverage – to file claims with their insurance carriers and to bring litigation related to those coverage claims.

- ***Sixth,*** the bill would provide $500 million in direct and expedited relief to small businesses that have been directly and severely affected by the terrorist attacks. This provision will help to mitigate the business losses of persons whose claims for purely economic losses may be limited by the bill.

10/4/01 at 5:45 pm

ACT OF TERRORISM - For purposes of this Act, an "act of terrorism" means any act, certified by the Secretary of the Treasury in his sole discretion after consultation with the Secretary of State [the Secretary of Defense} and the Attorney General, as a violent act or act dangerous to human life, property or infrastructure, within the United States, that appears to be intended to intimidate or coerce the civilian population of the United States and to influence the policy or affect the conduct of the United States government by intimidation or coercion. The Secretary shall not certify any act as an act of terrorism if it is committed in the course of a war declared by the Congress of the United States. Any certification determination by the Secretary shall be final.

LIABILITY - 5 PRINCIPLES

(1) certification as terrorist incident by Secretary of Treasury

(2) federal cause of action - so preempt state suits

(3) consolidation of cases in single federal court - selected by Judicial Panel on Multidistrict Litigation

(4) high standard for liability - gross negligence

(5) limitations on damages
→ punitives - NONE
→ non-economic - limits

anguish, and loss of enjoyment of life; economic losses include medical expenses lost earnings, and other out-of-pocket expenses.

We also recommend the following policies, but believe they will be difficult to pass:

- For any civil action from a terrorist event against anyone other than the perpetrators, aiders, non-economic damages would be limited to $500,000 and available only to plaintiffs who suffered physical injury.
- For any civil action from a terrorist event against anyone other than the perpetrators, aiders, defendants would be liable only for acts of gross negligence.

Private Sector Reinsurance of Terrorism

Private insurers would be free to form reinsurance pools to diversify their risk. The federal government could also provide tax-exempt status to the assets of any new terrorism reinsurance pool. We believe that private pools could be formed under state laws, obviating the need for a federal charter.

Should the Federal Government be Involved in the Market for Terrorism Insurance? And if so, What Principles Should Guide the Involvement?

Possible Rationales for Federal Intervention

- Possible market failure could lead to underprovision: Unlike natural disasters or other insurable events, it is extraordinarily difficult to estimate a loss distribution on which to base insurance prices. This could lead the private market to under-provide terrorism insurance.
  - The consequence of insurance underprovision is that some socially worthwhile economic activities will not occur, e.g., buildings that should be built may not be built.

- Samaritan's Dilemma: Without clear policies about the government's role, the default position will be for the federal government to step in and offer aid and assistance whenever terrorist's strike. Thus, "doing nothing" could be the quickest step towards nationalizing the cost of terrorism risk. An explicit policy towards terrorism insurance may actually reduce the government's ultimate liability.

- Federal Government incentives: The policies of the federal government (e.g., national security policy, foreign relations) directly affects the probability of a terrorist event. Some would argue that the government should therefore internalize part of the cost.

- Threats to national symbols: To the extent that terrorists target symbols of our nation's economic, political and military power, it can be viewed as an attack on the nation, not the symbol *per se*.

- Taxation is broadest risk spreading device: To the extent that these shocks are truly random, the right policy would be to spread the risk as thinly as possible. The "broadest back" in the U.S. is the entire taxpaying public.

Possible Rationales for Avoiding Federal Intervention

- Moral hazard and improper incentives: If government provides excess loss reinsurance for free (or at subsidized rates), then economic actors will not face the right incentives, and we get inefficient outcomes. Examples:
  - This would implicitly subsidize the concentration of economic activity (in big cities, tall buildings, dense areas) → overproduction of "targets of terror"
  - May result in sub-optimal investment in security or other prevention activities.

- Crowd-out of private insurance markets: The private insurance market has, in the past, proven its ability to expand capacity in response to new information. Government overreaching could dampen such innovation. Example:

- Prior to Hurricane Andrew and Northridge, most reinsurance coverage was in place for small events; few insurers protected themselves against industry losses of more than $10 billion
- Today, protection of industry losses of $20-25 billion or more is common.

- Government cannot "solve" the market failure: To a large extent, the same information constraints that limit the private market's ability to estimate a loss distribution also apply to the government.

- Increased regulation of private markets: Even if the government acts only as the reinsurer of last resort, it could impose additional costs / regulations on the entire market. Examples:
  - The Pool Re model in the UK: HM Treasury is the insurer of last resort, in effect providing excess loss insurance. In order to avoid having insured parties and insurance companies off-load only its worst risks on the Pool (adverse selection), Treasury and Pool Re must impose uniform underwriting and pricing standards on the industry.

- Federalism issues: Insurance regulation in the U.S. is currently a state-level responsibility. Federal government involvement will likely necessitate federal regulation.

Principles for Intervention (if government intervention is pursued)

- Enhance private market's capacity to absorb and diversify risk
  - Reduce regulatory and tax barriers that inhibit US based reinsurance.
  - Reduce impediments to securitization of risks.
  - Discourage state level regulations that are obstacles to developing national markets for risk.

- Reduce private sector uncertainty about liabilities that arise from litigation.
  - Consider consolidation of claims in a single jurisdiction.
  - Place reasonable limitations on extent of private sector liabilities.

- If the federal government directly provides insurance, it should not do it for free. In effect, the UK Pool Re concept places a call option on HM Treasury, and provides this call option at a zero price.
  - Government should charge the private market premiums for being the insurer of last resort.
  - Market signals can be used to guide pricing. For example:
    - The federal government agrees to cover all losses (L) in excess of some predetermined amount (X). When the loss exceeds the private sector cap, the government pays the excess loss (L-X).
    - The government charges a premium for this reinsurance.

- To determine the market price, the government could securitize a very small fraction (e.g., 1%) of the excess loss and sell it in the private market, such as through a special treasury bond issuance that pays a higher rate of interest, but the principal of which is (partially) forfeited if the excess loss is triggered.

Pricing, Incentives and Terrorism Insurance

There are several proposals on the table that involve a federal government role in the market for insurance against losses from terrorist activities. The purpose of this memo is to:

1) Explain why *ex ante* pricing should be part of any proposal to have the government provide excess loss insurance
2) Suggest possible mechanisms for obtaining a market-based price for such insurance

I. Why Charge for Government Excess Loss Insurance?

1. The purpose of pricing insurance is to provide proper incentives for loss mitigation activity. The magnitude of losses from terrorist activity are not fixed, but depend on the level of *ex ante* mitigation activity. In the case of terrorism, mitigation activities could include such decisions as:
    - Investing in better data back-up systems to reduce business interruption
    - Reducing the spatial concentration of firm business activity
    - Locating future firm operations in areas that are less prone to terrorist attack
    - Focusing new construction on buildings that are less likely to be terrorist targets (e.g., smaller buildings)

    Because individual economic actors can affect the loss distribution, it is important that they internalize the cost of their decisions. Charging them the proper actuarial price provides the right incentives.

2. Ideally, these prices should be set *ex ante* rather than *ex post* for two reasons:
    - This is there is a credibility problem with *ex post* pricing. Actors will rationally expect that the government may not actually levy the charges after an incident. In other words, *ex post* pricing will is highly likely to reduce to "free coverage."
    - Even if the government could credibly commit to *ex post* pricing, it still would not get the incentives exactly right. The reason is that due to entry and exit from affected industries, the actors that would be levied *ex post* will not necessarily be the same actors who took the risks *ex ante*.

3. Note that *after* a terrorist attack, the question of "who pays" would is purely an issue about the distribution of losses. In aggregate, all losses from terrorist activities are paid for out of individual incomes. Such payments can take the form of:
    - Direct losses if underinsured
    - Tax payments in the event of government relief
    - Insurance premiums
    - Losses to shareholders
    - Charity

II. How Would the Government Fine Tune its Pricing?

From the perspective of providing the right incentives, charging even a somewhat arbitrary cost-based price would be an improvement over a zero price, but using market signals would be even better. Obtaining market prices is a challenge because the reason for government intervention in the first place is that the private market does not have the capacity to absorb extremely large losses.

Solution: "Scale" down the excess loss and obtain a price on a smaller scale version of the loss distribution.

The government could serve the role of excess loss insurer for losses above $X. In order to arrive at a price for such coverage, it could essentially securitize a "vertical" slice of that excess loss coverage, up to some cap. Examples (numbers are only for illustration):

- Industry pool is responsible for aggregate losses up to $50 billion
- Government agrees to pay for losses in excess of $50 billion
- The government then offers to the private market a securitized package along the lines of "1% of losses between $50 billion and $150 billion." Thus, the maximum exposure to the purchaser of this contract is $1 billion, and in expectation is much less.
- Such a package could be sold directly to a "middleman" (e.g., Warren Buffet) who could then break it down and re-sell it. Basically the middleman says "I need to be paid $X to accept that liability."
- Alternatively, the government could auction $1 billion worth of special Treasury bonds that paid a higher rate of interest in return for the (partial) loss of principal in the event of a terrorist incident.
- Other forms of securitization are also possible.
- The implicit price of risk from these transactions are then used as the basis for charging the insurance pool for the call option on the government.

NO FEDERAL

Agenda

I. Defining Our Deadline (NEC)

- Next incident
- Introduction of bill by Committee Chair
- Adjournment of Congress
- November 30 because policies expire 12/31/01

II. Rationales For and Against Federal Intervention (CEA)

III. Principles for Potential Insurance Legislation (Treasury/CEA)

- Legislation should enhance private market's capacity to absorb and diversify risk.
- Legislation should preserve private sector risk assessments and pricing to the greatest degree possible.
- Legislation should reduce private sector uncertainty about liabilities that arise from litigation.
- Government should be compensated for its risk exposure as much as practical.
- Government exposure should be limited to clearly identifiable losses.
- Government involvement should be limited to market segments that the private sector will not insure.
- Government involvement should sunset once the private sector is capable of providing insurance coverage.

IV. Options (Treasury)

- Minimal government intervention
- Modest government intervention
- Direct government intervention

V. Defining a Terrorist Incident and Losses Covered (to be assigned)

VI. Limiting Government Claims (WH Counsel) → federal cause of action

- Tort Reforms
- Consolidation of Claims in One Jurisdiction — Chief Justice

(1) Northridge

State law

October 9, 2001

TERRORISM INSURANCE

PROBLEM

Reinsurers will no longer cover acts of because: 1) they cannot price the risk; and 2) they will not risk absorbing another enormous loss.

Banks may not lend to new construction projects and many existing commercial properties may not be able to change hands.

OPTION ONE: Enhance Capacity of Private Sector to Absorb Risk

Federal government would not directly assume any liability for terrorist acts

- Provide tax incentives.
- Provide tort reforms.

Arguments:

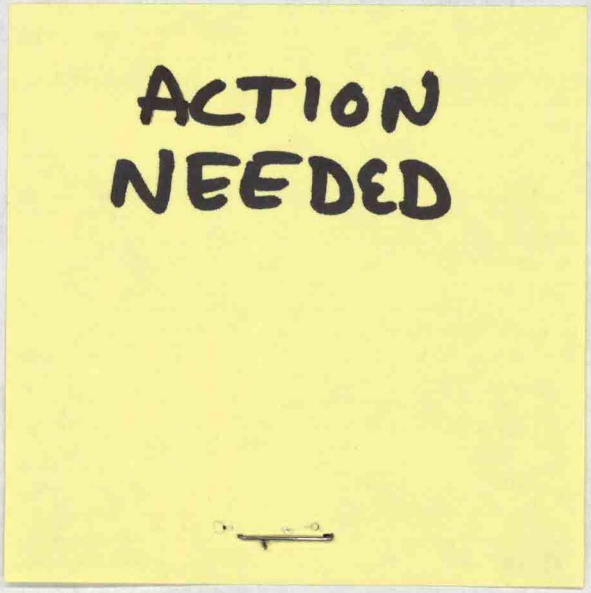
- Moral hazard and improper incentives.
- Government cannot solve the market failure.
- Crowd-out of private insurance markets:
  - P&C insurance market had an annual revenue flow of $297 billion.
  - P&C insurance market had a policyholder surplus of $320 billion.

OPTION TWO: Government Partially Reinsures against Terrorism

Federal "excess loss" coverage above a threshold:

Arguments:

- Samaritan's Dilemma.
- Worthwhile economic activities may not occur.
- Threats to national symbols.
- The taxpayer is the broadest back to spread risk.



POTENTIAL PLAN

Limitations on Liability
Apply to any certified terrorist event:

- Claims consolidated in a single federal court.
- No punitive damages.
- Non-economic damages would be proportional to the defendant's individual responsibility for the harm.

Scope of government coverage
Limited to property, liability, and worker's compensation insurance, not business interruption, health, or life insurance at this time.

Range of government's coverage

Option One
$10 billion deductible through 2002 and 10 percent of losses above that amount.
Deductible increases by $10 billion a year. Sunset in three years.
Above $100 billion, need explicit approval by the Congress.

Option Two
Identical, but deductible would begin at $30 billion.

Pricing

Option One
Treasury/Legislative Affairs argues against charging a premium because:

- Mechanisms to price and assess premiums may be costly.
- High deductible is a meaningful commitment of industry resources.
- Federal premium would exacerbate the premium hikes that are likely to occur.

Option Two
CEA argues for a "fair market" *ex ante* premium determined by the Sec. of Treasury:

- Maximizes incentive to prevent and respond to terrorist.
- The risk could be priced either by: 1) private actuarial firm; 2) selling a vertical slice; or 3) selling catastrophic options.
- Even an arbitrary cost-based price is better than no price.

Definition of Terrorist Attack
The primary decision needed is whether or not the definition should cover acts of war.

The Secretary of Treasury, in consultation with any other official designated by the President, would certify that an event was an act of terrorism:

The term "act of terrorism" means a violent [or destructive] act causing [damage to any type of property or] injury to a person or persons, within the United States, for which (a) the perpetrator or perpetrators committed such act for political or ideological reasons and that (b) a principal purpose of the perpetrator or perpetrators was to (i) intimidate or engender fear among the U.S. civilian population; (ii) disrupt one or more segments of the U.S. national or U.S. regional economy or (iii) coerce, influence or retaliate against U.S. governmental action or policy. An act of terrorism shall include any act described above, whether or not perpetrated by an official, employee or agent of a foreign state acting on behalf of such state, [but shall not include an act committed pursuant to a declaration of war by the United States].

Private Sector Reinsurance of Terrorism

Private insurers would be free to form reinsurance pools to diversify their risk.

Tax-exempt status to the assets of any new terrorism reinsurance pool.

Insurance Industry –
Government Intervention in Response to Terrorism

DRAFT -- 09/28/2001 12:07 PM -- DRAFT

Draft -- Pre-Decisional Staff Working Paper -- Draft

Objectives of Government Intervention

- Ensure that the terrorist attacks of September 11 and the potential for future terrorist attacks have a minimal impact on economic activity by ensuring uninterrupted availability of property and casualty insurance coverage for acts of terrorism.

- Limit any potential government loss exposure to clearly identifiable losses and a fixed amount (or fixed proportion of losses) per incident or underwriting year.

- Limit to market segments that the private sector will not insure.

Principles Guiding Government Intervention

- Encourage private sector initiatives to mitigate risk.

- Preserve private sector risk assessments and pricing to the greatest degree possible.

- Provide for some degree of compensation to the government for its risk exposure.

- Sunset government involvement once the private sector is capable of providing insurance coverage.

Options for Government Intervention

Minimal Government Intervention

A. Remove regulatory impediments to the development of the risk securitization market

   - Provide federal clarification that catastrophe bonds are a financial vehicle that is not subject to state insurance regulation.

   - Streamline tax and other regulations to encourage creation of on-shore special purpose vehicles used in catastrophe bonds.

   - Provide tax benefits to catastrophe bonds (both for terrorist events and natural disasters).

Pros

- Relies on private capital markets.

Cons

- No evidence that private capital markets could provide the coverage needed quickly enough in the current environment. It suffers from the same information uncertainties inhibiting insurance and reinsurance companies.

B. Enact tax law changes (in terms of structure or relief) that improve the loss absorbing capacity of insurance companies.

Pros

- Relies on existing private infrastructure.

Cons

- Tax benefits may be insufficient to keep companies in the game.
- Tax benefits can be hard to remove once in place and have tendency to spread.

C. Limit types and amount of damage claims that are available from a terrorist incident. Damage claims greater than the cap would be determined though a government based claims process. (Based loosely on Price-Anderson)

Pros

- Makes insurance company risks more manageable.
- Clear approach that limits government exposure.

Cons

- Leaves unknown amount of risk exposure that is uninsured.
- Remaining risk exposure could impair capital markets. For instance, would commercial mortgage lenders extend credit on buildings with potential limits on insurance coverage that leave the lender exposed?

