

DEPARTMENT OF HOMELAND SECURITY
Office of Inspector General

**A Review of the World Trade Center
Captive Insurance Company**



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Preface

The Department of Homeland Security Office of Inspector General (OIG) was established by the *Homeland Security Act of 2002 (Public Law 107-296)* by amendment to the Inspector General Act of 1978. This is one of a series of audit, inspection, and special reports prepared as part of our oversight responsibilities to promote economy, efficiency, and effectiveness within the department.

This report addresses concerns raised by Congressman Jerrold Nadler regarding the World Trade Center Captive Insurance Company's handling of claims arising from debris removal work at the World Trade Center site following the September 11, 2001, terrorist attacks. It is based on interviews with employees and officials of relevant agencies and institutions, direct observations, and a review of applicable documents.

The recommendations herein have been developed to the best knowledge available to our office, and have been discussed in draft with those responsible for implementation. It is our hope that this report will result in more effective, efficient, and economical operations. We express our appreciation to all of those who contributed to the preparation of this report.

A handwritten signature in cursive script that reads "Richard L. Skinner".

Richard L. Skinner
Inspector General

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Abbreviations

DHS	Department of Homeland Security
FEMA	Federal Emergency Management Agency
OIG	Office of Inspector General
OMB	Office of Management and Budget
VCF	Victim Compensation Fund
WTC	World Trade Center

OIG

*Department of Homeland Security
Office of Inspector General*

Executive Summary

After the September 11, 2001, terrorist attacks in New York City and collapse of the World Trade Center (WTC) towers, city agencies and private contractors began to remove debris from the site. Contractors normally purchase insurance for such projects, and are reimbursed by the Federal Emergency Management Agency (FEMA). However, the magnitude of the disaster, ensuing environmental concerns, and the potential for unknown liabilities left the city and its contractors with insufficient insurance, as insurance markets were averse to the inherent risks of providing coverage for workers at the site.

Due to the risks assumed by the city and its contractors working without commercial insurance coverage, *Public Law 108-7* directed FEMA to provide up to \$1 billion to create an insurance company. New York City, with funding from FEMA, established the World Trade Center Captive Insurance Company in July 2004. The company was to insure the city and its contractors for claims arising from debris removal at the WTC and related sites. As of March 2008, individuals alleging health problems from work at the WTC site had filed 9,397 suits against the city and its contractors. While 6 claims totaling \$320,936 were settled with insureds for plaintiffs with broken bones and cuts, no claims involving alleged cases of respiratory problems, gastrointestinal illness, or cancer have been settled, since such cases are the subject of litigation.

Agreements between FEMA, New York State, New York City, and the World Trade Center Captive Insurance Company allow for payment of legal fees to defend insureds, which totaled \$103,700,734 as of March 2008. These agreements also permit the company to invest the federal funds to offset operational costs. As of March 2008, the company's assets totaled \$1,011,230,283.

The World Trade Center Captive Insurance Company also hired a private firm that specializes in third-party claims administration services. This firm has implemented procedures to receive and catalog claims, assess whether claims are covered under the insurance policy, and notify the defense counsel of lawsuits. We made five recommendations for FEMA to improve its oversight of the Captive's procurement process and financial reporting. FEMA concurred with all recommendations.

Background

Our review of the World Trade Center (WTC) Captive Insurance Company responds to concerns raised by Congressman Jerrold Nadler of “possible mishandling of claims brought by individuals who have suffered deleterious health effects as a result of their rescue and recovery work at the WTC site.” In his July 27, 2006, letter, Congressman Nadler questioned (1) why the Captive opted to litigate every claim that has been filed, (2) whether a process to handle such claims has been established, and (3) the amount of funds spent on legal fees to defend the city and other named insureds.

Immediately following the September 11, 2001, terrorist attacks in New York City, municipal agencies and private sector contractors worked with other responders to rescue survivors and remove debris from the collapsed WTC towers. In response to the attacks, President Bush declared a national emergency, triggering a federal response that drew several agencies, including the Federal Emergency Management Agency (FEMA), into the rescue and recovery effort. FEMA, under disaster number DR-1391-NY, ultimately expended about \$8.8 billion for rescue and recovery efforts in lower Manhattan. These funds covered rescue and debris removal operations, assistance grants to those affected by the tragedy, and compensation to municipal agencies for additional expenses related to the emergency response and recovery operations.

Throughout the recovery effort, the uniqueness of the disaster remained apparent. Beyond the sheer scale of the attack and the collapse of the 110-story Twin Towers, rescue and recovery workers faced over a million tons of debris nearly 12 stories high, fires that smoldered for almost 3 months, and layers of asbestos-laden dust, pulverized concrete, glass fibers, and other hazardous materials. Debris was transported from the WTC site by truck to various loading and unloading areas, transfer stations, and piers where additional sorting and recovery of human remains took place before final disposal.¹

¹ See Appendix E for a description of the “WTC site” locations.

Recovery Workers at the WTC Site in Lower Manhattan



Source: FEMA Photo Library

Municipal agencies and private contractors responded to the disaster immediately, without waiting to negotiate and sign contracts, search for adequate insurance coverage, or obtain indemnity for the work they would perform. AMEC Construction Management Inc., Bovis Lend Lease LMB, Inc., Tully Construction Co., Inc., and Turner Construction Company ultimately worked as the four prime contractors at the WTC site, in addition to dozens of subcontractors and consultants, collectively referred to as contractors.

While insurance coverage is normally a prerequisite for debris removal and a reimbursable expense under FEMA's public assistance program, neither New York City nor the contractors were able to purchase adequate insurance for their work at the WTC site. Commercial insurers were wary of issuing a comprehensive policy due to the uniqueness of the disaster and the potential for unknown liabilities resulting from exposure to hazardous materials at the site. Rescue and recovery efforts continued nonetheless. New York City was able to obtain \$500 million in marine insurance from Lloyds of London and \$79 million in general liability insurance from Liberty Mutual and London Market insurers for itself and its contractors. This coverage, however, was limited and insufficient. FEMA reimbursed New York City for the cost of that insurance coverage.

With the commercial insurance market unwilling to issue a comprehensive policy, New York City and the contractors initially sought federal immunity from potential liabilities associated with debris removal. This attempt was unsuccessful and the search for insurance coverage continued into 2002. New York City and its contractors continued to seek a federal solution, eventually gaining White House and congressional backing for a \$1 billion allocation of federal funds to address the insurance gap.

Throughout 2002, FEMA, officials from New York City and New York State, and contractor representatives held discussions on how best to secure the necessary coverage. Representatives from New York City and the contractors continued to meet with members of Congress and White House staff to discuss the issue. In December 2002, New York City, acting in conjunction with the New York State Emergency Management Office and the contractors, submitted a final proposal to FEMA, formally requesting that the federal government fund the creation of a captive insurance company with a \$1 billion premium. In general, captive insurance offers a means to acquire coverage for risks that might not otherwise be available, and to do so at a lower cost than through standard insurance companies. One or more entities may establish a captive insurance company, contributing premiums that can be invested and used to pay claims should the need arise. Under New York City's proposal, however, the federal government's grant would pay the entire premium for New York City and the WTC site contractors.