Modest Government Intervention

D. Provide Federal Reinsurance Coverage to an Industry Terrorism Reinsurance Pool (based on the UK's Pool Re model) – The federal government would provide reinsurance to a terrorism reinsurance pool operated by the insurance industry. The AIA proposal is based in part on the UK's Pool Re model.

Pros

- Has industry support.
- Based on a model that has worked in the UK.
- Provides first-loss coverage through the industry pool.
- Provides mechanism for establishing a broad risk pool and industry, not government, pricing, of insurance.

Cons

- Could take months to make fully operational.
- Has characteristics of a GSE for insurance, suggesting it would grow over time while further extending the government's ultimate backstop.
- Puts the government in the role of ensuring no adverse selection.

E. Provide Federal Reinsurance with Ex-Post Pricing that Shares the Cost of Actual Losses Between Taxpayers and all P&C Insurance Carriers (based on the Price-Anderson Act Model) – For a temporary period, have the federal government offer reinsurance to the pool described in the previous option but do not require the pool to build reserves. Losses from a terrorist incident above some threshold amount would be reinsured by the government through the pool. Actual claims would be initially financed by Treasury and premiums would then be assessed pro rata on the pool participants in the next year (or years). Loss sharing with taxpayers could be established to limit losses put back to the industry.

Pros

- Eliminates idle capital.
- Avoids deadweight losses from mispriced insurance.
- Could quickly be made operational and easily sunset or replaced by more permanent legislation.

Cons

- Ex post pricing makes the insurance free up front, which increases moral hazard.
- Industry (and accountants?) could have difficulty handling a large future premium - unclear how they could/would reserve for such contingencies ex ante.
- Contingent deferred premiums could impact coverage levels and premium costs, thus reducing the amount of insurance available.

F. Sell Federal Reinsurance Directly to Insurers (similar to disaster insurance proposals) – The federal government would sell federal reinsurance (either with fixed pricing or through an auction process) that would be tied to insurance company losses from terrorist attacks.

Pros

- Ensures availability of P&C insurance coverage.
- Socializes the costs.

Cons

- Requires a government bureaucracy be created to initiate and manage thousands of individual reinsurance contracts with individual carriers.
- Crowds out any possible private market for terrorist reinsurance.
- Difficult to mimic market-based pricing or risk-taking incentives, leading to potential moral hazard problems.

G. Provide Federal Reinsurance through State-Based Plans (based on FAIR Act Approach) – The FAIR Act (passed in response to riots and civil disorders of the 1960s) set up a structure whereby each state would set up a plan to assure access to insurance requirements. The state plans were reinsured by the federal government through FEMA.

Pros

- Works within the existing state regulatory structure.
- Less bureaucracy than dealing with individual insurance companies.

Cons

- The states need to each set up a plan, and the federal government needs to approve the plans.
- Reinsurance rates must be determined by the government.

Direct Government Intervention

H. Directly Underwrite and Sell Terrorism Insurance Coverage (based on a War Damages Corporation approach) – Terrorism insurance would be underwritten by a government agency and sold directly to customers by insurance companies.

Pros

- Provides certainty that terrorism risks will be covered.

Cons

- Government pricing of insurance risks.

- Potential for lack of underwriting discipline and increased government risk exposure.
- Requires a government bureaucracy.

I. Provide Direct Government Insurance for Terrorist Attacks Through a Proportional Risk-Sharing Arrangement with the Insurance Industry (based on a Federal Crop Insurance approach) –Under Federal Crop Insurance, the federal government shares in premiums and the risks on a proportional basis with private insurers. The federal government also provides back-up reinsurance based on the financial condition of insurers that participate in the program.

Pros

- Provides certainty that terrorism risks will be covered.
- Private sector involvement may improve pricing and risk management.

Cons

- Government risk sharing (if large enough) may weaken private sector incentives.
- Proportional risk sharing may weaken private sector incentives in comparison to excess loss risk sharing.
- Requires a government bureaucracy.

Other Issues in Providing Government Terrorism Insurance

- Defining a Terrorist Incident – The government (perhaps the Treasury Secretary in consultation with federal law enforcement) should have the final authority in determining if an incident was caused by terrorist activities.

- Limiting Government Claims Above a Certain Dollar Amount – In order to limit the government's liability, provisions that trigger tort reforms when losses exceed a certain threshold, e.g., $10 billion, should be put in place. These provisions would include consolidating all claims in one jurisdiction; and limiting types of damages (e.g., only money damages).

Price-Anderson Act

(42 U.S.C. 2014)

Purpose -- To encourage the development of the nuclear industry and to ensure prompt and equitable compensation in the event of a nuclear incident.

Coverage -- For licensed nuclear power plants indemnified by the Nuclear Regulatory Commission (NRC), the Act provides for three tiers of protection against third party "public liability arising from a nuclear incident" (covering "any legal liability" with certain exceptions):

(1) Private insurance: Each reactor must purchase the maximum private insurance commercially available (currently $200 million).
(2) Retrospective pooling: If damage from an incident exceeds $200 million, each of the 110 reactors is assessed a pro-rata share of the excess up to $83.9 million, capped at $10 million per year per reactor ($83.9x 110= $9.23 billion pool+ $200 million= $9.43 billion coverage cap to the industry). The NRC may in specified circumstances, on a case-by-case basis, postpone all or part of the annual deferred premium. NRC also may provide reinsurance or guarantee payment of deferred premiums if there is a shortfall. In that event, NRC must advance necessary funds based on a Congressional appropriation or (to the extent approved in appropriation Acts) by issuing obligations to the Treasury.
(3) Government commitment: If damage exceeds $9.43 billion, the Act contains a moral commitment from Congress to provide full and prompt compensation to the public, based on a plan the President submits.

[For contractors and suppliers indemnified by the Department of Energy, the Act provides full indemnification up to $9.43 billion without private insurance. In effect, the government self-insures against nuclear incidents from contractual activities conducted on its behalf.]

Basis of Liability -- Liability is based on state tort laws of the jurisdiction where the incident occurs. Since many states provide strict liability for ultrahazardous activities, it's possible that liability for a nuclear incident could be established without fault. For "extraordinary nuclear occurrences," the Act requires waiver of certain defenses so that claimants need not prove fault and defendants may not claim charitable or sovereign immunity. In limited situations, the Act supercedes state law with uniform rules such as a limitation on awarding punitive damages or the time in which claims may be brought.

Consolidated Jurisdiction -- Claims are consolidated in a single U.S. District Court where the incident occurs. This channels liability through one court to one source of funds, so there is no need to sue all potential defendants or allocate liability among multiple defendants.

International Coverage -- Damages for injuries suffered in other countries from incidents in the U.S. may be sought in U.S. courts under the Act. The Act cannot control liability exposure in other countries.

Sunset -- The Act sunsets provisions permitting coverage for potential licensees and new contracts. Congress renewed and amended the 1957 Act in 1966, 1969, 1975, and 1988.

Pool Re (Pool Reinsurance Co. Ltd.)

Purpose -- To create an independent, mutual reinsurance company backed by the government that provides reinsurance to member companies for property loss and business interruption due to fire and explosion from "acts of terrorism" (primarily car bombs) that the insurance and reinsurance markets would not otherwise insure. Since its inception in 1993, Pool Re has covered three major losses for a total of 600 million pounds.

Participants -- Member companies are insurers (and Lloyd's syndicates) authorized to underwrite property insurance and business interruption for risks located in England, Wales and Scotland. Currently there are about 200 members, including all of the largest insurers in the U.K. commercial insurance market.

Reinsurance Coverage -- Members are required to offer reinsurance to first line insurers in excess of the retention, which is 100,000 pounds per "head of cover" per incident or 2.5 million pounds per policy per cover per incident. "Heads of cover" include: (1) buildings and completed structures, (2) other property (including contents, engineering contractors and computers), (3) business interruption, and (4) book debts (unclear how many heads of cover there actually are). Insureds have the option of buying protection beyond the 100,000 pounds of coverage, in which case the insurer cedes the additional premium to Pool Re, which assumes the risk.

Government (Retrocession) Liability -- Under the retrocession agreement, the government becomes liable to make payments to Pool Re when Pool Re's financial resources, including a [500 million] pound loan facility, have been exhausted. Members may reinsure only with Pool Re, which agrees to reinsure each member in excess of its retention. The Reinsurance (Acts of Terrorism) Act of 1993 enabled the Secretary for Trade and Industry to enter into the retrocession agreement with Pool Re subject to the consent of the Treasury. Pool Re's only retrocessionaire is the government.

Premiums -- Pool Re is funded through "market" rate premiums set by the government in exchange for the government underwriting excess exposure to the fund. Companies pay rates depending on the locations of risks in different geographic zones -- currently 150 pounds per million pounds of coverage in metropolitan areas, and 30 pounds per million of coverage in rural areas. The retrocession agreement provides that when Pool Re's funds reach one billion pounds, a retrocession premium becomes payable to the government. If Pool Re incurs an underwriting loss (an underwriting year is closed after three years), each member must pay an additional premium equivalent to 10% of the underwriting loss subject to a maximum of 10% of the premium income it paid to Pool Re for the underwriting year in question. If Pool Re makes an underwriting profit, each member is entitled to a 10% return premium.

Certification -- According to the retrocession agreement, the Secretary of State is required to provide a certificate to the effect that an "act of terrorism" has occurred for which indemnity is claimed under a reinsurance agreement.

Dispute resolution -- The agreements provide a dispute resolution procedure in addition to the usual arbitration clause.

FAIR Plans --Fair Access to Insurance Requirements
(12 U.S.C. 1749bbb)

Purpose -- To create statewide plans to make essential property insurance more readily available in urban areas following the 1968 riots by providing Federal reinsurance for property losses arising from "riots or civil disorders." The statutory authority terminated in 1985, but 29 states still run FAIR programs.

Role of FEMA -- The FEMA Director, in consultation with a public-private Advisory Board, establishes and carries out the FAIR program, the Federal reinsurance program (including a "National Insurance Development Fund"), and a Federal crime insurance program, described below. FEMA reports to Congress at least annually on its operations under the Act.

Reinsurance -- FEMA is authorized to offer reinsurance from the National Insurance Development Fund to each insurer or pool for property losses arising from "riots or civil disorders." Reinsurance is offered only on "standard lines" of property insurance, as defined.

Premiums -- Insurers pay FEMA reinsurance premiums, determined by FEMA in consultation with the Advisory Board, for deposit into the Fund. FEMA thereafter may adjust premiums after consulting with the Advisory Board and the NAIC. The Fund can borrow from the Treasury to meet its needs.

Reimbursement for Losses -- The Act requires states to pass legislation stating that they will reimburse FEMA for any reinsured losses up to 5% of the aggregate property insurance premiums earned in that state during the previous year, to the extent the losses exceed the amount FEMA received in reinsurance premiums.

Federal Crime Insurance -- FEMA is required to critically review the market availability in each state of burglary and robbery insurance at affordable rates. If there is a critical unavailability, FEMA must make it available at affordable rates through the facilities of the Federal government after consulting with state insurance authorities in estimating what rates are affordable.

Participation in State FAIR Plans -- Participation in a state FAIR plan is required for an insurer to qualify for Federal reinsurance. (Most states also require property insurers to join the FAIR program before getting a certificate of authority to do business.) Each insurer wishing to participate in a FAIR program must cooperate with the appropriate state insurance authority in establishing and carrying out the FAIR plan. Plans are approved and administered by state insurance authorities. Plans must be run in a way that makes essential property insurance more readily available in urban areas. Plans must include various requirements regarding property inspection, reporting of reasons for declining coverage or requiring changes in the property, etc. A potential insured can request coverage under the program after being denied coverage otherwise.

War Damage Corporation Act
56 Stat. 174 (1942)

Purpose -- To establish WDC as a subsidiary of the Reconstruction Finance Corporation (RFC) to provide property owners in the U.S. with reasonable insurance protection against loss or damage from enemy attack or U.S. military resistance during WWII, since basic fire and extended coverages contained a war risk exclusion.

History -- WDC was established in 1941 as the War Insurance Corporation and renamed the WDC in 1942. It is a subsidiary of the RFC, which was established by Congress in 1940 to aid in the national defense program. The WDC program grew from the War Risk Insurance Act of 1914 (38 Stat. 711), which provided insurance for maritime vessels and was amended in 1917 in response to WWI. WDC's charter and all policies expired in 1947. WDC's assets were liquidated by 1949, and in 1957 its stock was transferred to the Secretary of the Treasury for cancellation after all suits against the WDC had been settled.

Coverage -- The Act directs the RFC to empower the WDC to use its funds to provide, through insurance, reinsurance or otherwise, reasonable protection against loss or damage to real or personal property resulting from enemy attack or U.S. military resistance, with such exceptions as WDC, with the approval of the Secretary of Commerce, may deem advisable.

RFC Funding -- The Act directs the RFC, upon the request of the Secretary of Commerce and with the President's approval, to provide funds to WDC and issue obligations sufficient to carry out the Act's purposes. The aggregate amount of funds supplied by the RTC may not exceed $1 billion.

Premiums -- WDC protection would be made available upon the payment of such premium and subject to such terms and conditions as WDC may establish with the approval of the Secretary of Commerce.

Establishment of Rates -- In view of the national interest involved, the Act required WDC to establish from time to time uniform rates for each type of property for which protection was made available. To establish a basis for such uniform rates, the Act required WDC to estimate the average risk of loss on all property of such type in the U.S.

Limitation of Protection -- Protection was available only in the U.S., its territories and possessions, and other places determined by the President to be under U.S. dominion and control, and not to property on which the Maritime Commission was authorized to provide marine war-risk insurance. WDC, with approval of the Secretary of Commerce, could suspend or restrict protection in areas in consideration of loss of control by the U.S.

Losses Sustained between Dec. 7, 1941 and the Start-Up Date -- WDC was authorized to provide compensation without requiring an insurance contract or payment of premium, adjusting the loss as if a policy were in effect.

Insurance Industry –
Government Intervention in Response to Terrorism

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Draft -- Pre-Decisional Staff Working Paper -- Draft

Objectives of Government Intervention

- Ensure that the terrorist attacks of September 11 and the potential for future terrorist attacks have a minimal impact on economic activity by ensuring uninterrupted availability of property and casualty insurance coverage for acts of terrorism.
- Limit any potential government loss exposure to clearly identifiable losses and a fixed amount (or fixed proportion of losses) per incident or underwriting year.
- Limit to market segments that the private sector will not insure.

Principles Guiding Government Intervention

- Encourage private sector initiatives to mitigate risk.
- Preserve private sector risk assessments and pricing to the greatest degree possible.
- Provide for some degree of compensation to the government for its risk exposure.
- Sunset government involvement once the private sector is capable of providing insurance coverage.

Options for Government Intervention

Minimal Government Intervention

A. Remove regulatory impediments to the development of the risk securitization market

- Provide federal clarification that catastrophe bonds are a financial vehicle that is not subject to state insurance regulation.
- Streamline tax and other regulations to encourage creation of on-shore special purpose vehicles used in catastrophe bonds.
- Provide tax benefits to catastrophe bonds (both for terrorist events and natural disasters).

Pros

- Relies on private capital markets.

Cons

- No evidence that private capital markets could provide the coverage needed quickly enough in the current environment. It suffers from the same information uncertainties inhibiting insurance and reinsurance companies.

B. Enact tax law changes (in terms of structure or relief) that improve the loss absorbing capacity of insurance companies.

Pros

- Relies on existing private infrastructure.

Cons

- Tax benefits may be insufficient to keep companies in the game.
- Tax benefits can be hard to remove once in place and have tendency to spread.

C. Limit types and amount of damage claims that are available from a terrorist incident. Damage claims greater than the cap would be determined though a government based claims process. (Based loosely on Price-Anderson)

Pros

- Makes insurance company risks more manageable.
- Clear approach that limits government exposure.

Cons

- Leaves unknown amount of risk exposure that is uninsured.
- Remaining risk exposure could impair capital markets. For instance, would commercial mortgage lenders extend credit on buildings with potential limits on insurance coverage that leave the lender exposed?

Modest Government Intervention

D. Provide Federal Reinsurance Coverage to an Industry Terrorism Reinsurance Pool (based on the UK's Pool Re model) – The federal government would provide reinsurance to a terrorism reinsurance pool operated by the insurance industry. The AIA proposal is based in part on the UK's Pool Re model.

Pros

- Has industry support.
- Based on a model that has worked in the UK.
- Provides first-loss coverage through the industry pool.
- Provides mechanism for establishing a broad risk pool and industry, not government, pricing, of insurance.

Cons

- Could take months to make fully operational.
- Has characteristics of a GSE for insurance, suggesting it would grow over time while further extending the government's ultimate backstop.
- Puts the government in the role of ensuring no adverse selection.

E. Provide Federal Reinsurance with Ex-Post Pricing that Shares the Cost of Actual Losses Between Taxpayers and all P&C Insurance Carriers (based on the Price-Anderson Act Model) – For a temporary period, have the federal government offer reinsurance to the pool described in the previous option but do not require the pool to build reserves. Losses from a terrorist incident above some threshold amount would be reinsured by the government through the pool. Actual claims would be initially financed by Treasury and premiums would then be assessed pro rata on the pool participants in the next year (or years). Loss sharing with taxpayers could be established to limit losses put back to the industry.

Pros

- Eliminates idle capital.
- Avoids deadweight losses from mispriced insurance.
- Could quickly be made operational and easily sunset or replaced by more permanent legislation.

Cons

- Ex post pricing makes the insurance free up front, which increases moral hazard.
- Industry (and accountants?) could have difficulty handling a large future premium - unclear how they could/would reserve for such contingencies ex ante.
- Contingent deferred premiums could impact coverage levels and premium costs, thus reducing the amount of insurance available.

F. Sell Federal Reinsurance Directly to Insurers (similar to disaster insurance proposals) – The federal government would sell federal reinsurance (either with fixed pricing or through an auction process) that would be tied to insurance company losses from terrorist attacks.

Pros

- Ensures availability of P&C insurance coverage.
- Socializes the costs.

Cons

- Requires a government bureaucracy be created to initiate and manage thousands of individual reinsurance contracts with individual carriers.
- Crowds out any possible private market for terrorist reinsurance.
- Difficult to mimic market-based pricing or risk-taking incentives, leading to potential moral hazard problems.

G. Provide Federal Reinsurance through State-Based Plans (based on FAIR Act Approach) – The FAIR Act (passed in response to riots and civil disorders of the 1960s) set up a structure whereby each state would set up a plan to assure access to insurance requirements. The state plans were reinsured by the federal government through FEMA.

Pros

- Works within the existing state regulatory structure.
- Less bureaucracy than dealing with individual insurance companies.

Cons

- The states need to each set up a plan, and the federal government needs to approve the plans.
- Reinsurance rates must be determined by the government.

Direct Government Intervention

H. Directly Underwrite and Sell Terrorism Insurance Coverage (based on a War Damages Corporation approach) – Terrorism insurance would be underwritten by a government agency and sold directly to customers by insurance companies.

Pros

- Provides certainty that terrorism risks will be covered.

Cons

- Government pricing of insurance risks.

- Potential for lack of underwriting discipline and increased government risk exposure.
- Requires a government bureaucracy.

I. Provide Direct Government Insurance for Terrorist Attacks Through a Proportional Risk-Sharing Arrangement with the Insurance Industry (based on a Federal Crop Insurance approach) –Under Federal Crop Insurance, the federal government shares in premiums and the risks on a proportional basis with private insurers. The federal government also provides back-up reinsurance based on the financial condition of insurers that participate in the program.

Pros

- Provides certainty that terrorism risks will be covered.
- Private sector involvement may improve pricing and risk management.

Cons

- Government risk sharing (if large enough) may weaken private sector incentives.
- Proportional risk sharing may weaken private sector incentives in comparison to excess loss risk sharing.
- Requires a government bureaucracy.

Other Issues in Providing Government Terrorism Insurance

- Defining a Terrorist Incident – The government (perhaps the Treasury Secretary in consultation with federal law enforcement) should have the final authority in determining if an incident was caused by terrorist activities.

- Limiting Government Claims Above a Certain Dollar Amount – In order to limit the government's liability, provisions that trigger tort reforms when losses exceed a certain threshold, e.g., $10 billion, should be put in place. These provisions would include consolidating all claims in one jurisdiction; and limiting types of damages (e.g., only money damages).

Price-Anderson Act

(42 U.S.C. 2014)

Purpose -- To encourage the development of the nuclear industry and to ensure prompt and equitable compensation in the event of a nuclear incident.

Coverage -- For licensed nuclear power plants indemnified by the Nuclear Regulatory Commission (NRC), the Act provides for three tiers of protection against third party "public liability arising from a nuclear incident" (covering "any legal liability" with certain exceptions):

(1) Private insurance: Each reactor must purchase the maximum private insurance commercially available (currently $200 million).
(2) Retrospective pooling: If damage from an incident exceeds $200 million, each of the 110 reactors is assessed a pro-rata share of the excess up to $83.9 million, capped at $10 million per year per reactor ($83.9x 110= $9.23 billion pool+ $200 million= $9.43 billion coverage cap to the industry). The NRC may in specified circumstances, on a case-by-case basis, postpone all or part of the annual deferred premium. NRC also may provide reinsurance or guarantee payment of deferred premiums if there is a shortfall. In that event, NRC must advance necessary funds based on a Congressional appropriation or (to the extent approved in appropriation Acts) by issuing obligations to the Treasury.
(3) Government commitment: If damage exceeds $9.43 billion, the Act contains a moral commitment from Congress to provide full and prompt compensation to the public, based on a plan the President submits.

[For contractors and suppliers indemnified by the Department of Energy, the Act provides full indemnification up to $9.43 billion without private insurance. In effect, the government self-insures against nuclear incidents from contractual activities conducted on its behalf.]

Basis of Liability -- Liability is based on state tort laws of the jurisdiction where the incident occurs. Since many states provide strict liability for ultrahazardous activities, it's possible that liability for a nuclear incident could be established without fault. For "extraordinary nuclear occurrences," the Act requires waiver of certain defenses so that claimants need not prove fault and defendants may not claim charitable or sovereign immunity. In limited situations, the Act supercedes state law with uniform rules such as a limitation on awarding punitive damages or the time in which claims may be brought.

Consolidated Jurisdiction -- Claims are consolidated in a single U.S. District Court where the incident occurs. This channels liability through one court to one source of funds, so there is no need to sue all potential defendants or allocate liability among multiple defendants.

International Coverage -- Damages for injuries suffered in other countries from incidents in the U.S. may be sought in U.S. courts under the Act. The Act cannot control liability exposure in other countries.

Sunset -- The Act sunsets provisions permitting coverage for potential licensees and new contracts. Congress renewed and amended the 1957 Act in 1966, 1969, 1975, and 1988.

Pool Re (Pool Reinsurance Co. Ltd.)

Purpose -- To create an independent, mutual reinsurance company backed by the government that provides reinsurance to member companies for property loss and business interruption due to fire and explosion from "acts of terrorism" (primarily car bombs) that the insurance and reinsurance markets would not otherwise insure. Since its inception in 1993, Pool Re has covered three major losses for a total of 600 million pounds.

Participants -- Member companies are insurers (and Lloyd's syndicates) authorized to underwrite property insurance and business interruption for risks located in England, Wales and Scotland. Currently there are about 200 members, including all of the largest insurers in the U.K. commercial insurance market.

Reinsurance Coverage -- Members are required to offer reinsurance to first line insurers in excess of the retention, which is 100,000 pounds per "head of cover" per incident or 2.5 million pounds per policy per cover per incident. "Heads of cover" include: (1) buildings and completed structures, (2) other property (including contents, engineering contractors and computers), (3) business interruption, and (4) book debts (unclear how many heads of cover there actually are). Insureds have the option of buying protection beyond the 100,000 pounds of coverage, in which case the insurer cedes the additional premium to Pool Re, which assumes the risk.

Government (Retrocession) Liability -- Under the retrocession agreement, the government becomes liable to make payments to Pool Re when Pool Re's financial resources, including a [500 million] pound loan facility, have been exhausted. Members may reinsure only with Pool Re, which agrees to reinsure each member in excess of its retention. The Reinsurance (Acts of Terrorism) Act of 1993 enabled the Secretary for Trade and Industry to enter into the retrocession agreement with Pool Re subject to the consent of the Treasury. Pool Re's only retrocessionaire is the government.

Premiums -- Pool Re is funded through "market" rate premiums set by the government in exchange for the government underwriting excess exposure to the fund. Companies pay rates depending on the locations of risks in different geographic zones -- currently 150 pounds per million pounds of coverage in metropolitan areas, and 30 pounds per million of coverage in rural areas. The retrocession agreement provides that when Pool Re's funds reach one billion pounds, a retrocession premium becomes payable to the government. If Pool Re incurs an underwriting loss (an underwriting year is closed after three years), each member must pay an additional premium equivalent to 10% of the underwriting loss subject to a maximum of 10% of the premium income it paid to Pool Re for the underwriting year in question. If Pool Re makes an underwriting profit, each member is entitled to a 10% return premium.

Certification -- According to the retrocession agreement, the Secretary of State is required to provide a certificate to the effect that an "act of terrorism" has occurred for which indemnity is claimed under a reinsurance agreement.

Dispute resolution -- The agreements provide a dispute resolution procedure in addition to the usual arbitration clause.

FAIR Plans --Fair Access to Insurance Requirements
(12 U.S.C. 1749bbb)

Purpose -- To create statewide plans to make essential property insurance more readily available in urban areas following the 1968 riots by providing Federal reinsurance for property losses arising from "riots or civil disorders." The statutory authority terminated in 1985, but 29 states still run FAIR programs.

Role of FEMA -- The FEMA Director, in consultation with a public-private Advisory Board, establishes and carries out the FAIR program, the Federal reinsurance program (including a "National Insurance Development Fund"), and a Federal crime insurance program, described below. FEMA reports to Congress at least annually on its operations under the Act.

Reinsurance -- FEMA is authorized to offer reinsurance from the National Insurance Development Fund to each insurer or pool for property losses arising from "riots or civil disorders." Reinsurance is offered only on "standard lines" of property insurance, as defined.

Premiums -- Insurers pay FEMA reinsurance premiums, determined by FEMA in consultation with the Advisory Board, for deposit into the Fund. FEMA thereafter may adjust premiums after consulting with the Advisory Board and the NAIC. The Fund can borrow from the Treasury to meet its needs.

Reimbursement for Losses -- The Act requires states to pass legislation stating that they will reimburse FEMA for any reinsured losses up to 5% of the aggregate property insurance premiums earned in that state during the previous year, to the extent the losses exceed the amount FEMA received in reinsurance premiums.

Federal Crime Insurance -- FEMA is required to critically review the market availability in each state of burglary and robbery insurance at affordable rates. If there is a critical unavailability, FEMA must make it available at affordable rates through the facilities of the Federal government after consulting with state insurance authorities in estimating what rates are affordable.

Participation in State FAIR Plans -- Participation in a state FAIR plan is required for an insurer to qualify for Federal reinsurance. (Most states also require property insurers to join the FAIR program before getting a certificate of authority to do business.) Each insurer wishing to participate in a FAIR program must cooperate with the appropriate state insurance authority in establishing and carrying out the FAIR plan. Plans are approved and administered by state insurance authorities. Plans must be run in a way that makes essential property insurance more readily available in urban areas. Plans must include various requirements regarding property inspection, reporting of reasons for declining coverage or requiring changes in the property, etc. A potential insured can request coverage under the program after being denied coverage otherwise.

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56 Stat. 174 (1942)

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Compensating Victims of Terrorism: The Current Framework in the United States

SUMMARY

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I. INTRODUCTION

> The political and psychological potential of hostage-taking as a symbolic act of power is of the greatest magnitude. No social organization sharing in the power structure of any society is immune. The fear inspired by the possible use of hostages by very small groups to exert pressure on very large groups within the existing power structure is potentially one of the most disruptive forces in technologically advanced societies.[1]

As this passage suggests, the effects of terrorism are devastating, not only to those individuals involved in a particular terrorist incident, but to society in general. Fortunately, many nations have made progress toward dealing with terrorism's societal effects.[2] However, many individuals directly affected by terrorists—those suffering the most immediate harm—have largely been ignored in the United States and elsewhere:

> A number of other countries have had diplomats kidnapped and held hostage but inquiries by our embassies abroad revealed that none of them has any regular legislative or administrative program

1. R. CRELINSTEN & D. SZABO, HOSTAGE-TAKING ix (1979).
2. *See, e.g.*, LEGISLATIVE RESPONSES TO TERRORISM (Y. Alexander & A. Nanes eds. 1986).

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> for the payment of compensation in such cases. All followed the practice of continuing salary payments, as does the United States, and a few granted cash bonuses for family expenses or extra leave on an ad hoc basis.[3]

This shortcoming has been recognized in recent years and subsequent analysis has resulted in the formulation of several responses from nations affected by terrorist acts. The purpose of this Note is to provide a guide to the various methods available in the United States to gain compensation for terrorist victims.[4] Section II examines the problem of defining who is a victim of terrorism. Section III discusses relevant statutory remedies. In Section IV, the use of legal actions in U.S. courts as a method for obtaining compensation receives attention. Section V focuses on private compensatory methods.

II. DEFINING THE "VICTIM OF TERRORISM"

The threshold question to be answered when considering terrorist victim compensation is who is a victim of terrorism; that is, who is to be compensated. Obviously, any hostages held in a terrorist incident are direct victims[5] of terrorism,[6] but some persons beyond the hostages themselves may also be victims.

For example, family members of hostages may suffer compensable injuries[7] during a terrorist incident:

> Family, friends, and close associates of direct victims may undergo even greater stress during or after an incident than the direct

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3. PRESIDENT'S COMMISSION ON HOSTAGE COMPENSATION, THE FINAL REPORT AND RECOMMENDATIONS OF THE PRESIDENT'S COMMISSION ON HOSTAGE COMPENSATION, at 29 (Sept. 21, 1981) [hereinafter COMMISSION REPORT]. Private U.S. citizens are not entitled to statutory terrorist victim compensation. *See infra* notes 31-35 and 63-66 and accompanying text.

4. This Note is limited to a discussion of compensatory methods applicable to victims receiving personal injuries due to a terrorist incident; *i.e.*, former hostages and their families. A discussion of compensation for "economic" injuries, *i.e.*, property damage, is beyond the scope of this Note.

5. The direct-indirect label is used to distinguish victims who are actively involved in a terrorist incident, *i.e.*, hostages, from those who are incidentally affected by the incident, *i.e.*, hostage families. A different, but useful, model of hostage victim labeling is provided in R. CRELINSTEN & D. SZABO, *supra* note 1, at 3-6, where hostages are labeled "passive" or "secondary" victims, and those who are expected to fulfill the terrorist's demands are labeled "active" or "primary" victims.

6. Terrorism has been described as "the threat and use of psychological and physical force—including intimidation, coercion, repression, and, ultimately, destruction of human lives and property—for the purpose of attaining real or imaginary ideological and political goals." LEGISLATIVE RESPONSES TO TERRORISM, *supra* note 2, at v. Another description characterizes terrorism as "a fear-provoking tactic involving the callous use of innocent people to achieve political or personal ends." R. CRELINSTEN & D. SZABO, *supra* note 1, at ix.

7. *See infra* note 37 and accompanying text.

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victim himself, by virtue of the fact that the latter's coping mechanisms have been fully activated to deal with the situation, whereas the former feels totally helpless and useless.[8]

Diego C. Asencio, former United States Ambassador to Brazil and a former terrorist hostage,[9] has stated that: "the [hostage] knows what condition he is in, how he is feeling, what to expect, but the family is in a state of uncertainty. . . . I am convinced that in some cases members of the family suffer more even than the victim."[10]

Providing benefits to a hostage's family members may also be of immense psychological benefit to the hostage himself. As Representative Daniel A. Mica has noted:

> We have learned from the hostage experience in Iran that, in a long-term hostage situation, a major concern of a captive is for the welfare of his or her family. We have not fully provided for security of our personnel until we have enacted legislation which provides safeguards against the mental as well as physical strain which sometimes comes with serving our country overseas.[11]

The decision of who is a compensable victim of terrorism thus reaches beyond just providing for those involved in a particular hostage incident. Different compensatory methods will have their own peculiar and competing goals to satisfy, in addition to monetary compensation. Ultimately, the definition of "terrorist victim" will reflect the compensatory method selected.

III. STATUTORY REMEDIES

A. *Statutory Aims*

United States statutes regarding compensation for victims of terrorism allow benefits only to U.S. government employees who have been involved in a hostage incident and their families.[12] This restriction has come about for two reasons. First, many terrorist incidents have involved U.S. government

8. R. CRELINSTEN & D. SZABO, *supra* note 1, at 130.

9. Ambassador Asencio was held hostage in Bogota, Colombia for 61 days. Asencio, *The Psychological Impact of Communication on the Hostage and Family: A Hostage Experience in Colombia*, in PROCEEDINGS OF THE 10TH ANNUAL SYMPOSIUM ON THE ROLE OF BEHAVIORAL SCIENCE IN PHYSICAL SECURITY—"OUTTHINKING THE TERRORIST: AN INTERNATIONAL CHALLENGE" 1 (1985) *reprinted in H.R. 1956 and H.R. 2019, Benefits to Federal Employees Who are Victims of Terrorism: Joint Hearings Before the Subcomm. on Civil Service and the Subcomm. on Compensation and Employee Benefits of the House Comm. on Post Office and Civil Service and the Subcomm. on International Operations of the House Comm. on Foreign Affairs*, 99th Cong., 1st Sess. 139, 140 (1985) [hereinafter *Joint Hearings*].