Creation of the WTC Captive Insurance Company

With White House and congressional support, FEMA participated in drafting legislation that authorized it to fund a captive insurance company. The legislation was reviewed and passed by Congress, signed by the President, and appeared in a Consolidated Appropriations Resolution in February 2003, which became *Public Law 108-7*. Specifically, *Public Law 108-7* directed FEMA to use "up to \$1,000,000,000 to establish a captive insurance company or other appropriate insurance mechanism for claims arising from debris removal, which may include claims made by city employees." The \$1 billion was allocated from the total \$8.8 billion appropriation that covered FEMA's reimbursements for the rescue and recovery efforts in New York City.

A FEMA official said congressional representatives were concerned about protecting the city and its contractors, due to their inability to acquire sufficient liability insurance coverage in the

commercial market, and the potential for enormous liability was factored into the decision to provide insurance coverage. FEMA responded to Congress' directive by coordinating closely with New York State, New York City, and the affected contractors to establish the World Trade Center Captive Insurance Company, Inc., hereafter referred to as the Captive. Agreements between FEMA and New York State, the state and the city, and the city and the Captive formalized this project and outlined many of the Captive's obligations. The Captive was incorporated in July 2004, and all agreements were officially signed by December 2004. After expending \$100,000 to hire insurance industry consultants to provide expertise on how captive insurance companies work, FEMA granted \$999,900,000 to New York State. The state then transferred the funds through a sub-grant to the city, which transferred the funds to the Captive as a premium, and the insurance company commenced operations.

As a captive insurance company, the Captive provides liability insurance to New York City and over 140 private contractors who participated in the recovery work in lower Manhattan and other areas used for debris removal. In addition to the agreements between FEMA, New York State, New York City, and the Captive, the insurance company is further governed by its own bylaws, certificate of incorporation, liability insurance policy, and applicable New York State insurance law. The insurance policy is issued to New York City and numerous private contractors, all confirmed as insureds. These documents were drafted through a collaborative process that involved FEMA, New York State, New York City, the contractors, and several private consulting firms. The Captive's liability insurance policy is the only policy it will issue, because the company's sole purpose is to provide insurance for New York City and its contractors that participated in debris removal from the WTC site.

The Captive's staff consists of four full-time employees, including a president, chief financial officer, general counsel, and an administrative assistant. A board of directors oversees the company's operation. This five-member body is appointed by the mayor of New York City and includes a contractor representative. In addition, several board members form an audit committee that is responsible for financial oversight of the insurance company. In early 2007, the Captive created a three-member advisory committee to resolve claims disputes.

The Captive contracts with private firms for much of its operational work. These companies provide services such as

claims administration and processing, document control, legal consultation and defense, financial and investment management, media relations, and administrative functions.

The Captive and Ongoing Litigation

As of March 2008, the Captive recorded 9,397 suits by individual plaintiffs against New York City and its contractors alleging they have been harmed through their work at the WTC site or by exposure to certain materials at or near the site. As of March 2008, the Captive had settled with insureds for six claims arising from WTC recovery work totaling \$320,936. One settlement in 2006 partially reimbursed a private insurer after its own decision to settle with a plaintiff who had suffered a broken bone. In May 2007, Captive officers said the company similarly settled with an insured regarding five additional claims involving broken bones and cuts from workplace accidents that were supported by medical records. According to the Captive's president, none of the settled claims were part of ongoing litigation in the federal courts. The Captive has not settled any claims involving alleged cases of respiratory problems, gastrointestinal illness, cancer, or fear of cancer, which continue to be the subject of litigation.

The ongoing lawsuits cite a range of complaints, from respiratory problems to fear of cancer. Medical research and clinical work performed since the terrorist attacks suggest that work and exposure to materials at the site likely resulted in or exacerbated certain respiratory and other health problems. Medical researchers and practitioners working on September 11, 2001, health issues agree that the full scope of the health effects of the disaster will not be known for decades, particularly regarding certain kinds of cancer.

As a basis for their suits, the plaintiffs allege that New York City and its contractors were negligent for not providing adequate safety measures, which resulted in these injuries or illnesses. Two New York City law firms that specialize in mass torts and personal injury cases have coordinated the plaintiffs' lawsuits. In August 2005, those firms filed a master complaint on behalf of named and unnamed individuals in the U.S. District Court for the Southern District of New York requesting trial by jury to resolve these allegations.

The Captive, on behalf of New York City and the more than 140 private contractors it insures, has consolidated and funded the defense against lawsuits. Though many lawsuits were initially

filed in state court, the Second Circuit Court of Appeals ruled in 2005 that the Airline Transportation Safety and System Stabilization Act, passed by Congress after the September 11, 2001, attacks, channeled all related litigation to the U.S. District Court for the Southern District of New York.

Defense attorneys hired by the Captive to represent New York City and its contractors argued for broad immunity from liability for the work conducted at the WTC site. In October 2006, the district court judge ruled that the defendants might be benefited by “limited immunity” but that each case must be decided on an individual basis through a process of discovery and possibly by trial. The defendants appealed the district court’s ruling, again arguing for broad immunity. The Second Circuit Court of Appeals agreed to consider the defendants’ appeal of the lower court’s ruling and, in March 2007, issued a stay of trial and pretrial proceedings pending resolution of the immunity question.

In March 2008, the appeals court ruled that under New York state law, defendants were not entitled to immunity from suit, but that they might be entitled to immunity from liability. Thus, the plaintiff construction workers, firefighters, police, and others are to be allowed to pursue their claims, and defendants can raise immunity as a defense to liability, to be determined under state law. The court further ruled that defendants might benefit from federal derivative immunity, depending on the defendants relationship with federal agencies involved in managing the WTC site. Significant fact-finding remains to resolve the complex questions whether the federal government was acting within the scope of its immunity for discretionary functions, the levels of control and direction federal agencies exercised over the New York defendants’ activities, and whether the defendants violated state statutes. The ruling returned the litigation to the district court, which has initiated discovery proceedings. The district court judge requested the submission of documentation to further develop claims against New York City and its contractors.

According to Captive officials, if legal proceedings determine the validity of claims and liability is established, the Captive will pay those claims. If litigation advances to where affected parties are willing to negotiate, Captive officials will negotiate in good faith.

Results of Review

The Captive's Litigation of Claims Does not Violate *Public Law 108-7* or the Grant and Subgrant Agreements

Based on *Public Law 108-7*, accompanying House Conference Report 108-10, and the grant agreements, we conclude that the Captive is operating pursuant to, and not in violation of, these mandates and other documents that guide the Captive's actions, including the liability insurance policy. *Public Law 108-7* directed FEMA to provide up to \$1,000,000,000 to establish a captive insurance company or other appropriate insurance mechanism for claims arising from debris removal, which may include claims made by city employees. In House Conference Report 108-10, Congress stated that the insurance will provide the City of New York and its debris removal contractors with coverage for claims arising from debris removal performed after collapse of World Trade Center buildings on September 11, 2001, including claims brought by City of New York employees.

Congressional Support for New York City's Insurance Proposals

New York City submitted a May 13, 2002, proposal to FEMA requesting "funding as needed to pay the premium, plus associated costs, for an insurance policy providing a minimum aggregate limit of liability amount equal to \$1 billion of non-risk-transfer insurance, whether in the form of finite risk or captive insurance." On June 20, 2002, FEMA approved the city's proposal with stipulations that the city and state provide a detailed package describing the mechanism for implementing the insurance coverage and the manner in which the insurance carrier would be funded. FEMA also acknowledged that there would be a minimum of \$1 billion in insurance.