10. *Joint Hearings*, *supra* note 9, at 72-73 (testimony of Diego C. Asencio, former United States Ambassador to Brazil).

11. *Joint Hearings*, *supra* note 9, at 18 (statement of Rep. Daniel A. Mica).

12. *See infra* notes 33-35, 62-64 and accompanying text. The Internal Revenue Code provides for the exclusion from gross income of:

> [a]mounts received by an individual as disability income attributable to injuries incurred as a direct result of a violent attack which the Secretary of State determines to be a terrorist attack and which occurred while such individual was an employee of

employees rather than private citizens.[13] Government employees stationed abroad are often both the easiest prey and the greatest prize for terrorists wishing to strike out at the United States.[14] In describing his own hostage experience, Ambassador Asencio stated, "the gentlemen who held me were not angry at me personally but, in fact, were interested only in my value as a symbol, as a representative of the President of the United States, of the people of the United States. . . ."[15]

The second reason for limiting compensation to government employees is the view that such compensation fulfills a duty owed by the United States to its employees. The President's Commission on Hostage Compensation,[16] for example, recommended "that the Government view its obligation toward the [Iranian] hostages as those of an employer and assume the costs of restoring the hostages to health, provide disability compensation if their health cannot be restored, provide compensation for material losses and safeguard their employment rights and career prospects."[17] The Hostage Relief Act of 1980[18] established "the principle that the government as a reasonable and compassionate employer had a responsibility to . . . hostages to provide . . . some material relief to partially offset the duress suffered by them and their families."[19] Apparently, the question of the existence of a similar duty to private citizens victimized abroad because they are Americans has yet to be decided.[20]

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the United States engaged in the performance of his official duties outside the United States.

I.R.C. § 104 (a)(5) (1982).

13. *See* Appendix D, COMMISSION REPORT, *supra* note 3, at 88-99 (setting out dates, locations, and descriptions of 50 terrorist incidents involving U.S. officials from 1968 to 1980). United States Representative Patricia Schroeder has related the story of a State Department employee who stated that "[g]overnment employees overseas, regardless of agency and whether they work in Africa, the Middle East, South America, or Paris, are terrorism targets purely because they are Government employees. Carrying a diplomatic or official passport can be an automatic death warrant." *Joint Hearings, supra* note 9, at 1 (statement of Rep. Patricia Schroeder). *But see* Schussel, *Kidnap & Ransom Insurance: The Industry's Red Hot, Hush Hush Topic,* 37 CONTACT No. 3 at 3, 4 (1985) ("[I]n 1984, incidents against American businesses overseas for the first time exceeded those against the U.S. government.") (CONTACT is a publication of the American International family of insurance companies and agencies) (copy on file with *Texas International Law Journal*).

14. *Joint Hearings, supra* note 9, at 91 (testimony of Vice President L. Bruce Laingen, National Defense University). Mr. Laingen was held hostage in Tehran, Iran for 444 days. Appendix C, COMMISSION REPORT, *supra* note 3, at 85.

15. *See Joint Hearings, supra* note 9, at 71.

16. *See infra* note 38 and accompanying text.

17. COMMISSION REPORT, *supra* note 3, at 31.

18. *See infra* note 21.

19. *Joint Hearings, supra* note 9, at 43 (statement of Norman Painter, President, Local 1812, American Federation of Government Employees).

20. *Id.* at 67 (statement of Rep. Patricia Schroeder).

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B. *The Hostage Relief Act of 1980*

The Hostage Relief Act of 1980[21] was the first statute expressly drafted to compensate victims of a particular act of terrorism. The Act was passed in response to the Iranian hostage incident[22] in which seventy-two persons were seized or forced into protective refuge in Tehran, Iran.[23] All but one of these persons was a U.S. government employee or a person working under contract to the U.S. government, and fifty-two of these were held in captivity for 444 days.

On January 19, 1981, the United States and Iran entered into the Declaration of the Government of the Democratic and Popular Republic of Algeria (Algiers Agreement),[24] a treaty providing for, among other things, the release of the American hostages.[25] President Jimmy Carter issued Executive Order 12,283 on the same day in fulfillment of the United States' commitment under the Agreement.[26] That Order directed the Secretary of the Treasury to issue the regulations necessary to enforce the provisions of the Agreement, and directed that he notify all appropriate courts of his action.[27] The hostages were released on January 20, 1981. President Ronald Reagan implemented the Algiers Agreement by Executive Order on February 24, 1981.[28] Among the provisions of the Agreement, it was agreed that no hostage would bring suit against Iran for damages incurred during the hostage incident.[29] The penalty for instituting such a suit was a fine of $50,000 and a ten-year prison term.[30]

21. Hostage Relief Act of 1980 §§ 101-301, 5 U.S.C. § 5561 (1982).

22. H.R. REP. NO. 1349, 96th Cong., 2d Sess. 1, *reprinted in* 1980 U.S. CODE CONG. & AD. NEWS 4178.

23. The facts are taken from COMMISSION REPORT, *supra* note 3, at 3-10.

24. Declaration of the Government of the Democratic and Popular Republic of Algeria, Jan. 19, 1981, United States-Iran, 20 I.L.M. 224 (1981) [hereinafter Algiers Agreement].

25. *Id.* at 225.

26. Exec. Order No. 12,283, 3 C.F.R. 114-15 (1982), *reprinted in* 50 U.S.C. § 1701 notes at 261-62 (Supp. 1987).

27. *Id.*

28. Exec. Order No. 12,294, 3 C.F.R. 139-40 (1982), *reprinted in* 50 U.S.C. § 1701 notes at 263-64 (Supp. 1987).

29. Algiers Agreement, *supra* note 24, at 227; *see also* 31 C.F.R. § 535.216(a) (1986), prohibiting:

> [p]ersons subject to the jurisdiction of the United States . . . from prosecuting in any court within the United States or elsewhere, whether or not litigation was commenced before or after January 19, 1981, any claim against the Government of Iran arising out of events occurring before January 19, 1981 relating to: (1) The seizure of the hostages on November 4, 1979; (2) The subsequent detention of such hostages; (3) Injury to United States property or property of United States nationals within the United States Embassy compound in Tehran after November 3, 1979; or (4) Injury to United States nationals or their property as a result of popular movements in the course of the Islamic Revolution in Iran which were not an act of the Government of Iran.

30. 31 C.F.R. § 535.701 (1986).

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In an attempt to compensate the Iranian hostages by some alternative means, Congress enacted the Hostage Relief Act of 1980.[31] The Act designates compensable victims of terrorism as "American hostages" and "family members."[32] An American hostage is defined as any individual who, while in the civil service or the military or while a citizen or resident alien of the United States rendering personal service to the United States abroad, is placed in "captive status" during the applicable hostage period.[33] Captive status means a missing status due to "hostile action abroad . . . which is directed against the United States during the hostage period . . . ."[34] A family member is defined as any dependent of an American hostage and any member of the hostage's family or household.[35]

The Hostage Relief Act is important not only because of its particular purpose, but also because it expressly recognizes that a hostage's family members are compensable victims. The benefits provided by the Act were specifically tailored to meet the differing needs of hostages and their families. Thus, the Act provided several very specific and goal-oriented benefits that were formerly unavailable. Among these were:

> [1] Creation of an interest-bearing salary savings fund, including retroactive interest on salary held prior to establishment of the fund.
>
> [2] Reimbursement of medical expenses of the hostages and members of their families which are attributable to the hostage experience. . . .
>
> [3] Extension of the Soldiers and Sailors Relief Act to hostages, thereby permitting courts to defer legal actions against hostages and their families when the enforced absence is prejudicial to their defense.
>
> [4] Exemption from gross income of compensation paid while in hostage status.
>
> [5] Exclusion from income tax when an employee dies as a result of hostile action.
>
> [6] Deferred assessment of taxes and penalties and refund of any tax collected before enactment.
>
> [7] Authorization for spouse to file joint [income tax] return.

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31. Hostage Relief Act of 1980, §§ 101-301, 5 U.S.C. § 5561 (1982).

32. *Id.* § 101, 5 U.S.C. § 5561 (1982).

33. *Id.* § 101(1), 5 U.S.C. § 5561 (1982). Congress chose not to compensate the one Iranian hostage who was a private U.S. citizen. *See id.* § 101, 5 U.S.C. § 5561 (1982). "Congress has made a clear distinction between the private American hostage and public official hostages in the Hostage Relief Act of 1980 by providing only . . . tax relief benefits . . . to the private citizen while making the government employees eligible for the other benefits . . . ." COMMISSION REPORT, *supra* note 3, at 32. *See also supra* notes 16-20 and accompanying text.

34. Hostage Relief Act of 1980 § 101(4)(A), 5 U.S.C. § 5561 (1982).

35. *Id.* § 101(3), 5 U.S.C. § 5561 (1982).

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[8] Reimbursement of educational expenses (post-secondary) of hostage families . . . and retraining of hostages.[36]

While the Act was of enormous benefit to the victims of the Iranian hostage incident, it lacked any means of compensating the hostages or their families for all of their damages; no compensatory monetary award existed for the pain, suffering, and mental anguish of the victims and their families.[37] Furthermore, since the Act was enacted expressly to compensate the American hostages in Iran, it was an ad hoc response. No permanent legislation existed for the benefit of subsequent terrorist victims. The issues of hostage compensation and U.S. policy towards terrorist victims thus became the topic of study for the President's Commission on Hostage Compensation.

C. *The President's Commission on Hostage Compensation and the War Claims Act of 1948*

The President's Commission on Hostage Compensation was formed by President Jimmy Carter on January 19, 1981,[38] for the purpose of "making recommendations to the President as to whether the United States should provide financial compensation to the United States nationals held hostage in Iran . . . ."[39] In its study, the Commission considered the events surrounding the Iranian hostage incident, the existing statutory remedies and benefits available to the hostages, and the obligation of the United States government to provide compensation to the hostages.[40] Ultimately, the

36. Appendix G, COMMISSION REPORT, *supra* note 3, at 120. *See generally* Hostage Relief Act of 1980 §§ 101-301, 5 U.S.C. § 5561 (1982) (statutorily providing these benefits).

37. American tort law generally recognizes three basic kinds of compensable losses suffered by victims in personal injury actions. D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES: DAMAGES-EQUITY-RESTITUTION § 8.1, at 540 (1973). First, there are losses relating to lost wages and lost earning capacity. A tort victim is normally entitled to recover for his lost wages and for "any loss of working capacity resulting from his injury, whether the loss in capacity actually reduces his earnings or not." *Id.* Second, there are expenses incurred due to the injury, usually medical expenses. "The value of any services rendered as the result of an injury is the usual measure of recovery for this particular element of damage. . . . [R]ecovery is not limited to expenses of treatment. Any reasonable expense, adequately proved to be the result of the injury, is an item of damage." *Id.* at 543. Finally, victims receive "intangible" injuries, often described as pain, suffering, and mental anguish. *Id.* at 544. Courts will typically allow "fair" or "reasonable" compensatory damages for such injuries. *Id.* at 545.

Indirect victims, such as family members, may also suffer from intangible injuries. Recovery of damages for "mental distress" may be allowed where "it would appear that there was a very high degree of probability that the mental disturbance would follow, and that the defendant [the terrorist, for example] proceeded in conscious and deliberate disregard of it, so that the defendant's conduct would properly be called wilful, wanton or reckless." PROSSER AND KEETON ON THE LAW OF TORTS § 12 (W. Page Keeton 5th ed. 1984).

38. Exec. Order No. 12,285, 3 C.F.R. 117-18 (1982).

39. COMMISSION REPORT, *supra* note 3, at 1.

40. *See generally* COMMISSION REPORT, *supra* note 3, for a detailed discussion of each of these topics.

Commission concluded that paying "compensation in the tort sense was not appropriate."[41] The Commission specifically recommended "that the United States Government make no payment to the Iranian hostages or their family members of any compensation intended to be the equivalent to compensatory damages for injuries incurred as the result of the unlawful detention of the hostages by the Iranian Government."[42] Instead, "[t]he Commission considered various bases under which direct financial benefits for the hostages might be warranted and concluded that monetary benefits, modeled after [the War Claims Act of 1948,[43] a] statute providing similar payments to American prisoners of war and wartime civilian internees on account of their detention, would be appropriate."[44]

The War Claims Act allows for the compensation of prisoners of war,[45] civilian U.S. citizen internees captured by hostile forces,[46] and certain employees of contractors working abroad for the United States.[47] Benefits received under the Act are payable only to designated beneficiaries, usually the captive himself or his immediate family members.[48]

Using the War Claims Act as a precedent, the Commission recommended that legislation be adopted providing for payment to the hostages equivalent to $12.50 per day[49] for each day of captivity.[50] While the Commission acknowledged that distinctions existed between prisoners of war and civilian

41. Letter from James S. Dwight, Jr., Chairman, President's Commission on Hostage Compensation, to President Ronald Reagan (Sept. 21, 1981), *reprinted in* COMMISSION REPORT, *supra* note 3, at i.

42. COMMISSION REPORT, *supra* note 3, at 35-36.

43. War Claims Act of 1948, 50 U.S.C. App. §§ 2001-2017 (1982).

44. COMMISSION REPORT, *supra* note 3, at 20. The War Claims Act may have been chosen as the Commission's model for hostage compensation because of the then recent release of Vietnam POWs who had received awards under this statute. *Joint Hearings, supra* note 9, at 49 (statement of Walter F. Weiss, Congressional Liaison, American Foreign Service Association).

45. War Claims Act of 1948, 50 U.S.C. App. § 2005 (1982).

46. *Id.* § 2004.

47. *Id.* § 2003. Compensable employees are described in 42 U.S.C. § 1701(a) which provides compensation for injury proximately resulting from a war-risk hazard.

48. War Claims Act of 1948, 50 U.S.C. App. §§ 2004(d), 2005(c) (1982). Benefits due to U.S. contractor employees are payable to the employee or his dependents. *Id.* § 2003(a) (referring to 42 U.S.C. § 1701(b)).

49. The selection of this specific amount sparked some controversy:

> The Commission noted that the daily detention benefit payable to persons eligible under the War Claims Act was last adjusted upward in 1970 and now stands at $5.00 per day for prisoners of war. The Commission felt it proper to recommend that the President suggest to the Congress a further upward adjustment in this figure [for the hostages] to $12.50 per day to take into account the impact of inflation since 1970.

COMMISSION REPORT, *supra* note 3, at 22. This figure was subsequently referred to as "ridiculous"; Letter from Brice M. Clagett to Rep. Patricia Schroeder (June 12, 1985), *reprinted in Joint Hearings, supra* note 9, at 38; "condescending"; *id.* at 73 (statement of Diego C. Asencio); and an "insult"; *Id.* at 80 (statement of Thomas D. Boyatt, former United States Ambassador to Brazil).

50. *Joint Hearings, supra* note 9, at 33.

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internees held during war on the one hand, and the hostages on the other,[51] the Commission also felt "that the holding of hostages by international terrorists and the well-documented tendency of some nations to disregard international standards for the treatment of prisoners of war and internees have brought the two situations much closer together."[52]

It is significant that the Commission chose the War Claims Act as its model, since this Act, like the Hostage Relief Act of 1980, expressly allows for the compensation of a hostage's family.[53] Unlike the Hostage Relief Act, however, the War Claims Act does not provide specific nonmonetary benefits, such as payment of medical expenses, to either a hostage or his family. Benefits are provided as a lump sum monetary award,[54] and in the event of the hostage's death, the designated family members are entitled to the lump sum which the hostage himself would have received.[55]

Ultimately, the Commission's recommendations, including the $12.50 per day payment to the Iranian hostages, were never implemented.[56] Sensing the inequity in such a result,[57] members of Congress subsequently introduced several bills that provided some form of compensation to the Iranian hostages as well as a permanent compensation system for future terrorist victims.[58]

D. The Victims of Terrorism Compensation Act

The most recent legislative attempt at compensating victims of terrorism is the Omnibus Security and Antiterrorism Act of 1986.[59] The pertinent portion of that statute is Title VIII, the Victims of Terrorism Compensation Act,[60] which provides benefits for "captives" and their "family members."[61] A captive is defined as an individual held involuntarily while such individual is in the civil service, or a U.S. citizen, national, or a resident alien rendering service to the United States.[62] "Captive status" is defined as "a missing status which, as determined by the President, arises because of a hostile action

51. *Id.* at 20.
52. *Id.* at 21.
53. *See supra* notes 32-35 and accompanying text.
54. War Claims Act of 1948, 50 U.S.C. App. §§ 2003(a), 2004(c), 2005(b) (1982).
55. *Id.* §§ 2003(a), 2004(d), 2005(b).
56. H.R. REP. No. 201, 99th Cong., 1st Sess., pt. 1, at 6 (1985) [hereinafter HOUSE REPORT]; *see also Joint Hearings, supra* note 9, at 19 (statement of Ronald I. Spiers, Under Secretary of State for Management); *id.* at 41 (statement of Walter F. Weiss, Congressional Liaison, American Foreign Service Association).
57. *See* HOUSE REPORT, *supra* note 56, at 25.
58. *E.g.*, H.R. 1956, 99th Cong., 1st Sess. (1985); H.R. 2019, 99th Cong., 1st Sess. (1985); H.R. 2851, 99th Cong., 1st Sess. (1985).
59. Omnibus Diplomatic Security and Antiterrorism Act of 1986, Pub. L. No. 99-399, 1986 U.S. CODE CONG. & AD. NEWS (100 Stat.) 853 (Supp. No. 8).
60. *Id.* § 801, (100 Stat.) 879 [hereinafter Victims of Terrorism Compensation Act].
61. Victims of Terrorism Compensation Act § 803, (100 Stat.) 879.
62. *Id.*

and is a result of the individual's relationship with the [U.S.] Government."[63] A family member is any dependent of a captive or any other individual who is a member of the captive's family or household.[64]

The Victims of Terrorism Compensation Act is thus "permanent" in that it is not restricted to victims of any particular terrorist incident. It is limited only by the requirements that the victim be associated with the U.S. government and that the compensable incident have occurred after January 21, 1981,[65] the date of the release of the Iranian hostages.[66] The Iranian hostages are included in the Act, and specifically provided a payment of $50 per day of captivity.[67]

The nonmonetary benefits of the Victims of Terrorism Compensation Act are similar to those of the Hostage Relief Act. For example, the Secretary of the Treasury is authorized to establish interest-bearing savings funds to which captives' pay and allowances may be allotted.[68] Captives and family members are entitled to payment of medical and health care expenses arising from the terrorist incident to the extent such expenses are not covered by insurance or a government program.[69] The Act provides for the extension of portions of the Soldiers' and Sailors' Civil Relief Act to captives,[70] thereby staying legal actions against them during the period of their captivity. Captives, their spouses, and their children are also entitled to educational benefits for a period not to exceed forty-five months.[71]

Notwithstanding these similarities, the Victims of Terrorism Compensation Act differs sharply from the Hostage Relief Act because it provides that monetary benefits be paid directly to captives or their family members. Iranian hostages receive a payment of $50 per day of captivity.[72] Other individuals taken captive after November 4, 1979, the date of the taking of the Iranian hostages,[73] will receive a payment of "not less than one-half of the amount of the worldwide average per diem rate under section 5702 of this title which was in effect for each day that individual was so held."[74] The Act further provides that compensation be paid in case of disability or death pursuant to regulations prescribed by the President.[75]

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63. *Id.*
64. *Id.*
65. *Id.* § 803, (100 Stat.) 882.
66. *See supra* notes 24-28 and accompanying text.
67. Victims of Terrorism Compensation Act § 802, (100 Stat.) 879.
68. *Id.* § 803, (100 Stat.) 879-80.
69. *Id.* § 803, (100 Stat.) 880.
70. *Id.* § 803, (100 Stat.) 881.
71. *Id.* § 803, (100 Stat.) 881-82.
72. *See supra* note 67 and accompanying text.
73. *See supra* notes 22-23 and accompanying text.
74. Victims of Terrorism Compensation Act § 803, (100 Stat.) 880-81. Indirect victims receive no monetary award for any mental anguish they may have suffered. *See id.*
75. *Id.* § 803, (100 Stat.) 882-83.

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Another significant difference between the Hostage Relief Act and the Victims of Terrorism Compensation Act is that the latter provides benefits for members of the military taken captive in a terrorist incident,[76] while the former makes no mention of them. Members of the military receive nonmonetary benefits similar to those described above. They will have their pay and allowances deposited in an interest-bearing savings fund,[77] will receive payment of medical expenses arising from the terrorist incident,[78] and will receive educational assistance.[79] Medical and educational benefits are also provided for the dependents of such captives.[80] Probably the most important benefit provided to military personnel is a monetary payment similar to that designated for other U.S. government employees.[81] Members of the military are also entitled to disability and death compensation as determined by the President.[82]

The Victims of Terrorism Compensation Act is obviously a major step in the direction of compensating victims of terrorism. It provides a permanent source of benefits, both monetary and nonmonetary, which can be immediately implemented in response to a terrorist incident. Victims will no longer have to endure a long uncompensated period, awaiting special legislation. This Act does not, however, compensate all victims or fully compensate those it does cover. Victims may thus be forced to turn to a more traditional source of obtaining compensation for injuries—the courts.

IV. LEGAL ACTIONS IN U.S. COURTS

While many victims have brought lawsuits seeking recovery for injuries sustained in terrorist incidents, these actions have for the most part been unsuccessful. The two cases described below, probably the most important in this area, illustrate the typical problems that terrorist victims will continue to face in such suits.

A. Suits by U.S. Citizens—The Iranian Hostage Suits

Perhaps the most prolific source of hostage compensation litigation has been the Iranian hostage incident.[83] The seminal case stemming from that incident is *Persinger v. Islamic Republic of Iran*.[84] The decision in that case

76. *Id.* § 806, (100 Stat.) 884-89.
77. *Id.* § 806, (100 Stat.) 884.
78. *Id.* § 806, (100 Stat.) 886-87.
79. *Id.* § 806, (100 Stat.) 887-88.
80. *See supra* notes 78-79 and accompanying text.
81. Victims of Terrorism Compensation Act § 806, (100 Stat.) 884-85. *See supra* note 74 and accompanying text.
82. *Id.* § 806, (100 Stat.) 885-86.
83. *See supra* notes 22-30 and accompanying text.
84. Persinger v. Islamic Republic of Iran, 729 F.2d 835 (D.C. Cir.), *cert. denied*, 105 S. Ct. 247 (1984).

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was extremely important because it ultimately disposed of several other similar suits.[85]

Persinger involved an action for damages brought by a former Iranian hostage, U.S. Marine Sergeant Gregory Allen Persinger, and his parents, against the Islamic Republic of Iran for injuries inflicted during the seizure and detention of the American hostages at the United States Embassy in Tehran.[86] The district court dismissed the action, holding that the Executive Order implementing the Algiers Agreement[87] validly extinguished the plaintiffs' claims, first because the President has the power to " 'dispose of private claims against foreign states to resolve, or avoid, international crises,' "[88] and "in the alternative, because even in the absence of a valid executive order, Iran would be immune under the Foreign Sovereign Immunities Act [FSIA] from suit for tortious acts in the United States Embassy in Tehran."[89]

On appeal, the District of Columbia Circuit Court initially affirmed the district court's first basis, holding the Executive Order enforceable.[90] The United States, which had intervened as a party defendant, petitioned the circuit court for a rehearing, which was granted.[91] The court's first decision was then vacated, and a second opinion issued in which the court upheld the district court's dismissal on the alternative basis—that Iran remained immune under the FSIA.[92]

The effect of the second opinion was to make any consideration of the issue of the Executive Order's validity improper,[93] since the FSIA provides that, unless an express exception exists, "a foreign state shall be immune from the jurisdiction of the courts of the United States."[94] The only FSIA exception considered possibly applicable to Iran by the court states that immunity shall not apply in cases where damages are sought from a foreign state "for personal injury or death, or damage to or loss of property, occurring *in the United States* and caused by the tortious act or omission of that foreign state or any official or employee of that foreign state while acting within the scope of his office or employment."[95]

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85. *Persinger*, 729 F.2d at 838 n.3.

86. *See supra* notes 22-30 and accompanying text.

87. *See supra* note 28 and accompanying text.

88. *Persinger*, 729 F.2d at 837, *citing* Persinger v. Islamic Republic of Iran, No. 81-00230, slip op. at 2 (D.D.C. Aug. 21, 1981). *Cf.* Dames & Moore v. Regan, 453 U.S. 654 (1981) (upholding an executive order issued as part of the effort to implement the Algiers Agreement).

89. *Persinger*, 729 F.2d at 837-38.

90. Persinger v. Islamic Republic of Iran, No. 81-2003 (D.C. Cir. Oct. 8, 1982), *vacated*, 729 F.2d at 835.

91. *Persinger*, 729 F.2d at 837.

92. *Id.*

93. *Id.* at 838.

94. 28 U.S.C. § 1604 (1982).

95. 28 U.S.C. § 1605(a)(5) (1982) (emphasis added).

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In determining whether this exception applied to Iran, the court examined the issue of "whether Congress, in enacting the FSIA, intended to exercise its jurisdiction to give [United States] courts . . . competence to hear suits against foreign states for torts committed on United States embassy premises abroad."[96] The court concluded, on the basis of the statutory language, the legislative history, and "the consequences of adopting a contrary position,"[97] that the exception did not apply.[98]

The claims brought by Sergeant Persinger's parents specifically sought damages for mental and emotional distress suffered within the United States as a result of a family member's detention.[99] The Persingers argued that the FSIA exception, which had not applied to their son's claim, did apply to their's, and they were therefore not prevented from bringing suit against Iran.[100] The circuit court held, however, that the FSIA exception requires not only the injury, but also the tort causing it to have occurred in the United States.[101] The court pointed out the inconsistency of holding otherwise:

> It would be anomalous to say that Congress intended to deny a remedy to [Sergeant Persinger]—a hostage imprisoned for more than a year—and yet also intended to expose Iran to suit by his parents for their emotional distress. Indeed, [the Persingers'] argument would have the result that had one hostage died in Tehran and another been released and died in the United States, both deaths being due to injuries inflicted while they were held hostage, the district court would have jurisdiction over the second suit but not over the first. Such results would deprive the statute of any policy coherence.[102]

The court concluded that it was prohibited by the FSIA from taking jurisdiction over any of the Persingers' claims against Iran.[103]

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96. *Persinger*, 729 F.2d at 839.

97. Such a position was described as:

> [t]he "functional equivalent" of making U.S. embassies part of the U.S. territory "for jurisdictional purposes." Such a result could, for example, cause the French government to be subject to suit in the United States if a French government vehicle were involved in an automobile accident on the U.S. embassy grounds in West Germany. Furthermore, foreign states "might hesitate in providing services to U.S. embassies or consulates were they to be subject to suit in U.S. courts for negligent acts or omissions on those premises." In addition, since some foreign states base their sovereign immunity decisions on reciprocity, or parity of reasoning, it is possible that a decision to exercise jurisdiction in this case would subject the United States to suits abroad for torts committed on the premises of embassies located here.

Id. at 841 (citations omitted).

98. *Id.* at 839.

99. *Id.* at 842.

100. *Id.*

101. *Id.*

102. *Id.* at 842-43.

103. *Id.*

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Persinger thus rang the death knell for the Iranian hostage suits.[104] Furthermore, due to the circuit court's broad interpretation of the protection afforded by the FSIA, *Persinger* places a virtually insurmountable barrier before any future terrorist victim's suit involving state-sponsored terrorism abroad.

B. *Suits by Aliens*

United States citizens have not been the only terrorist victims seeking compensation through the U.S. courts. The case of *Tel-Oren v. Libyan Arab Republic* involved a lawsuit brought by alien victims of terrorism against alien terrorists in a United States federal court.[105] The terrorist incident forming the basis of the suit occurred on March 11, 1978, when thirteen members of the Palestinian Liberation Organization (PLO) landed by boat in Israel.[106] The terrorists set out for the main highway between Haifa and Tel Aviv, where they seized two civilian buses, a taxi, and a car. The passengers were taken hostage with the result that twenty-two adults and twelve children were killed and seventy-three adults and fourteen children were seriously wounded. Most of the victims were Israeli citizens; a few were American or Dutch citizens.

The alien victims brought suit against the terrorists in a United States district court, asserting jurisdiction under several statutes,[107] most notably the Alien Tort Statute.[108] In a terse per curiam decision, the court of appeals affirmed the lower court's dismissal of the action.[109] Each of the circuit judges did, however, file a lengthy concurrence, fully explaining his own reasoning behind the dismissal, and these three concurrences are where the importance of the case lies. On wholly separate and distinct grounds, each judge found that an alien plaintiff could not bring a lawsuit against an alien terrorist in a United States federal court.

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104. *See supra* note 85; *see also* McKeel v. Islamic Republic of Iran, 722 F.2d 582 (9th Cir. 1983), *cert. denied*, 105 S. Ct. 243 (1984) (also holding FSIA precludes jurisdiction in an Iranian hostage suit).

105. Tel-Oren v. Libyan Arab Republic, 726 F.2d 774 (D.C. Cir. 1984), *aff'g*, 517 F. Supp. 542 (D.D.C. 1981), *cert. denied*, 470 U.S. 1003 (1985).

106. The facts are taken from Judge Edwards' opinion in *Tel-Oren*. *Tel-Oren*, 726 F.2d at 776.

107. Both the alien and the U.S. citizen plaintiffs claimed federal question jurisdiction under 28 U.S.C. § 1331 (1982), diversity jurisdiction under 28 U.S.C. § 1332 (1982), and jurisdiction under the Foreign Sovereign Immunities Act, 28 U.S.C. §§ 1330, 1602-1611 (1982). *Tel-Oren*, 726 F.2d at 775. The district court rejected plaintiffs' arguments for jurisdiction under the diversity statute and the Foreign Sovereign Immunities Act, and those arguments were abandoned by the plaintiffs on appeal. *Tel-Oren*, 726 F.2d at 799 n.3. The circuit court declined, with very little discussion, to extend jurisdiction to the U.S. citizen plaintiffs under 28 U.S.C. § 1331, the Alien Tort Statute being inapplicable to them. *See Tel-Oren*, 725 F.2d at 779 n.4, 800.

108. 28 U.S.C. § 1350 (1982).

109. *Tel-Oren*, 726 F.2d at 775.

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Tel-Oren. *Tel-Oren*, 726 F.2d at

ned federal question jurisdiction
r 28 U.S.C. § 1332 (1982), and
, 28 U.S.C. §§ 1330, 1602-1611
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l jurisdiction to the U.S. citizen
ıg inapplicable to them. *See Tel-*

In the first concurrence, Judge Edwards initially found that the Alien Tort Statute granted the plaintiffs in *Tel-Oren* a right to sue under two possible theories. Under one theory, he claimed that an expansive view of the Alien Tort Statute could be taken, following the reasoning of the Second Circuit in the case of *Filartiga v. Pena-Irala*.[110] In that case, the Second Circuit held that torture by a state official violated the "law of nations" as described in the Alien Tort Statute,[111] and the plaintiffs were thus entitled to bring suit in a U.S. federal district court.[112]

Judge Edwards' second jurisdictional theory was derived from *Adra v. Clift*,[113] in which the court based Alien Tort Statute jurisdiction on first, a violation of a municipal tort law, and second, a law of nations violation. Judge Edwards noted that while the plaintiff's action in *Adra* was "grounded directly on a domestic tort"—the unlawful taking of a minor child from a parent—it implicated a law of nations violation, the falsifying of a passport.[114] The *Adra* court's jurisdiction to decide the domestic tort issue would thus allow it to also decide the law of nations issue.[115]

Judge Edwards was, however, unable to find Alien Tort Statute jurisdiction under either theory on the *Tel-Oren* facts. He noted a major distinction between *Tel-Oren* and *Filartiga* in that, while the *Filartiga* defendant "acted under color of state law," the *Tel-Oren* plaintiffs did "not allege facts to show that official or state-initiated torture [was] implicated . . . ."[116] Judge Edwards was also unable to find that an act of terrorism constituted a law of nations violation as required by the Alien Tort Statute.

> While [the United States] unequivocally condemns all terrorist attacks, that sentiment is not universal. Indeed, the nations of the world are so divisively split on the legitimacy of such aggression as to make it impossible to pinpoint an area of harmony or consensus. . . . [T]errorism has evoked strident reactions and sparked strong alliances among numerous states. Given this division, I do

110. Filartiga v. Pena-Irala, 630 F.2d 876 (2d Cir. 1980). In *Filartiga*, the Second Circuit found an alien defendant liable to alien plaintiffs for causing the death of a seventeen-year-old who was one plaintiff's son and the other's brother. The victim had been tortured to death by the defendant, Pena-Irala, who was at that time Inspector General of Police in Asuncion, Paraguay. The Filartigas' claimed that the death was in retaliation for Dr. Filartiga's political activities and beliefs. *Id.* at 878-80.

111. *Id.* at 884.

112. *Id.* at 887-88.