In December 2002, New York State submitted a final proposal to FEMA, including a detailed response to FEMA's request, on how the required insurance coverage could be acquired. New York State, New York City, and the private contractors submitted a "joint insurance package that will protect all the entities involved in the debris removal project to accomplish the mission of the FEMA approval letter." This proposal described the need for insurance coverage due to "substantial losses or extensive litigation costs to defend against such allegations." The proposal also outlined the need for insurance due to "vast litigation and defense costs exposure for the Contractors and the City" generally associated with mass tort cases. The proposal concluded that, "The

City and contractors will have to incur considerable legal expense simply to manage and refute such claims.”

At the time this document was created, many claims had already been filed against New York City and its contractors, and the timing and volume of future claims was uncertain. In accordance with the December 2002 proposal, “The Captive has been structured to preserve all available defenses and mitigants to lawsuits brought against the insured, including City immunities for emergency response, ... and whatever recourse City workers may have under the Victim Compensation Fund.” The Victims Compensation Fund (VCF) was created to compensate victims or their families for death or injuries resulting from the terrorist attacks. Acknowledging that lawsuits were inevitable, it provided that the “existence of a funded Captive will not change the litigation dynamics in any appreciable fashion.”

The New York State and New York City proposals received endorsements from members of both the United States Senate and the United States House of Representatives, as documented in their letters to FEMA in May and December of 2002. In two separate but similarly worded letters sent to FEMA in May 2002, both New York State Senators and thirty New York State Representatives urged the agency to give a “prompt review and approval of the City’s proposal.” In these letters, members of Congress noted that “because of the extraordinary circumstances of the attacks, and the need to begin recovery efforts immediately, the contractors began work without securing insurance coverage. Despite the City’s best efforts, the private insurance market has provided only minimal liability coverage, and none for potential environmental damages.”

These letters express appreciation for the Administration’s commitment to help “fill the insurance gap by providing the resources that will enable the City to secure \$1 billion in insurance on its own behalf and for the contractors.” They also added, “The coverage envisioned in this proposal will ensure that sufficient resources will be available to satisfy legitimate claims by individuals affected by the recovery operations while safeguarding the fiscal health of the City and the contractors.” Both New York State Senators wrote to FEMA again in December 2002, noting that the response “was prepared by the City, in close cooperation with the Contractors, and is fully supported by the State.” The senators urged FEMA to give the submission “prompt and favorable review and to provide the requested \$1 billion in funding,” and thanked FEMA for its commitment to meet the insurance needs of the City and the Contractors related to the

massive debris effort at the WTC site, noting that all the parties involved in the debris removal undertaking would be protected.

Criteria for Captive Operations

Following approval of New York City's final proposals and the passage of *Public Law 108-7* in February 2003, FEMA began to work with New York City, State, and the contractors to create the Captive. Three agreements clarify the provision of federal funds from (1) FEMA to New York State, (2) New York State to New York City, and (3) New York City to the Captive. The grant agreement between FEMA and New York State and the subgrant agreement between New York State and New York City anticipate and incorporate defense costs and responsibilities into their terms, which are further outlined in the Captive's liability insurance policy. The terms of the New York City and Captive agreement are intended to ensure the Captive's conformity with the grant and subgrant agreements.

Third-party liability insurance offers specific protection for insured parties in the event of a lawsuit. When a lawsuit is filed, the insurer is obligated to defend its insured pursuant to the insurance policy issued. The Captive's liability insurance policy, certificate of incorporation, and bylaws were incorporated by reference into the New York State and New York City grant agreements, and provided the foundation for the Captive's obligation to defend its insureds.

The Captive exercises its duty to defend by litigating lawsuits filed against New York City and its debris removal contractors. The Captive's involvement in ongoing litigation is consistent with these documents, as well as with statements from federal, state and local officials on the intended operation of the Captive.

FEMA - New York State Grant, New York State - New York City Subgrant, and New York City - Captive Agreements

According to a FEMA official, FEMA took the lead in drafting the grant agreement. In addition, FEMA hired attorneys that specialized in captive insurance to provide advice on establishing a captive insurance company and to draft the terms of the grant agreement.

In November 2004, FEMA and the grantee, New York State Emergency Management Office, entered into the

grant agreement for the Captive project. The State Emergency Management Office also entered into a subgrant agreement with New York City in November 2004. That subgrant agreement was based on the terms and conditions of the FEMA and state grant agreement.

In September 2004, New York City entered into an agreement with the Captive to provide insurance pursuant to the liability insurance policy. The agreement, signed in anticipation of the federal-state grant, was entered into to ensure compliance with the expected terms and conditions of the FEMA grant agreement and the State Emergency Management Office subgrant agreement.

Liability Insurance Policy

According to a Captive official, the Captive Liability Insurance Policy, Section 2.04(a), governs the business of the company, outlines the duty to defend, and establishes the scope of operations. Captive officials also explained that not taking action to defend its insureds would be a breach of its duty, and that the company is constrained by the terms of the grant agreement and the insurance policy.

The Captive's liability insurance policy, which became effective retroactively to September 2001, specifies the company's right and duty to defend an insured against any suit seeking damages to which the policy applies, even if the suit is groundless, false, or fraudulent. The duty to defend includes providing and paying for legal counsel in the event lawsuits are filed against the insureds. The Captive assumes the defense of any covered pre-existing claim not resolved prior to the creation of the Captive, pays fees and expenses of the appointed defense counsel, and becomes responsible for any settlement, judgment, or other disposition of the claim. In the event of a settlement or final judgment in a suit, the Captive will pay the amount due when it has received evidence of its obligation to pay. Also included in the liability insurance policy is the Captive's right and obligation to appoint and retain counsel for defending suits against its insureds.

Should a lawsuit against an insured succeed, either through a jury decision or settlement, the Captive's attention would focus on financial compensation. Pursuant to the coverage clause of the Captive's liability insurance policy, the

company will pay any monies its insureds are legally obligated to pay provided the claims fall into at least one of the following categories:

- General liability – liability arising from bodily injury or property damage;
- Marine liability – liability arising from the use of barges in transit on the Hudson River or other waterways, to include piers, docks and adjacent facilities for loading and unloading, on which such barges operated in furtherance of debris removal;
- Environmental liability – liability arising from the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of pollutants into or upon the land, water, atmosphere, or any other natural resource damage; or
- Professional liability – liability arising from any alleged act, error or omission, misstatement, misleading statement, neglect or breach of duty committed in the performance of professional services.

Claims must have arisen from any occurrence of illness or injury that is one or a series of accidents, happenings, or events. Also, claims must arise from an exposure, or continuous or repeated exposures, to conditions that result in damages covered under the insurance policy that resulted from work during the exposure period. The exposure period began with the removal of debris starting September 11, 2001, until August 30, 2002. All exposures to the same general conditions existing at or emanating from the WTC site are considered one occurrence.

We received the following comments concerning the Captive's duties and responsibilities under the liability insurance policy:

- A New York City Office of Management and Budget official said the Captive was authorized through the federal legislative process, and was taking the expected legal action to defend its insureds against claims. The official further explained that the Captive was abiding by the terms of its agreement with the city and all reporting requirements.