113. 195 F. Supp. 857, 862-65 (D. Md. 1961). In *Adra*, an alien plaintiff sued his former alien wife and her American husband, contending that he was legally entitled to custody of his daughter by the wife, that the daughter was being wrongfully withheld from him, and that the defendants had concealed the child's name and nationality by falsifying her passport, a violation of the law of nations. *Id.* at 860-62.

114. *Tel-Oren*, 726 F.2d at 786.

115. *Id.* at 786-87.

116. *Id.* at 791. "Nor do I think they could," Judge Edwards stated, "so long as the PLO is not a recognized member of the community of nations." *Id.*

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> not believe that under current law terrorist attacks amount to law of nations violations.[117]

Judge Edwards thus concluded that, while the Alien Tort Statute served as a basis of jurisdiction for the alien plaintiffs, the fact that they received their injuries from private citizens acting as terrorists prevented them from bringing suit.

Judge Bork, on the other hand, found that the Alien Tort Statute itself prevented a federal court from having jurisdiction in *Tel-Oren*. He first held that the case should be dismissed on act of state and political question grounds,[118] since adjudication "would present grave separation of powers problems" in United States foreign policy matters.[119] He also pointed out the difficulty of the required "analysis of international legal principles," such as the status of terrorism, "that are anything but clearly defined and that are the subject of controversy touching 'sharply on national nerves.' "[120]

The major thrust of Judge Bork's opinion, however, is that the Alien Tort Statute does not itself provide alien plaintiffs with a right to bring suit in a federal district court. He analogized the statute to the federal question jurisdiction statute,[121] stating that "[n]either of those statutes either expressly or impliedly grants a cause of action. Both statutes merely define a class of cases federal courts can hear; they do not themselves even by implication authorize individuals to bring such cases."[122] Judge Bork thus reasoned that the right to bring suit must arise from the law of nations in order for jurisdiction to be extended under the Alien Tort Statute.[123] He found that neither the United States treaties which the *Tel-Oren* plaintiffs cited,[124] nor "international human rights law" provided the requisite right of action.[125]

Judge Robb disposed of the case by holding it nonjusticiable under the political question doctrine.[126] As with Judge Bork, one of Judge Robb's major concerns was maintaining the separation of governmental powers in United States foreign policy matters:

> Cases which would demand close scrutiny of terrorist acts are far beyond [the] limited exceptions to the traditional judicial reticence displayed in the face of foreign affairs cases. That traditional deference to the other branches has stemmed, in large part, from a fear of undue interference in the affairs of state, not only of this nation but of all nations.[127]

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117. *Id.* at 795.
118. *Id.* at 801.
119. *Id.* at 805.
120. *Id.* (*citing* Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 428 (1964)).
121. 28 U.S.C. § 1331 (1982).
122. *Tel-Oren*, 726 F.2d at 811.
123. *Id.* at 816.
124. *Id.* at 808-10.
125. *Id.* at 816-19.
126. *Id.* at 823.
127. *Id.* at 825.

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Judge Robb also hesitated to extend United States federal jurisdiction in an area with almost limitless potential plaintiffs:

> The victims of international violence perpetrated by terrorists are spread across the globe. It is not implausible that every alleged victim of violence of the counterrevolutionaries in such places as Nicaragua and Afghanistan could argue just as compellingly as the plaintiffs here do, that they are entitled to their day in the courts of the United States.[128]

Like Judges Edwards and Bork, Judge Robb therefore also came to the conclusion that because jurisdiction did not exist, dismissal was proper.[129]

The significance of *Tel-Oren* is that it severely limits the possibility that an alien plaintiff will be able to seek compensation from any terrorist defendant in a United States federal court. The desirability of such a limitation and possible further ramifications of *Tel-Oren* for U.S. terrorist victims[130] are issues that will continue to invite close scrutiny.[131]

V. PRIVATE COMPENSATORY METHODS

The oldest[132] and most sophisticated form of terrorist victim compensation now available is private insurance. Kidnap, ransom and extortion (K/R&E) insurance is currently offered by seven insurance companies, although only three—American International Group, Lloyd's of London, and Chubb & Son—dominate the field.[133] It is estimated that more than half of the Fortune 500 companies maintain some form of K/R&E insurance.[134] Companies with such insurance usually keep that fact:

> cloaked in secrecy. One reason might be that insurers and corporate executives rarely discuss the topic in public or even behind closed doors. Companies fear that if they reveal that their executives . . . are covered by K/R&E, the publicity will only bring

128. *Id.* at 826.

129. *Id.* at 827.

130. Such victims would be those U.S. citizens victimized by "private" terrorists or involved in terrorist incidents within the United States since *Persinger* precludes actions against state-sponsored terrorists inflicting injuries abroad. *See supra* notes 96-103 and accompanying text.

131. For a critical discussion of *Tel-Oren* and its theoretical implications, see Koh, *Civil Remedies for Uncivil Wrongs: Combatting Terrorism Through Transnational Public Law Litigation*, 22 TEX. INT'L L.J. 211 (1987).

132. This compensation system dates back to the Middle Ages:

> Although Lloyd's [of London] in the 1930s was the first insurer to offer kidnap insurance in modern times, the concept is almost 500 years old. With the advent of shipping in the 1200s, pirates and other enemies not only seized ships' cargoes but also the wealthy traders who were sometimes aboard. At first, cargoes were insured. Then, in 1500, the Guidon de la Mer, a French marine code, first provided for kidnap insurance. . . . In 1681, Louis XIV of France provided for the insurance when he included the provision in his Ordonnance de la Marine.

Schussel, *supra* note 13, at 5-6.

133. *Id.* at 4-5.

134. *Id.* at 5.

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> trouble. Indeed, most policies require that the coverage be kept confidential or the policies become void. Therefore, only a few key people in a corporation may know of the coverage, and many who are covered never hear about it.[135]

A company may typically maintain ransom coverage from $1 million to more than $20 million, paying premiums ranging from $1,000 to more than $100,000.[136] The coverage in K/R&E policies can be quite comprehensive. For example, a policy obtained through American International Group may include the following:

> (1) Payment of ransom for kidnapping or alleged kidnapping;
>
> (2) payment of ransom on a threat to kill or bodily injure an insured;
>
> (3) protection against loss by reason of destruction, disappearance, or wrongful appropriation of ransom monies while being delivered;
>
> (4) payment of expenses incurred for negotiators and consultants, reward, interest costs of a loan, legal fees, damages, and salaries;
>
> (5) payment of loss of earnings resulting from an interruption of business caused by a kidnapping or extortion incident;
>
> (6) payment of an accidental death and dismemberment benefit if an insured sustains bodily injury during a kidnap; and
>
> (7) payment of a wrongful detention benefit, reimbursing the insured for salary losses and other costs resulting from involuntary confinement by a host government or other organization.[137]

K/R&E policies should become increasingly popular because, "[w]ith improved protection afforded to government interests, terrorist activities directed at business concerns are likely to increase."[138] Policies covering family members, rather than employees, should also become more common as terrorists begin to target family members of corporate employees.[139] This may occur because "[f]amilies may not be as well protected as corporate staff and [terrorist] kidnappers may perceive them as more willing to pay a ransom quickly than a corporation."[140] Currently, such insurance is only available at a price prohibitive to most individuals. As terrorism incidents continue to increase, however, K/R&E insurance may prove to be a more attractive, if not the only, method available for private U.S. citizens to obtain terrorist victim compensation.

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135. *Id.*

136. *Id.*

137. AIG Special Services Division, *The Policy*, in SPECIAL RISK INSURANCE (copy on file with *Texas International Law Journal*).

138. AIG Special Services Division, *Corporate Kidnapping*, in SPECIAL RISK INSURANCE (copy on file with *Texas International Law Journal*).

139. AIG Special Services Division, *Individual/Family Kidnapping*, in SPECIAL RISK INSURANCE (copy on file with *Texas International Law Journal*).

140. *Id.*

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VI. CONCLUSION

While victims of terrorism often went uncompensated in the past, various schemes have developed within the United States to remedy this situation. Statutes like the Victims of Terrorism Compensation Act guarantee that some future victims will be compensated for their injuries. Private insurance, when available, performs the same function for those not covered by such statutes.

However, not all terrorist victims come within the purview of these schemes. Methods available to individuals not provided for by statute or covered by insurance have proven largely unsuccessful. Decisions like *Persinger* and *Tel-Oren* have made recovery through the U.S. court system highly unlikely for these individuals. It is inevitable, therefore, that there will be individuals, including U.S. citizens, who will be victimized by terrorism and forced to suffer injury without remedy.

Ultimately, the issue of terrorist victim compensation has the potential to extend even beyond those involved in a specific terrorist incident. The words of one scholar best sum up the final ends of terrorist victimization:

> Those not involved in an incident either directly or by virtue of knowing someone who is involved may still feel touched by a particular incident. The psychology of terror and the fear of indiscriminate or random violence are key factors here. . . . Whether people actually avoid visiting Israel, walking in certain areas of Belfast, accepting certain diplomatic missions or business posts, or speaking out publicly on various issues out of fear of being targeted by terrorists is not easily measured or verified. However, it is a fact that most ordinary citizens will accept severe curtailment of civil liberties in the name of security. This is the ironic lesson that has been repeatedly demonstrated in country after country faced with serious terrorist campaigns. This fact alone is sufficient evidence that the general public is victimized in some way by terrorist acts.[141]

*Kimberly A. Trotter**

141. R. CRELINSTEN & D. SZABO, *supra* note 1, at 130.

* J.D. Candidate 1987, University of Texas.

Terrorism Risk Insurance Approach

Background

- The September 11 terrorist attacks have created widespread market uncertainties with regard to the risk of losses resulting from possible future terrorist attacks.

- Such uncertainties have disrupted the current ability of private insurance markets to price insurance coverage for losses resulting from future attacks, thereby threatening the continued availability of affordable insurance for such losses. Without terrorism risk insurance, banks may not lend to new construction projects and many existing commercial properties may not be able to change hands.

- This approach would provide a limited, transitional program to give the private insurance market time to re-establish pricing mechanisms for terrorist risk and build capacity to absorb future losses.

- It accomplishes this by providing that the government will pay a share of compensation to policyholders for insured losses over the next three years. The portion of insured losses compensated by the government would recede each year. The share of losses compensated by the government would also be a function of actual losses in a given year from terrorist acts.

- This approach would limit the immediate disruptions in the insurance market, and assure the continued availability of affordable insurance coverage for risks associated with future terrorist acts.

General Structure

- Individuals, businesses, and other entities would continue to obtain property and casualty insurance from insurance providers as they did before September 11. The terms of the coverage would be unchanged and would be the same as that for other risks. Any loss claims resulting from a future terrorist act would be submitted by the policyholder to the insurance company. The insurance company would process the claim and pay the policy holder that portion of the claim for which the insurer is responsible according to the loss sharing arrangement established by this approach.

- The insurance company would then submit a claim to the Treasury, and certify that it was a valid claim and that the insurer had paid its share of the loss. The Treasury would then immediately compensate the policyholder for the balance of the insured loss.

Act of Terrorism

- This approach would narrowly define an "act of terrorism" and direct the Secretary of the Treasury to certify that a terrorist act had taken place for purposes of activating the shared loss compensation arrangement described below. This decision by the Secretary would be made in consultation with the Attorney General, [Secretary of State, and Secretary of Defense] or [Chief Justice of the United States] or [Chairman of the Federal Reserve Board]. There would be a limited Federal pre-emption of State insurance law as to what constitutes and "act of terrorism."

Shared Loss Compensation Program

- Through the end of 2002, the government would absorb 80 percent of the first $20 billion of insured losses resulting from terrorism and 90 percent of insured losses above $20 billion. Thus, the private sector would pay 20 percent of the first $20 billion in losses and 10 percent of losses above that amount.

- The role of the federal government would recede over time, forcing the private sector to develop its capacity each year.

- In 2003, the private sector would be responsible for 100 percent of the first $10 billion of insured losses, 50 percent of the insured losses between $10 and $20 billion, and 10 percent of the insured losses above $20 billion. The government would be responsible for the remainder.

- In 2004, the private sector would be responsible for 100 percent of the first $20 billion of insured losses, 50 percent of the insured losses between $20 and $40 billion, and 10 percent of the insured losses above $40 billion. The government would be responsible for the remainder.

- To preserve flexibility in an extraordinary attack, combined private/public liability for losses under the program would be capped at $100 billion in any year. It would be left to Congress to determine payments above $100 billion.

- The legislation would sunset after three years, so that lawmakers could reevaluate the need for federal intervention. [The President could extend the program for an additional two years.]

Lines of Coverage

This approach would cover losses generally covered by any type of property and casualty policy or endorsement for property located in the United States, as well as U.S. owned air carriers and ships. This would include damage to commercial property, commercial liability, commercial automobile, workers' compensation, financial guarantee, private passenger automobile [business interruption] and homeowner's insurance. The approach would not cover life and health

insurance lines, but would give the Secretary the authority to add additional lines of coverage to the program if he determines there are future disruptions in the private markets' pricing of such lines resulting from acts of terrorism.

Loss Mitigation

This approach would provide an exclusive federal cause of action for damages resulting from acts of terrorism certified by the Secretary. It would also provide for the consolidation of claims into a single federal forum, a prohibition on punitive damages, limits on non-economic damages, offset provisions, application of a gross negligence standard, and one-year statute of limitations.

these provisions all will ensure an ~~reasonable~~ efficient, fair, and orderly litigation process.

Outstanding Issues

In addition to those issues bracketed above, outstanding issues include:

Should the Secretary be given discretionary authority to make ex-poste assessments on the industry to recoup costs associated with the program?

Should there be federal pre-emption of state rate regulation of terrorism risk insurance?

Should there be tax incentives for the private sector to build reserves against terrorist risk?

HUDSON INSTITUTE

PROJECT FOR INTERNATIONAL RELIGIOUS LIBERTY

MEMORANDUM

Michael J. Horowitz
Director

TO: **Brad Berenson**
Brett Cavanaugh
Viet Dinh

FROM: Michael Horowitz MH

RE: **September 11 Tort Reform Legislation Now Being Drafted**

Per my conversation with Brad, I am faxing draft legislative language taken from the mass tort case fee reform endorsed by the President. The language sets out a lodestar/multiplier basis for fees and should easily fit easily in the tort reform bill now being drafted. (Please note that I'm only faxing Section (c)(1)(B) of the generic reform bill; for your purposes, its lodestar/multiplier language is all you are likely to need.)

I can't imagine a more opportune moment to establish the precedent that lodestar/multiplier rather than percentile compensation is the most appropriate means of protecting mass tort case claimants. Given its timing and setting, the bill now being drafted provides an ideal vehicle for doing so.

FYI, I'm enclosing the October 10 Wall Street Journal editorial calling for a lodestar/multiplier formula in the airline bill. I'm also faxing Weekly Standard and National Review pieces I've written that demonstrate how the "mere" multi-million dollar fees provided by the shareholder cases on which the lodestar/multiplier reform is modeled are more than enough to attract extraordinary, sophisticated lawyers in high risk and complex contingency claims. As an example of how such fees are adequate for cases far more complex than any of the September 11 cases are likely to be, please note Judge Pollack's decision in the Sumitomo case at 74 F. Supp. 2d 393 (S.D.N.Y. 1999). *See also*, Blum v. Stenson, 465 U.S. 886 (1984); Pennsylvania v. Delaware Valley Citizens' Council 478 U.S. 546 (1986); In re Agent Orange Product Liability Litigation, 818 F.2d 226 (2d Cir., 1987). *And see* Janet C. Alexander, Do The Merits Matter? A Study of Settlements in Securities Class Actions, 43 Stanford L.Rev. 497, 537-38 (1991).

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Lodestar/multiplier language is particularly apt because of the tort bar's strenuous assertions that September 11 victims should be particularly protected – a claim that will make it difficult to defend multibillion-dollar fees literally, unnecessarily (and unethically) taken from victims' pockets.

The September 11 crisis should not provide cover for tort lawyers to gain billions of dollars in unethical fees, flaunt the President's tort reform agenda, and secure a permanent 21st Century capacity to capture critical elements of the American legal, political and business systems. The legislation now being drafting offers an ideal opportunity not only to protect September 11 victims, but to also serve as a powerful precedent that will facilitate the adoption of generic mass tort case fee reform legislation in the reasonable future. Given its immediate and strategic significance, I urge you to include lodestar/multiplier language in the bill now being drafting.

MJH/kar

cc: Jay Lefkowitz

Privileged and Confidential
July 9, 2001

SECTIONS 4958A and 7437 WITH COMMENTS

TITLE ___—EXCESS FEE TRANSACTIONS

SEC. ___. EXCESS TAXES ON EXCESS FEE TRANSACTIONS OF CERTAIN ATTORNEYS.

(a) IN GENERAL.—Subchapter D of chapter 42 (relating to failure by certain charitable organizations to meet certain qualification requirements) is amended by adding at the end the following new section:

"SEC. 4958A. TAXES ON EXCESS FEE TRANSACTIONS.*[1]*

"(a) INITIAL TAXES.—There is hereby imposed on the collecting attorney in each excess fee transaction a tax equal to 10 percent*[2]* of the excess fee. The tax imposed by this paragraph shall be paid by any collecting attorney referred to in subsection (f)(1) with respect to such transaction.

"(b) ADDITIONAL TAXES ON THE COLLECTING ATTORNEY.—In any case in which an initial tax is imposed by subsection (a) on an excess fee transaction and the excess fee involved in such transaction is not corrected within the taxable period, there is hereby imposed a tax equal to 200 percent of the excess fee involved. The tax imposed by this paragraph shall be paid by any collecting attorney referred to in subsection (f)(1) with respect to such transaction.

"(c) EXCESS FEE TRANSACTION; EXCESS FEE.—For purposes of this section—

"(1) EXCESS FEE TRANSACTION.—

"(A) IN GENERAL.—The term 'excess fee transaction' means any transaction in which a fee is provided by an applicable plaintiff directly or indirectly*[3]* (including payments resulting from litigation on behalf of an applicable plaintiff determined on an hourly or percentage basis) to or for the use of any collecting attorney with respect to such applicable plaintiff

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1 This proposed § 4958A is modeled on § 4958.

2 A first tier excise tax rate of 10% was used instead of 25% (which is the rate in § 4958) because a 10% tax was considered to be sufficient due to the size of the excess fees expected to be involved in $100 million cases. The 10% rate should not be excessive given the ability of the attorney to argue reasonable cause in appropriate cases under § 4962, if the excess fee is corrected.

3 The term "indirectly" is intended to mean that the section applies to payments to attorneys directly from amounts payable to plaintiffs and also applies where the payment to the attorneys is separately negotiated and separately paid.

if the amount of the fee provided exceeds the value of the services received in exchange therefor.

"(B) DETERMINATION OF VALUE.—For purposes of subparagraph (A), in determining whether the amount of the fee provided exceeds the value of the services received in exchange therefor, the value of the services shall be the sum of—

"(i) the reasonable expenses incurred by the collecting attorney in the course of the representation of the applicable plaintiff, and

"(ii) a reasonable fee based on—*[4]*

"(I) the number of hours of non-duplicative, professional quality legal work provided by the collecting attorney of material value to the outcome of the representation of the applicable plaintiff,

"(II) reasonable hourly rates for the individuals performing such work*[5]* based on hourly rates charged by other attorneys for the rendition of comparable services, including rates charged by adversary defense counsel in the representation,*[6]* and

"(III) to the extent such items are not taken into account in establishing the reasonable hourly rates under subclause (II),*[7]* an appropriate adjustment factor, including reasonable multipliers, to compensate the collecting attorney for risks of non-payment of fees and,

---

[4] It is expected that the reasonable fee would generally be calculated with respect to any attorney or paralegal by multiplying the number of hours times the rate per hour and the multiplier. However, the term "based on" is used rather than "by multiplying" to provide flexibility to deal with complexities such as multiple attorneys and staff working at different rates.

[5] The reference to "individuals performing such work" is intended to reflect the fact that multiple attorneys or paralegals working at different rates may be involved.

[6] ***The reference to rates charged by adversary defense counsel is included to provide some helpful guidance in determining the appropriate rate. It is also included to address the argument that large percentage fees should be allowed for plaintiff's lawyers because defense lawyers working on the same case charge high hourly rates that are otherwise not available to plaintiff's lawyers and are paid on a win-or-lose basis.***

[7] The adjustment factor should not be based on risks, exceptional skills or factors already taken into account in determining appropriate hourly rates.

when clearly established, for exceptionally skillful or innovative services provided during such periods of risk.*8*

The appropriate adjustment factor under clause (ii)(III) shall be no greater than 6 and shall be determined in accordance with the strict standards established by the Federal courts for permissible lodestar multipliers.

"(2) EXCESS FEE.—The term 'excess fee' means the excess referred to in paragraph (1)(A).

"(d) JOINT AND SEVERAL LIABILITY.—For purposes of this section, if more than 1 person is liable for any tax imposed by subsection (a), all such persons shall be jointly and severally liable for such tax.

"(e) APPLICABLE PLAINTIFF.—For purposes of this subchapter, the term 'applicable plaintiff' means any person represented by a collecting attorney with respect to a claim described in subsection (f)(1).

"(f) OTHER DEFINITIONS.—For purposes of this section—

"(1) COLLECTING ATTORNEY.—The term 'collecting attorney' means any person engaged in the practice of law*10* who represents—

"(A) any organization described in paragraph (3) or (4) of section 501(c) and exempt from tax under section 501(a) in a claim for damages

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8 The reference to "periods of risk" is intended to mean that "copycat" lawsuits do not merit as high a multiplier for levels of skill or risk than the original lawsuit with respect to a particular type of claim. Similarly, once the defendant has offered or agreed to settle the case, fees subsequently incurred would not ordinarily warrant as high a multiplier as fees before the offer or agreement.

Applicable plaintiff is defined in accordance with subsection (f) based on the type of entity represented (generally charities, States and natural persons) and the type of claims (generally breaches of duty and medicaid reimbursement). Defining applicable plaintiff in terms of both the type of entity represented and the type of claim reflects the purposes of the section better than basing the definition only on one of these criteria. As a general matter, the section is not intended to apply to claims solely between large, for-profit companies. The term "breach of duty" is intended to be very broad and can include both tort and contract duties.

10 "[A]ny person engaged in the practice of law" is intended to include both natural persons as well as legal entities such as P.C.s and PLLCs engaged in the practice of law. This interpretation should apply since § 7701(a)(1) defines person to include any individual or entity.

WSJ
10/10/01

REVIEW & OUTLOOK

War Profiteers

Things must be getting back to normal: There's litigation in the air. Yesterday the Supreme Court denied an appeal from Microsoft, which means that the case will continue to work its way through the lower courts. At the same time, the High Court shut down an effort to reverse a state ban on cities suing gun manufacturers over crime costs. Meanwhile, the trial lawyers are crossing their hearts and hoping everyone believes they have no intention of litigating liability for the World Trade Center attack.

The day after the worst atrocity on American home soil, trial lawyers association president Leo V. Boyle posted a letter on the group's Web site titled "A National Tragedy." For "the first time in our history," Mr. Boyle announced, "the Association of Trial Lawyers of America, in this time of national crisis, urges a moratorium on civil lawsuits that might arise out of these awful events."

Oh, bravo. Now, we don't question their horror at the attack. But if our tort warriors really wanted to demonstrate solidarity with the nation—and especially with those families whose loved ones were buried in the rubble of lower Manhattan—a pledge to accept a reform limiting outrageous fees would be more persuasive than a moratorium with no real meaning. Especially when they can count on friends in Congress to protect their core interests. Does anyone believe that Tom Daschle and Richard Gephardt didn't know exactly what they were doing when they made sure that the airline bailout bill that ended up going before both their houses wasn't the one that would have limited attorneys fees?

The lost passage we refer to appears in the version of the bill introduced by Rep. Don Young (R., Ark.). It reads as follows: "ATTORNEY FEES.—Reasonable attorneys fees for work performed in any action commenced pursuant in this section shall be subject to the discretion of the court, but in no event shall any attorney charge, demand, receive, or collect for services rendered, fees in excess of 25% of the damages ordered by the court to be paid pursuant to this section." Contingency fees, of course, normally scale up from 33%.

With airlines desperate for cash and warning of imminent bankruptcies, it wasn't likely in any event that the bill was going to get held up over lawyers fees. Now any future claimants have two choices: Either sue in federal court in New York, or submit a claim to a federal compensation fund to be administered by a special master appointed by the Attorney General—and give up the right to sue.

The devil . . . er, the plaintiffs bar . . . is in the details.

ATLA says it is encouraging people to take the administrative route and has set up a program to provide pro bono representation for those in need. But because no one knows what the criteria or award levels will be, victims and their families not in immediate need of money will likely hang back until they see what's what—one reason a moratorium has little significance now. After all, claimants have two years to file. And whatever pious advisories ATLA might send its members, they're still free to do what comes naturally.

This is all the more reason to try to rescue some good from the wreckage by applying a reform endorsed by George W. Bush in the campaign: Redefine the fee relationship between a tort lawyer and his client as a fiduciary one. A version of this principle already operates in so-called securities cases. Here, lawyers fees are determined by the lodestar method: They submit bills detailing the hours they worked, which a court then multiplies by a reasonable rate that factors in a measure of the risk involved. Not only would such a reform ensure that money from this tragedy go to widows and orphans rather than their attorneys; it would set a badly needed example for all future mass tort claims. Courts are still dealing with cases from the 1993 World Trade Center bombing.

Tort lawyers, of course, shrink from the sunshine of hourly rates. They'd be loath to abandon the percentage-of-the-take arrangement, which can translate into hourly rates of tens of thousands of dollars. It strikes us that behind ATLA's counsels of restraint lurks an understanding that theirs is not the kind of business that would show very well in the public spotlight of this particular crisis.

All the more reason to address the issue head-on, with clarifying legislation if necessary and administratively where possible. We would think, for example, that a ruling on reasonable fees would be one of the first issues a special master for the September 11 attacks would address, especially for a largely administrative process where no one has to prove causation. And if the master does limit fees on the administrative side, it becomes even more important to have them limited on the courtroom option, so that attorneys advising their clients which road to take do so without a strong personal incentive to sue.

ATLA's pronouncements of self-restraint notwithstanding, the fact that their Congressional partners deep-sixed any limitations on legal fees in the airline bailout bill tells us that some folks want this door kept ajar. If only on the principle of helping those who have a hard time helping themselves, we'd sure like to know if we could count on ATLA's support for some supplemental legislation making it harder for the lawyers to stick their hands into the pockets of the victims.

Can Tort Law Be Ethical?

A proposal to curb ill-gotten gains.

BY MICHAEL HOROWITZ

SOMEONE STICKS A LOADED GUN to your head and asks for your wallet. Do you resist if you know the bullets are cheap and likely (but not certain) to be duds?

Today, mass tort litigation creates similar bet-your-life scenarios for increasing numbers of industries. Federal circuit court judge Richard Posner has noted that when a jury can "hold the fate of an industry in the palm of its hand . . . and hurl [it] into bankruptcy . . . the industry is likely to settle—whether or not it really is liable." Law increasingly counts for little in mass tort cases; fixing the size of payoffs to make the cases go away has become its primary function.

Think otherwise? Then imagine yourself general counsel of McDonald's, faced with a nationwide class action brought on behalf of millions of Happy Meal customers who claim that their diabetes, obesity, and heart attacks were caused by your products, and with a companion series of suits brought by government agencies that paid for their medical care.

Your first reaction would be fury and incredulity. You know—or think you do—that french fries aren't cigarettes. You know that McDonald's tried and failed to sell low-fat hamburgers, that it gainfully employs vast numbers of young people, that millions of customers enjoy its products every day. That's when reality intrudes.

The first dose would come when you noted that the damages claimed in the combined suits vastly exceed the entire net worth of McDonald's—that it will be out of business if the cases are tried and lost. You then realize that the company's files almost certainly contain memos discussing the health effects of your products. You also note that the public is less aware of the risks of eating Big Macs than of smoking Camels, that you've done little to advise your customers of those risks, that many of those patrons are young and unschooled, that you've made it hard for them to know the fat and calorie content of what you sell, that armies of expert witnesses and government officials are prepared to second-guess your menu and recipe decisions and to allege that "junk foods" are killing America. Your government relations vice president then describes the price the company will pay for waging sustained public war on political officials eager for massive lawsuit windfalls they can spend without having to pass tax increases. Your media people also warn that document leaks and angry politicians orchestrated by media-savvy lawyers can metastasize the company's happy face image into a skull and crossbones faster than you can say asbestos or Bill Gates.

Finally, you note that 8 or 9 state supreme courts—or has it now become 19 or 20?—are, like the Florida Supreme Court, dominated by tort lawyers implacably eager to redistribute your assets without regard to fault. And, if that isn't enough, the value of the company's stock has dropped precipitously since the lawsuits were filed. As a prudent lawyer and company officer, you'll soon come to understand what you need to do.

First, make sure all your competitors—Popeyes and Taco Bell, as well as Wendy's and Burger King—are also named in the suit. Then, after learning from your marketing people that the bottom won't drop out of sales as long as you (and your competitors) don't add more than 30 cents to the price of Big Macs, conduct a kabuki ritual of discovery proceedings whose singular objective is a settlement that will increase burger prices by no more than a quarter (with comparable increases for chicken wings and burritos).

Settling will be easy, for all you'll need to do is pay a nickel a burger for the next 25 years to the 300 or so lawyers who brought and control the cases. To be sure, this tort tax on your products will hurt business, and you'll be squeezed some by the nutrition education programs and modest salt and calorie reductions you'll be required to implement as part of the settlement. But offering a nickel rather than a penny a burger for legal fees (and offering government health care programs more lucrative settle-

Michael Horowitz is a senior fellow at the Hudson Institute and director of its Project for Civil Justice Reform.

ments than individual plaintiffs) will do wonders in getting a settlement you can live with. Among other things, it will convert the lawyers who sued you into self-interested guarantors of the health of the fast food industry; and it will immediately return your stock price to where it was when the cases were brought.

The settlement will of course add eight or ten new tort lawyer billionaires to the Forbes 400 and will give the tort bar more disposable income to "invest" in the political process than all parties now spend in all U.S. elections in any given year. But that will be the next industry's worry, not yours.

The above scenario is, precisely, the story of the great asbestos and tobacco lawsuits of the 1990s. It explains why, in order to save itself, Dow threw its Dow Corning division to the wolves in the junk science breast-implant cases. As former *Washington Post* business editor David Ignatius has written, it will one day be the story of an oil industry that sits with global warming risk memos in its files if droughts or floods depreciate property values in different regions of the country. And consider this recent Department of Agriculture report: Carbonated soda provides more sugar in a typical 2-year-old's diet than cookies, candies, and ice cream combined, while more than half of 8-year-olds drink a can of soda per day and a third of all teenage boys drink at least three cans per day. Do you think for a second that creative tort lawyers won't try to link this "soda addiction" to any number of present and future health and social ills? Are you ready, Coke? Will you be ready when the tort bar dominates 30 state supreme courts? Cheer up, for you'll be able to get out of it all without too much damage if you pay the tort lawyers a penny a can for 25 years or so. On second thought, maybe you'll need a penny and a half to make them go away.

Under every canon of legal ethics, these blackmail scenarios should be proscribed. The central premise of legal ethics—that lawyers are fiduciaries restricted to reasonable and risk-based fees—is shattered when, as in the tobacco cases, lawyers are scheduled to receive $200,000 per hour fees for late-filed, copycat cases. Fee ethics mandates are said to be particularly critical in contingency fee cases where, as courts and scholars have noted, $100-million cases seldom require ten times as much risk and effort as $10-million cases. In fact, the relationship of case size to attorney risk is reversed in mass tort cases, where survival threats to defendants make $245-billion cases more than a thousand times harder, to win than "mere" $245-million cases.

The central premise of legal ethics is shattered when lawyers receive $200,000 per hour fees for late-filed, copycat cases.

President Bush proposed during the campaign to apply to lawyers in mass tort cases the Internal Revenue Code provisions that govern fiduciary breaches of duty by pension fund trustees, foundation executives, and employees of 501(c)(3) non-profits. Under this so-called Jim and Tammy Faye Bakker provision of the 1996 Taxpayer Bill of Rights, overreaching fiduciaries have the "choice" of refunding their excess payments or paying a federal tax of $2 for every dollar they keep. Under the president's proposed reform, attorneys in successful mass tort cases would be handsomely but not obscenely compensated. Based on a developed body of law governing the compensation of lawyers in shareholder suits, mass tort fees would be based on high hourly "lodestar" fees multiplied by a factor as high as six to cover the risks the lawyers assumed when they brought their cases.

Acting as if President Bush's reform proposal never had been made, a group of tobacco attorneys recently sold a 12-year strip of about $1 billion in future fees for $308.1 million in immediate cash—thereby transferring the risk of non-payment of their fees to banks and investors. That cash-out was reported to be the first step in a planned two-year securitization of all future fees from the tobacco lawsuits, estimated to provide a payout of no less than $3 billion and as much as $10 billion.

Perhaps the lawyers and their bankers believed that the Bush proposal was not meant to be applicable to the tobacco settlement fees, and early comments from unnamed Bush spokesmen may have given them grounds to believe that this was so. If so, the lawyers and their bankers are in for a rude surprise. Page 80 of the president's budget contains this terse and, to taxpayers, cheering sentence: "The budget also assumes additional public health resources for the States from the President's proposal to extend fiduciary responsibilities to the representatives of States in tobacco lawsuits."