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- A New York City Law Department official said the liability insurance policy was for the benefit of the city and its contractors to protect their interests in the event of lawsuits, and the Captive has a contractual and legal obligation to defend the insureds.
 - New York State Insurance Department officials explained that the purpose of the Captive was to indemnify New York City and private contractors for liabilities incurred during the WTC clean-up. The officials also said the Captive is obligated under its insurance policy to provide a legal defense for its insureds.
 - A former board member and contractor representative who worked for one of the four primary contractors said he believed the Captive had a fiduciary responsibility to the insureds because the contractors did not cause the problem; they were trying to solve it.
 - A FEMA official said the Captive was created as an insurance company to protect the interests of New York City and its contractors by defending them against claims arising from clean-up efforts at the WTC site after the terrorist attacks.
 - Captive officials said the liability insurance policy governs the business of the company, outlines the duty to defend, and establishes its scope of operations. Captive officials explained that not taking action to defend its insureds would be a breach of its duty, and the company is constrained by the terms of the grant agreement and insurance policy.

Certificate of Incorporation

The Captive's certificate of incorporation became effective in June 2004, and characterizes the company as a not-for-profit corporation formed to provide insurance for debris removal occurring on or after September 11, 2001. The insurance was solely for liabilities incurred by New York City and its affiliated companies. The insurance law for New York State, which regulates the Captive, defines affiliated companies as contractors, subcontractors, and consultants of New York City.

The Captive is authorized by the insurance law of New York State to transact business covering personal injury liability. The certificate of incorporation defines personal injury liability insurance, in part, as insurance against legal liability of the insured, and against loss, damage, or expense incident to a claim of such liability. The claims must arise from the death or injury of any person, or arise out of injury to the economic interest of any person, as the result of negligence in rendering expert, fiduciary, or professional service. It is further defined as insurance to protect an insured against liability for indemnification or contribution to a third party held responsible for injury to the insured's employee arising out of and in the course of employment.

Bylaws

The Captive's bylaws specify that the company shall receive grant funds pursuant to the grant agreement between FEMA and the New York State Emergency Management Office. The bylaws also indicate that the Captive shall not take any action that conflicts with the provisions of the grant agreement without prior written notice to FEMA, and shall conduct its affairs in compliance with the terms of the agreement. The bylaws also describe how the Captive issues a liability insurance policy to New York City as the named insured, and the contractors as additional named insureds, effective September 2001.

The Captive's Litigation of Claims

The ongoing litigation regarding debris removal claims with which the Captive is involved, while delaying possible relief to those with health problems arising from debris removal work, conforms to the Captive's mandate as an insurance company to defend an insured against any suit seeking any damages. Immunity is an available defense which New York City and contractors have urged the Captive to assert. In interposing immunity defenses, the Captive is not acting inconsistently with its charter, which conforms to *Public Law 108-7*.

We recognize the increased concerns regarding the number of claims the Captive has settled when compared to the thousands of individuals who allege health problems as a result of their work at the WTC site. However, the process of determining the legitimacy of lawsuits filed against New York City and contractors has been

ongoing in both the Second Circuit Court of Appeals and U.S. District Court for the Southern District of New York. As of April 2008, this process is proceeding through the discovery phase at the district court level. Importantly, in the context of tort litigation, which *Public Law 108-7* was enacted to address, determining the legitimacy of the claims depends not only on the existence of an illness or injury linked to WTC debris removal work, but also on whether another party's negligence caused such illness or injury.

Many agree that the tort system may not be best suited to providing compensation to WTC victims. Officials from both the Captive and New York City have publicly advocated meeting the needs of individuals injured as a result of debris removal efforts through other means. Specifically, in February 2007, the mayor of New York City proposed reopening the September 11th VCF to help ailing workers receive relief without having to prove fault. He also recommended granting immunity to the city and contractors, which would further help redirect claims away from the courts.

According to a February 13, 2007, statement by the Captive, its officials share the mayor's view that a VCF would provide a better way to resolve the claims of those involved in the post-9/11 rescue, recovery and debris removal process than the tort system and the current costly and time-consuming litigation. Captive officials stated, "It is within the congressional prerogative to create a new, or reopen the old, Victim Compensation Fund, which would make funds available on an appropriate and equitable basis to those involved in the post-9/11 rescue, recover and debris removal process."

Unlike the VCF, which was created to compensate victims or their families for death or injuries resulting from the terrorist attacks, the Captive was created as an insurance company to insure and defend New York City and its contractors from claims arising from debris removal at the WTC site. As such, the Captive operates differently from the VCF by legislative design, and cannot automatically pay claims without adhering to its insurance policy.

The Captive's Expenditures Are Offset Through Investment Income and Guided by Internal Controls

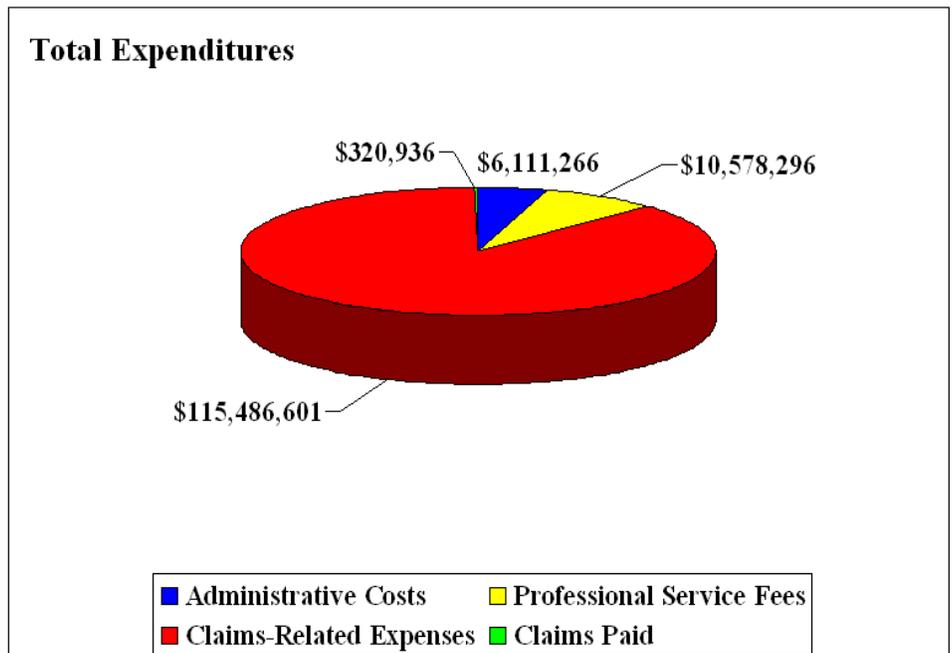
The grant agreements signed by FEMA, New York State, New York City and the Captive permit the insurance company to earn income by investing the \$999,900,000 premium. As a result of its investment strategy, the Captive has increased the value of FEMA's initial premium to

\$1,011,230,283 as of March 2008. The Captive also developed a system of internal controls that, if followed, should improve its ability to comply with the grant agreements.

Expenditures

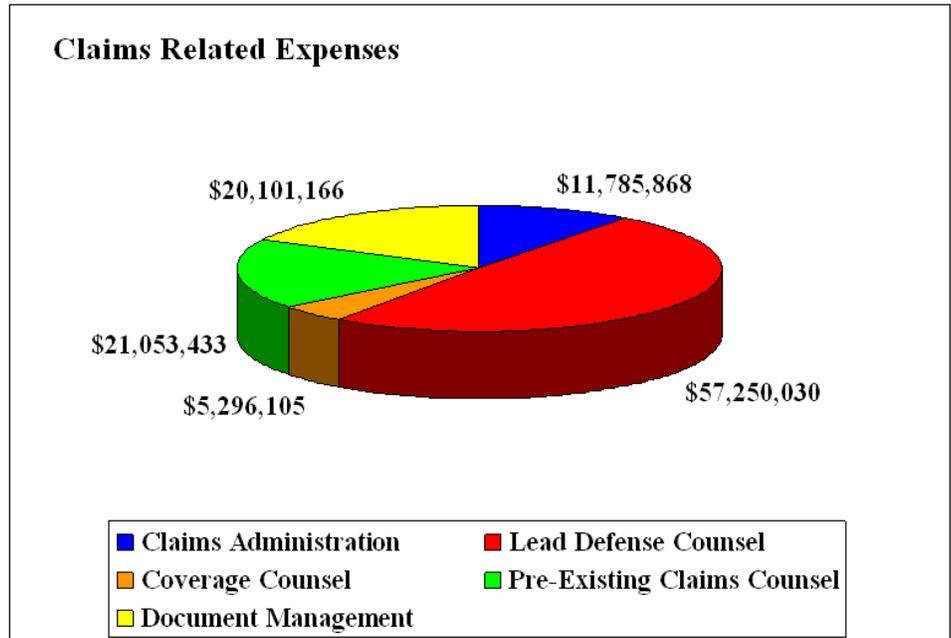
As shown in Chart 1, as of March 2008, the Captive’s expenditures totaled \$132,497,099. This includes administrative costs - staff salaries and office expenses; compensation for professional services - banking and accounting activities; claims related expenses - legal fees and claims administration; and claims paid. Chart 2 illustrates that claims-related expenses, including costs of attorneys and other legal services, totaled \$115,486,601 as of March 2008.

Chart 1: The Captive’s Total Expenditures as of March 2008



Source: WTC Captive Insurance Company

Chart 2: The Captive's Claims Related Expenses as of March 2008



Source: WTC Captive Insurance Company

As defense and plaintiffs' attorneys continue to argue before the courts, the Captive will continue to incur legal expenses on behalf of New York City and its debris removal contractors. The Captive's president said that the nature of tort liability involves proving damages through trial or negotiated settlements, a time consuming and costly process.

While FEMA does not control the Captive's expenditures, the grant agreements permit it to request cost-cutting measures. FEMA officials said they had not requested a reduction in the Captive's spending because no discrepancies or violations of the grant agreements had occurred.

Investments

The agreement between New York City and the Captive required the development of a general investment strategy for FEMA grant funds to be used until the Captive hired an independent investment manager. After consulting with FEMA and receiving the funds in December 2004, the Captive invested in treasury bills and a money market fund.

The Captive hired BlackRock Financial Management, Inc., as its investment manager in March 2005, and the company began active management of the insurance company's funds in April 2005. BlackRock Financial Management, Inc., developed an investment strategy designed, in part, to preserve the invested assets and to provide sufficient liquidity for payment of the costs and expenses of Captive's operations. According to the Captive, the insurance company held \$1,011,230,283 in assets as of March 2008.

Internal Controls

The grant agreements include requirements for the Captive to comply with Office of Management and Budget (OMB) Circulars A-133², A-102³ and A-87⁴.

OMB Circular A-133 establishes objectives for internal controls pertaining to compliance requirements for federal programs that ensure proper and lawful execution and recording of transactions, as well as safeguarding funds, property, and other assets against loss from unauthorized use or disposition. OMB Circular A-102 requires nonfederal entities receiving grant awards to establish and maintain internal controls to ensure compliance with federal laws, regulations, and program compliance requirements. OMB Circular A-87 provides for a uniform approach for determining costs and to promote effective program delivery, efficiency, and better relationships between governmental units and the federal government.

The Captive developed and documented internal controls to guide its day-to-day operations and fiscal responsibilities. These controls govern employment practices, legal and regulatory compliance, financial reporting, and information technology and data storage. We reviewed the Captive's internal control manual and determined that it included adequate processes and procedures to comply with the applicable OMB circulars.

In addition to our review, the Captive's internal controls were reviewed by Johnson Lambert & Co., an independent accounting firm. In March 2005, the Captive hired Johnson Lambert & Co. to conduct annual audits of its financial reports. The company issued an audit report in April 2005 for 2004, a report in April 2006 for 2005, and a third report for 2006 in March 2007. These audit

² OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, June 26, 1997

³ OMB Circular A-102, Grants and Cooperative Agreements With State and Local Governments, October 7, 1994, further amended August 29, 1997

⁴ OMB Circular A-87, Costs Principles for State, Local and Indian Tribal Governments, May 10, 2004

reports concluded that the Captive complied, in all material respects, with all requirements of OMB Circulars A-133, A-102 and A-87. The reports further concluded that the Captive's internal controls complied with the requirements of laws, regulations, contracts, and grants as required by OMB Circular A-133, and that there were no material weaknesses regarding the Captive's internal controls over compliance and its operation.

The agreements signed by FEMA, New York State, New York City, and the Captive provide that the insurance company is subject to additional oversight. The Captive's financial and performance reports, for example, are submitted to the following entities:

- FEMA
- House Appropriations Committee
- Senate Appropriations Committee
- New York State Emergency Management Office
- New York State Insurance Department
- Office of the New York State Comptroller
- New York City

Based on discussions with federal, state, and city officials, the Captive continues to fulfill its reporting requirements by providing the required information. FEMA officials in the Recovery Division and Grants Management Branch confirmed receipt of the required quarterly and annual reports. Officials from the New York State Emergency Management Office and New York State Insurance Department further attested to the receipt and completeness of Captive's reports. A New York City Office of Management and Budget official said he receives copies of the reports in his role as a member of the Captive's board of directors. These officials said that, based on their review of these reports, the Captive was functioning according to its obligations in the grant agreements.

Claims Administration Procedures Support the Captive's Current Activities

In January 2005, the Captive hired GAB Robins, a private firm that specializes in third-party claims administration services.⁵ At the Captive's direction, GAB Robins developed and implemented procedures to catalog claims received from an insured named in a lawsuit, as well as coordinate

⁵ In the fall of 2007, the Captive transferred claims administration functions from GAB Robins to Navigant Consulting, Inc. GAB Robins continues to handle specific administrative tasks.