The Bush budget thus ensures that members of Maryland's congressional delegation will soon be asked to decide whether sick Maryland smokers (and the government agencies that pay for their care) or tobacco attorney Peter Angelos will receive the overwhelming bulk of the $1.1 billion fee now sought by Angelos. They will do so knowing that Angelos's services were rendered under a statute which, in the words of the state senate president, Mike Miller, "changed centuries of precedent to ensure a win." They will do so with the country's leading ethics scholars arguing that almost all of the money must go to Maryland rather than Angelos if codes of ethics are to have any meaning at all. Ted Kennedy, meanwhile, will get to vote on whether the bulk of the $775 million awarded to the Massachusetts tobacco lawyers should go to them or that state's health authorities. This comes in the face of sworn testimony by tort lawyers from other states that the Massachusetts attorneys added little or nothing to the settlement received by Massachusetts. Other members of Congress will have similar opportunities to decide whether fiduciary standards that still allow tobacco lawyers to be paid as much as $3,000 per hour are too ungenerous to those lawyers.

The Bush proposal will chill the plans of the tobacco lawyers to take a $3-$10 billion payoff and run. It sets up what will be a defining national debate on the role and rule of lawyers. Finally, it offers the tort bar the lesson that many Americans are now also learning: Don't underestimate George W. Bush. •

The Road to Reform

How the trial lawyers can be fought

MICHAEL J. HOROWITZ

IMAGINE yourself the CEO of a major corporation approached by your chief marketer with plans for next year's sales campaign. "Let's save lots of money by putting fewer features on next year's widgets," he says. "Then let's ask our customers to buy lots of them by promising we'll make them happier after our profits increase." How long would it take you to fire that guy?

Amazingly, conservative Republicans, moderate Democrats, and the American business community have spent hundreds of millions of dollars—and precious political capital—on tort-reform campaigns that differ little from the widget marketer's scheme. Here's the pitch: "Because tort judgments are too high, Congress should limit the amount of damages its constituents can recover. Because there are too many tort claims, congressmen should vote to limit their constituents' right to sue."

It's not surprising that these multimillion-dollar campaigns have abysmally failed to restrain the growing power of the tort system to mow down whole industries in single cases. It's equally obvious that they've been unable to limit the growing number of tort-lawyer *billionaires* soon likely to have more disposable income to "invest" in politics than all candidates now spend on all elections in any given year. Voters know that the tort system is counterproductive and corrupt, but they've managed to restrain their enthusiasm for reforms asking them to sacrifice their rights to make the world safer for the Fortune 500.

Fortunately, there are better and more far-reaching routes to change. Strategically designed "new agenda" tort reforms increase rather than diminish consumer rights, benefit only those corporate defendants who first offer significant benefits to tort claimants, and require lawyers to comply with ethics rules mandating that they return unreasonable fees to their clients.

These reforms make political as well as policy sense: They provide immediate and tangible benefits to consumers—the reverse of traditional tort-reform proposals, whose direct savings go to corporate defendants. Also, importantly, they focus less on what injured parties receive than on the system's transaction costs—its growing, astonishing propensity to give more money to lawyers than to injured parties. For these reasons alone, new-agenda reforms enjoy strong support from both parties, from liberals as well as conservatives, and from overwhelming numbers of editorial boards and commentators.

A small number of business leaders have seen the need to shift to new-agenda reforms. They have been less concerned with eye-catching outrages like the McDonald's hot-cup-of-coffee case, and more focused on why, when a drunken doctor saws off the wrong leg, the tort system awards multimillion-dollar fees to lawyers who take few meaningful risks and add little value to their clients' claims. The reformers have been most interested in altering perverse incentives that encourage lawsuits rather than settlements. They have understood the value of broad, bipartisan reform coalitions—and the folly of waging wars that pit businesses against consumers. Unfortunately, however, they have yet to convince most of their business colleagues to abandon the old take-rights-away reform strategies.

The Bush administration has paid lip service to new-agenda reforms, but—sadly and surprisingly—has reverted to the old, failed scripts when the chips have been down. Here's what's available on the tort-reform front and what the Bush administration has done—or more accurately failed to do—in three critical areas.

Malpractice reform. Not surprisingly, Tom Daschle has eaten the administration's lunch on the patients' bill of rights. In the debate, the White House has taken the classic loser's position: accepting the Democrats' emphasis on lawsuits, but also calling for such "responsible" restrictions as capped pain-and-suffering damages and procedural barriers against getting to court. Predictably, the White House position hasn't held, and the president has been tagged with the classic Republican caricature: "too close to big business" and "no friend of the little guy."

A better approach to malpractice reform was proposed more than 15 years ago by—remarkably—Richard Gephardt. His reform required malpractice claimants seeking pain-and-suffering damages to prove their cases under a near-impossible "beyond any reasonable doubt" standard—*but only if* they had first received and rejected defendant offers to pay all of their lost wages, unreimbursed medical costs, and reasonable hourly attorney fees.

Had the White House gone with the Gephardt bill—or with a more consumer-friendly version introduced in 1995 by Sens. Mitch McConnell and Spencer Abraham—it could have seized the initiative in the patients'-rights debate. It would have been on the side of quickly reimbursing malpractice victims for their actual losses. It would have been able to exploit Rep. Gephardt's claim that the reform created a "preferable system [that] makes . . . recovery . . . cheaper, more rational, and . . . fairer." Gephardt, now the House minority leader, would surely have opposed the legislation he once championed—and Republicans would have been able to exploit that opposition as evidence of the tort bar's veto power over Democratic-party policies. Ironically, the reform would have effectively abolished—not merely capped—most malpractice pain-and-suffering claims; it also would have achieved massive attorney-fee reductions, and far greater health-care cost savings than the administration's current proposal will ever produce.

Years ago, Dick Gephardt figured out a way to reform the medical-malpractice system by devising *newer* rather than *fewer* consumer rights. To its great disadvantage, the Bush administration has not done so. Along with health-care consumers, it's paying a steep price for that failure.

Auto Choice. The administration is missing an equally great opportunity by failing to promote auto-insurance legislation strongly supported by an amazing coalition: Dick Armey, Mitch McConnell, the Chamber of Commerce, John McCain, Joe Lieberman, the Democratic Leadership Council, Michael Dukakis, National Conference of Black Mayors president

Mr. Horowitz is a fellow at the Hudson Institute.

/ellington Webb, the *New York Times*, *USA Today*, and 9 of the ountry's 16 largest-circulation newspapers.

The bill offers drivers the right to decide whether to partici-ate in, and pay for, the auto-tort system's wildly expensive pain-nd-suffering component. It separates pain-and-suffering claims rom the "economic loss" elements of state tort law, and allows :onsumers to choose both coverages—or economic-loss cover-ige only. It thus empowers drivers to opt for $40 *billion* in annu-al insurance-rate reductions; New York senator Pat Moynihan described it, in 1998, as "the largest tax cut of the decade."

Today, many drivers spend more on annual insurance premi-ums than their cars are worth, and a high proportion of the country's working-poor drivers must spend *more than 30 percent of their total disposable income* to buy minimum-coverage policies that barely compensate those they injure. Auto-choice reform deals directly with this problem by permitting drivers to save, on average, 23 percent of their total auto-insurance costs—with low-income drivers able to save an average of 36 percent. The reform reverses the priorities of a system that now pays billions for whiplash claims but only nine cents on the dollar to accident victims whose medical and other economic injuries exceed $100,000. (This is why Jim Brady and the International Brain Injury Association support auto-choice reform.)

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Reforming lawyer fees enforces the central premise of all codes of legal ethics.

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Because pain-and-suffering cash awards are calculated at two to three times medical costs and thus generate wildly excessive use of physician and chiropractor services, the reform would also target the system's principal source of fraud. It would undo the system's inexcusable payment of two dollars to lawyers for every dollar paid for medical services, lost wages, and related out-of-pocket costs, and would radically reduce the tort bar's estimated $15 billion to $20 billion annual take from auto cases. The reform would tap into growing voter outrage at the cost of driving, and force its opponents to claim that Americans can't be trusted to decide whether to spend $40 billion per year on pain-and-suffering insurance, on safer cars, or on food and medicine for their families.

Failure to support this reform loses the president the opportunity to join Michael Dukakis and the *New York Times* in opposing an unpopular, fraud-driven system. It's hard to see why he doesn't take it up.

Lawyer fees. Directly related to the integrity of the country's legal, commercial, and political systems, this may be the most important of all tort reforms. Its purpose is to enforce the central premise of all codes of legal ethics—that lawyers are fiduciaries subject to outside, neutral review to determine whether their clients have been fairly and reasonably treated.

The issue arises because of the rapidly growing epidemic of manifestly unethical multibillion-dollar fees paid to lawyers in mass-tort cases. These fees, paid as flat percentages of final settlements, often exceed effective rates of $200,000 *per hour* and bear little relation to the risks assumed by the lawyers when they were hired. The fees are paid nonetheless, because a whole industry put at risk of bankruptcy by the verdict of a single jury has no prudent alternative but to settle such a case without regard to its legal merits; and such a settlement can be reached only if the lawyers who brought the case are satisfied.

To be sure, appropriate incentives are needed to permit lawyers to represent consumers against powerful business interests. But "mere" multimillion-dollar paydays for prevailing lawyers should be more than adequate to do so—an obvious point, proven by the so-called "shareholder" cases brought on behalf of injured investors. In those cases, courts establish "lodestar" hourly rates roughly equal to what defense lawyers receive, and then multiply the rates by as much as six times to compensate winning plaintiffs' attorneys for the risks they assumed and the excellence of their work. The lure of $1,000-to $2,500-per-hour payments has more than ensured a full supply of sophisticated counsel in shareholder cases—and makes abundantly clear that ten- and eleven-figure mass-tort-case paydays involve unethical expropriations of clients' money.

Enacted in 1996, the Jim and Tammy Faye Bakker provisions of the tax code offer a model for reform. They compel fiduciaries receiving unreasonably large payments from charities, pension funds, or foundations to return their excess payments or pay two dollars to the IRS for every unreasonable dollar kept. Applying the same provision to the mass-tort lawyers—whose ethics codes expressly restrict them to reasonable fees—would ensure multibillion-dollar client paybacks.

Happily, the president endorsed this reform during the campaign, and again in his budget. Unhappily, it's not clear that he will seriously press for its enactment.

Strange that this should be so, for the president should know from his Texas experience what the country will look like if 20 or so tort-lawyer billionaires are created in the next five to ten years through gun-to-the-head payoffs from the soft-drink, fast-food, oil, alcohol, gun, and other industries. He should understand the undemocratic character of nationwide "tort taxes" enacted without congressional approval. He should realize that the reform will generate direct tension between client-voters and overreaching lawyers. He should welcome an up-or-down congressional vote on whether it should be the Massachusetts Health Department—or the small group of politically wired lawyers who brought a late-filed, copycat tobacco lawsuit—that receives the bulk of an incredible $750 million fee now scheduled to be paid. The president and the country would profit from debate over whether Maryland taxpayers—or Democratic contributor Peter Angelos—should receive the overwhelming share of the $1.2 billion tobacco fee that Angelos is seeking, for a case brought under a statute that, in the words of the state-senate president, "changed centuries of precedent to ensure a win."

Today's tort-reform debate echoes the days when the Left controlled politics by offering bigger and better voter benefits, with conservatives consigned to minority status for doing little but saying "no" and "less."

New-agenda tort reforms do what supply-side tax cuts have done: allow conservatives to throw away their green eyeshades, offer tangible benefits to consumers, and gain broad support. And, for a change, prevail. **NR**

SS/ RM NO. Brett

WHITE HOUSE STAFFING MEMORANDUM

Date: 10/12/01 ACTION / CONCURRENCE / COMMENT DUE BY: 10/12/01 11:00 AM

Subject: TERORISM INSURANCE

	ACTION	FYI		ACTION	FYI
VICE PRESIDENT	☑	☐	HUBBARD	☑	☐
CARD	☑	☐	IRASTORZA	☐	☐
HUGHES	☑	☐	JOHNSON	☑	☐
ROVE	☑	☐	LINDSEY	☑	☐
BOLTEN	☑	☐	SPELLINGS	☑	☐
HAGIN	☑	☐	MIERS	☐	☐
DANIELS	☑	☐	RICE	☑	☐
BLAKEMAN	☐	☐	CONNAUGHTON	☐	☐
CALIO	☑	☐	GERSON	☐	☐
FLEISCHER	☑	☐	CLERK	☐	☐
GONZALES	☑	☐	_____	☐	☐
HAWKINS	☑	☐	_____	☐	☐

REMARKS:
PLEASE FORWARD YOUR COMMENTS TO MARC SUMERLIN, EXTENSION 65584, BY 11:00 AM TODAY AND SEND A COPY TO THE STAFF SECRETARY. THANK YOU.

RESPONSE:

We have serious concerns whether the President should agree to this proposal, which is beyond what industry even sought and is a major departure from the approaches that were being seriously contemplated by the Working Group.

Brett Kavanaugh 6-7984

Harriet E. Miers
Assistant to the President
and Staff Secretary
Ext. 62702

October 12, 2001

MEMORANDUM FOR THE PRESIDENT

THROUGH: LARRY LINDSEY

FROM: MARC SUMERLIN

RE: TERRORISM INSURANCE

The White House, OMB, CEA, and the Departments of Treasury, Commerce, and Transportation have developed a consensus proposal for the federal government to provide coverage for losses incurred in terrorist attacks. If you approve of the proposal, we will start working with the relevant members of Congress immediately on legislation.

Problem

The September 11 tragedy has generated considerable confusion in the insurance market. Reinsurers argue that they will no longer cover acts of terrorism after their existing policies expire because: 1) they cannot price the risk; and 2) they will not risk absorbing another enormous loss after just suffering $30-$50 billion in losses. Lenders usually require businesses to insure any property they use to secure loans. Without terrorism coverage, banks may not lend to new construction projects and many existing commercial properties (skyscrapers, pipelines, power plants, etc.) may not be able to change hands.

Need for a Federal Role

Without clear policies about the government's role, the default position will be for the federal government to step in and offer aid whenever terrorists strike. An explicit policy towards terrorism insurance could reduce the government's ultimate liability. In addition, when terrorists target symbols of our nation's economic, political and military power, they are attacking the nation as a whole and not the symbol. Thus, some argue the cost should be spread across all taxpayers.

There are also reasons to limit the federal role. If property owners do not face any liability from potential attacks, they may under-invest in security measures and backup facilities. In addition, the insurance industry has resources available to share in the cost of coverage. In 2000, the U.S. property and casualty insurance

market had an annual revenue flow of $297 billion and a policyholder surplus of $320 billion.

Is this the right approach?

Terrorism Insurance Proposal

Our plan would limit the immediate disruptions in the insurance market and preserve a role for the private sector in the future. In the first year, the government would absorb 100 percent of all losses from terrorist acts. To preserve flexibility in an extraordinary attack, the federal government would not pay losses in excess of $100 billion without explicit approval by the Congress.

No percentage whatsoever for private carriers to pick up?

The role of the federal government would recede over time, forcing the private sector to develop its capacity each year. In the second year, the private sector would be responsible for 100 percent of the first $10 billion of losses, 50 percent of the losses between $10 and $20 billion, and 10 percent of the losses above $20 billion. In the third year, the private sector would be responsible for 100 percent of the first $20 billion of losses, 50 percent of the losses between $20 and $40 billion, and 10 percent of the losses above $40 billion. The legislation would sunset after three years, so that lawmakers could reevaluate the need for federal intervention.

This seems extraordinary and well beyond what industry even wanted!

Scope of government coverage

We recommend that the government backstop be limited to property, liability, and worker's compensation insurance. We do not believe there is a need to extend coverage to business interruption, health, or life insurance at this time.

No premiums of any kind payable to government?

Limitations on Liability

We believe it is important to ensure that any liability arising from terrorist attacks results from genuine, avoidable negligence rather than overzealous litigation. We recommend the following policies:

- Claims arising from a terrorist incident would be consolidated in a single federal forum.
- For any civil action from a terrorist event against anyone other than the perpetrators, aiders, or abettors, punitive damages would not be available.
- For any civil action from a terrorist event against anyone other than the perpetrators, aiders, or abettors, non-economic damages would be proportional to the defendant's individual responsibility for the harm. For economic losses, ordinary rules of joint and several liability would apply. Non-economic losses

include losses for pain and suffering, mental anguish, and loss of enjoyment of life; economic losses include medical expenses, lost earnings, and other out-of-pocket expenses.

Definition of Terrorism

Treasury, NSC, and White House Counsel are still developing a definition of terrorism that will be applicable to the insurance industry without raising any foreign policy concerns.

Recommendation

We recommend that you agree to the terrorism insurance proposal:

_____ Approve

_____ Disapprove

_____ Discuss