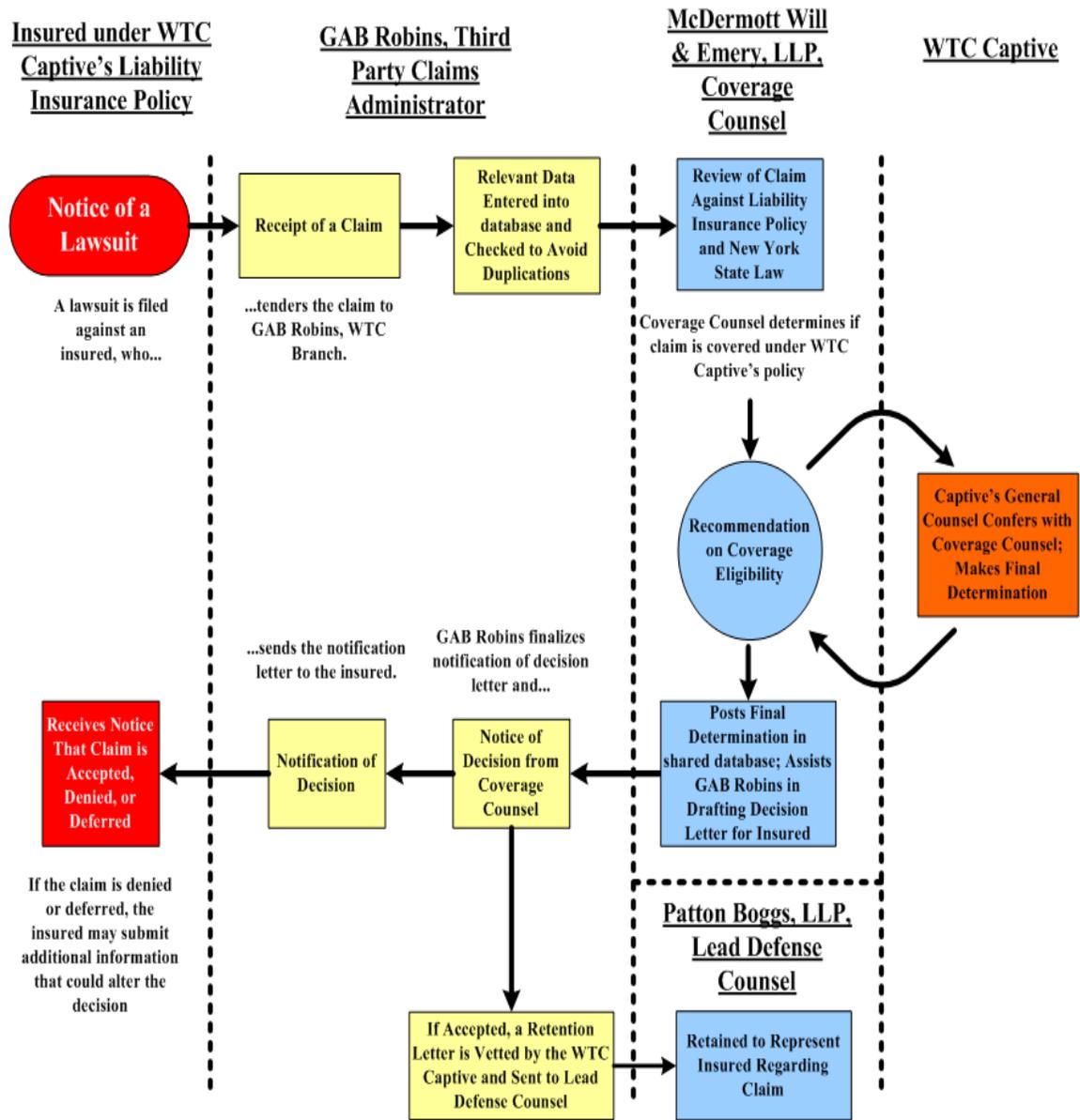
with the Captive's coverage counsel to determine each claim's coverage eligibility. This process allowed the Captive to determine whether claims were covered under its liability insurance policy, confirm the decision with its insureds, and notify the lead defense counsel of new lawsuits. As of March 2008, the Captive identified 9,397 plaintiffs who filed lawsuits or other pleadings against the Captive's insureds.

Once hired, GAB Robins developed procedures to receive legal documents from insureds and created electronic files using the information contained within each suit. Following receipt and documentation, complaints were sent to Captive's coverage counsel, McDermott Will & Emery, for coverage analysis. When a coverage determination was made, the claims administrator coordinated with the Captive, the Captive's insureds, and defense counsel to ensure that new lawsuits were accepted for defense.

McDermott Will & Emery undertakes coverage analysis on behalf of the Captive by determining whether claims in each complaint fall under the Captive's insurance policy or are excluded from coverage based on certain exceptions. Specifically, the exclusion section of the Captive's liability insurance policy bars liabilities for punitive damages, workers' compensation, disability, retirement benefits, fines, sanctions or penalties, and liability for intentional acts by an insured's employee. Claims are also reviewed to determine if they fall within the geographic and temporal limits of the insurance policy. McDermott, Will & Emery also confers with the Captive for a final decision on coverage eligibility.

GAB Robins managers told us that their process, from receipt of notice of a lawsuit to sending the notification of a decision, is completed within 45 days. Diagram 1 outlines the general steps involved in the Captive's claims administration activities as managed by GAB Robins. Appendix C provides a more comprehensive explanation of the Captive's claims administration process.

Diagram 1: Claims Administration Process



Source: The World Trade Center Captive Insurance Company and GAB Robins

Ongoing Litigation on the Claims Administration Process

New York City and its contractors initially argued before the district and appeals courts for broad immunity for their work at the WTC site based on state and federal laws. For this reason, the Captive's president informed us in February 2007 that traditional third-party administrator activities, such as direct contact with the plaintiffs' attorneys, claim investigation, and documenting damages, would be premature or inappropriate. GAB Robins' staff provided a similar assessment, saying that the extent to which the

claims administration process is implemented and the tasks involved depend on the litigation.

On March 26, 2008, the appeals court decided that state immunity laws may provide protection from liability rather than from lawsuit, and federal law may also provide protection from suit. The extent of these immunities will now be determined in district court, which has resumed discovery proceedings.

As of April 2008, the Captive had not broadened its claims administration procedures beyond those already described due to ongoing litigation. The plaintiffs have begun to submit additional information to support their claims and the Captive's lead defense counsel has begun to review this documentation. The Captive's president said that the responsibility for contacting the plaintiffs' attorneys and analyzing the documentation rests with the defense counsel. The Captive's claims administrator remains responsible for intake and cataloging of claims and providing notification of new lawsuits.

FEMA Oversight Activities Should Be Strengthened

According to OMB Circular A-123, "Management's Responsibility for Internal Control," management is responsible for developing and maintaining effective internal control, and should design management structures that help ensure accountability of results. In addition, internal controls must be established that reasonably ensure that funds and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation. As part of this process, agencies must take systematic and proactive measures to develop and implement appropriate, cost effective internal controls.

Under the grant agreement between FEMA and New York State, FEMA maintains full authority to negotiate, administer, and execute all terms and conditions of the grant agreement. While nothing came to our attention that would lead us to conclude that the Captive's operations have not been managed according to the grant agreement, we discovered specific areas related to financial reporting and procurement where FEMA's internal controls should be strengthened. Establishing such internal controls would provide greater assurance that the purpose of the grant is achieved, and federal grant funds are properly expended.

Oversight of the Captive's Financial and Performance Reporting

According to Article VII of the FEMA and New York State grant agreement, which describes FEMA's oversight role, the Captive must satisfy periodic reporting requirements that include submitting to FEMA:

- A report of each calendar quarter of losses incurred, losses paid, changes in experience account balances, and changes in individual and aggregate case reserves;
- Annual reports;
- Quarterly and annual financial statements; and
- Minutes for all meetings of Captive's board of directors and advisory committee.

The FEMA Grants Handbook, dated June 2002, establishes internal policies and procedures that govern FEMA's assistance management process for both non-disaster and disaster programs. The policies and procedures are intended to ensure that grant funds are used for approved purposes.

According to the Grants Handbook, monitoring FEMA's disaster grants is the joint responsibility of a disaster grants management specialist in the Grants Management Branch and a program officer from the responsible program office. Monitoring activities should include, at a minimum, quarterly reviews of financial and performance reports that are to be documented and placed in the official grant file. However, for the Captive grant, procedures for the coordination of monitoring activities between the grants management specialist and program officer have not been established, and there is no process to ensure the adequacy of financial and performance reviews. In addition, a system to ensure that all monitoring actions are appropriately documented and filed has not been developed.

A FEMA management official with extensive involvement in the creation of the Captive said the agency's oversight role was to review quarterly and annual reports submitted by the Captive. Another FEMA management official added that there is no precedent for establishing a billion-dollar insurance company after a terrorist attack. Consequently, there are no policies or procedures on exactly how to manage this project, as this situation is unique.

FEMA's Grants Management Branch

The Grants Management Branch is responsible for reviewing the grantees' financial and performance reports to determine their progress, as well as compliance with grant agreements. According to a FEMA grants management official, the office receives the Captive's financial reports from the FEMA program officer. A grants management specialist reviews the Captive's expenses, investment returns, and outstanding obligations for reasonableness. However, a written assessment of the review results is not prepared.

The Grants Handbook requires that the appointment of a grants management specialist and program officer consider a person's experience, training, and grants or program knowledge. A FEMA grants manager explained that numerous pages of back-up financial information are attached to the Captive's reports, such as balance sheets, financial status reports, and other documents that are not normally received. The official also said it was difficult to understand all of the financial information due to the level of detail. Moreover, FEMA does not perform a more thorough analysis of these documents because of staffing and time constraints. Therefore, this type of review results in the reports receiving "a really good glance."

A grants management official said that since the staff is short-handed, it uses signed and dated post-it notes to document status information. Also, some official information is documented in a memo-to-record. Both types of information become a part of the official file.

Communication between the grants management specialist and the program officer is informal. According to the grants management specialist, if discrepancies are found in a financial report, the program officer is contacted to resolve the problem before filing the report. However, no discrepancies have been found to date.

Program Office

Under the grant agreement between FEMA and New York State, the designated program office maintains responsibility for monitoring the technical performance of the Captive's activities as described in the project narrative. The program officer responsible for the Captive grant said that after receiving their financial reports, he reviews expenses and investments for any significant increases in expenses or decreases in investment returns that would

raise concerns that may need to be further explored. He also pays special attention to legal expenses and said that there has never been a reason for FEMA to request the Captive to initiate cost-cutting measures because most legal services are at reasonable rates.

The Captive grant is unique in that there is an initial performance period of 25 years from the effective date of the agreement, with provisions for extensions in 2-year increments. In addition, FEMA disbursed the entire award amount to the Captive at the beginning of the performance period, instead of through an allocation process that makes funds available for obligation. A grants management official said that, to their knowledge, this is the first time FEMA has transferred an entire award amount up front and for such an extended period of time. They also said that when the Captive award was granted, they knew the current staff would not be around for the close-out. Therefore, individuals replacing the present staff would have to become familiar with the grant by reviewing the files and making sure they know the major participants.

While we recognize that federal regulations do not outline a specific process for an awarding agency to assess the performance of a grantee, FEMA needs to establish a process to ensure the adequacy and consistency of reviews conducted of the Captive's financial and performance reports. Considering that many provisions of the Captive grant agreement are atypical in comparison to other FEMA grant awards, it is essential that a comprehensive financial and performance review process be established and documented. It is also important that the quality of this process provide assurance that grant funds are being properly expended.

Oversight of the Captive's Procurement Activities

In order to fulfill its mandate of insuring the city and its contractors for claims arising from debris removal at the WTC site, the Captive has solicited and awarded professional service contracts. These contracts include custodian and banking services, investment management, third-party claims administration, auditing, media and public relations, actuarial services, legal services, and Captive management.

The Captive's expense summary document shows \$126,064,897 in expenses for professional services from inception through March 2008. Due to the level of attention the Captive's contractual

service expenses have been subjected to from the media and other entities, we reviewed FEMA's internal controls over the Captive's solicitation and award procedures for professional service contracts.

According to the grant agreement between FEMA and New York State, the general management of the corporate affairs of the Captive is vested in a board of directors. FEMA officials said they approved pre-grant expenses until the funds were transferred to the Captive in December 2004. Since that time, the Captive and its board of directors have been solely responsible for expenditures as all grant funds are under their control.

The Captive's board of directors approved professional service contracts with minimal intervention by FEMA. A FEMA management official said that Captive's contracting requirements are not the sort that FEMA typically handles because the company is compelled to hire specialists within an insurance industry that is highly complex and technical. The official additionally said that FEMA is made aware of Captive's contracts through verbal presentations, board meetings, and reports. However, given the unique characteristics of this grant and FEMA's responsibility to ensure that federal grant funds are appropriately used, a more active role by FEMA in the procurement process is essential.

The FEMA and New York State grant agreement requires the Captive to comply with FEMA regulation, 44 Code of Federal Regulation (CFR) Part 13, "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments." However, the grant agreement exempts the Captive from 44 CFR Part 13.36, which covers the procurement of property and services. Instead, the Captive's procurement activities are governed by the requirements set forth in Exhibit A of the New York City and Captive agreement.

In general, Exhibit A outlines basic methods of procurement that parallel 44 CFR Part 13.36, but does not include all of the requirements. For example, under 44 CFR Part 13.36(g), an agency can request procurement information from the grantee or subgrantee under certain circumstances, such as when a procurement is expected to exceed specific thresholds and is awarded without competition, or is awarded to other than the lowest bidder under a sealed-bid procurement. In addition, 44 CFR Part 13.36(f) requires that a cost or price analysis be performed in connection with every procurement action. In contrast, these provisions are not incorporated in Exhibit A.

According to a FEMA management official, Exhibit A was developed to provide greater clarity of the procurement requirements, and provisions not included in Exhibit A were those not usually relied on by FEMA when administering 44 CFR Part 13. In addition, the separate procurement requirements make sure that Captive could compete in a highly specialized environment when possible.

A FEMA official said that, because FEMA does not typically deal with the types of contracting services the Captive requires, the agency would likely become involved “after the fact” regarding procurement issues. He said that service providers are costly, and FEMA does not become involved in the highly technical world of insurance.

According to a Captive management official, the company selected service providers pursuant to its procurement procedures. Generally, service providers are selected for an initial term of 3 years, and the agreements may authorize extensions beyond the initial term. The board of directors approves all selections and extensions. While there is not a specific limit on contract terms, the board has expressed a reluctance to extend an arrangement with a service provider beyond a term of 5 to 6 years without conducting a new request for proposal process.

Our review of documents related to the solicitation and award of current service provider contracts showed that the Captive has complied with the provisions as outlined in Exhibit A of the Captive and New York City grant agreement. However, although not specifically outlined in regulation, FEMA’s participation in Captive’s solicitation, award, and renegotiation of professional service contracts needs to be increased because of the unique mission and provisions of this grant agreement, as well as other related factors that include:

- The emphasis placed on systems of internal control for prudent business practices;
- The increased scrutiny surrounding Captive’s grant expenditures;
- The Captive’s exclusion from requirements of FEMA’s traditional procurement regulations; and
- FEMA’s accountability for the proper expenditure of federal grant funds.

Recommendations

We recommend that the Administrator, Federal Emergency Management Agency:

Recommendation #1: Develop and implement a review process for Captive financial and performance reports that will provide assurance that funds are being used prudently and according to provisions of the grant agreements. This review process should be documented in order to allow for continuity and subsequent follow up of all analyses and conclusions.

Recommendation #2: Establish a system of coordination between the responsible program office and the Grants Management Branch to improve and facilitate monitoring activities for Captive's financial and performance reporting.

Recommendation #3: Work in conjunction with the Captive and the Grants Management Branch to ensure that financial reports submitted include explanations to facilitate an understanding of the information reported.

Recommendation #4: Ensure that sufficient personnel with the appropriate level of expertise are assigned to perform substantive reviews of all Captive financial and performance reports, and subsequent attachments.

Recommendation #5: Develop and implement a review process to verify the appropriateness of the Captive's solicitation, award, and renegotiation processes, and document the results.

Management Comments and OIG Analysis

We evaluated FEMA's written comments and have made changes to the report where we deemed appropriate. Below is a summary of FEMA's written response to the report's recommendations, and our analysis of the response. A copy of FEMA's response, in its entirety, is included as Appendix B.

Recommendation #1: Develop and implement a review process for Captive financial and performance reports that will provide assurance that funds are being used prudently and according to provisions of the grant agreements. This review process should be

documented in order to allow for continuity and subsequent follow up of all analyses and conclusions.

FEMA Response: FEMA agreed with our recommendation. In its response, FEMA noted that while the Disaster Assistance Directorate, Grant Programs Directorate, and Office of Chief Counsel all play a role in reviewing the Captive's activities, its review process with respect to the Captive's financial and performance reports is somewhat informal and unstructured. FEMA proposed establishing an internal committee comprised of staff from its Disaster Assistance Directorate, Grant Programs Directorate, and Office of Chief Counsel to meet to discuss and document their review of the Captive's reports. FEMA also proposed to develop a standard operating procedure to memorialize an appropriate review process to address the unique nature of monitoring an insurance company that may operate for at least 25 years.

OIG Evaluation: We consider FEMA's proposal responsive to the recommendation. The recommendation is resolved and open pending verification that (1) standard procedures have been developed for conducting in-depth reviews and assessments of Captive financial and performance reports, and (2) regular meetings are being held with FEMA's staff from the Disaster Assistance Directorate, Grant Programs Directorate, and Office of Chief Counsel to discuss, assess, and document reviews of Captive reports.

Recommendation #2: Establish a system of coordination between the responsible program office and the Grants Management Branch to improve and facilitate monitoring activities for Captive's financial and performance reporting.

FEMA Response: FEMA agreed with our recommendation and reiterated its intent to establish a committee with staff from the Disaster Assistance Directorate, Grant Programs Directorate, and Office of Chief Counsel to meet regularly and summarize in writing their coordination and review process. FEMA said that the committee will meet at least quarterly upon receipt of the Captive's reports and will utilize a formal standard operating procedure to guide its activities.

OIG Evaluation: We consider FEMA's proposal responsive to the recommendation. The recommendation is resolved and open pending verification that the FEMA staff is meeting at least quarterly as proposed, and that standard operating procedures have

been developed as guidance for future program managers. This action should formalize regular contact between the program office and Grant Programs Directorate.

Recommendation #3: Work in conjunction with the Captive and the Grants Management Branch to ensure that financial reports submitted include explanations to facilitate an understanding of the information reported.

FEMA Response: FEMA agreed with our recommendation and said it has worked closely with the Captive over the last three years to ensure that the Captive provides all necessary financial reports in a manner that facilitates FEMA's review. FEMA said the Captive has always been willing to accommodate FEMA in this regard. FEMA noted that these reports can be complex but, as part of the committee process described above, it proposed to re-engage on this issue internally and communicate any additional reporting needs to the Captive.

OIG Evaluation: We consider FEMA's comment responsive to the recommendation, which is resolved and open. This recommendation will remain resolved and open until FEMA provides the results of internal discussions, and documentation of communications with the Captive regarding additional reporting needs to enhance understanding of the Captive's reports. In addition, any additional reporting needs should be incorporated in FEMA's standard operating procedures for conducting reviews of the Captive's financial and performance reports.

Recommendation #4: Ensure that sufficient personnel with the appropriate level of expertise are assigned to perform substantive reviews of all Captive financial and performance reports, and subsequent attachments.

FEMA Response: FEMA agreed with our recommendation. FEMA noted that the number of personnel assigned to monitor the Captive has been small, given that oversight of captive insurance companies is not ordinarily part of FEMA's mission. FEMA recognized the need to create a greater depth of expertise given the number of years FEMA may have to monitor the Captive's operations. FEMA proposed to further develop the depth of experience of its staff through the committee process described above for the key offices within the Disaster Assistance Directorate, Grant Programs Directorate and the Office of Chief Counsel.

OIG Evaluation: We consider FEMA’s proposal responsive to the recommendation. The recommendation remains resolved and open pending verification that FEMA has taken steps to ensure its committee includes personnel with sufficient knowledge and expertise to conduct in-depth assessments of the Captive’s financial and performance reports.

Recommendation #5: Develop and implement a review process to verify the appropriateness of the Captive’s solicitation, award, and renegotiation processes, and document the results.

FEMA Response: FEMA agreed in part, noting that the Captive is not a FEMA grantee or sub-grantee and that it is highly unusual for an agency to become involved in the procurement activities of an entity such as the Captive. FEMA said that the Captive is not subject to FEMA’s regulations at 44 CFR Part 13 regarding grantee and sub-grantee procurement requirements. FEMA said that it tends not to involve itself in its grantees’ and sub-grantees’ procurement activities, who are expected to follow applicable regulatory and policy guidance on procurement. FEMA added that there is no regulatory requirement that it become so involved and, in most instances, it would be ill-advised to interject itself into an independent procurement process for which it may not have the necessary expertise. FEMA said that it does not have expertise in the area of procuring investment firms, coverage counsel, third party claims administrators, and other professional service providers necessary to manage an insurance company.

FEMA said that during the creation of the Captive, it recognized that it was critical that such a large amount of Federal funds be well-managed and procurement processes ensure the Captive receive bids and undertake a formal bid review process. Therefore, specific procurement processes were included as a requirement of the documents creating the Captive and the Captive has complied with these requirements.

FEMA added that it does review major procurements undertaken by the Captive. FEMA said that the Captive alerts it to each such procurement the Captive intends to undertake as noted in the agendas for the Board of Director meetings. FEMA said that it is invited to attend all Captive Board of Directors meetings, and is provided with the minutes of each meeting. The minutes convey the Captive’s report to its board including a briefing by the Captive staff regarding the need for such procurements and are followed by the issuance of a Request for Proposal and an outreach, recruitment, and engagement strategy. FEMA noted that all

bidders are thoroughly reviewed by Captive staff and finalists are subject to oral interviews to determine the best qualified service providers. The whole process is shared with the Board of Directors, who approves each procurement and makes all final decisions. FEMA said that all of its reviews, to date, have demonstrated the Captive has undertaken its procurements in a sound, professional manner, consistent with the procurement requirements set forth in the grant and sub-grant agreements.

To address the OIG's concerns with respect to increased involvement, FEMA proposed to review how it monitors the Captive's procurement activities and examine whether it can create more formality in the process to carefully document its review. FEMA also agreed to work with the Captive to determine if there are more steps in the Captive's procurement process where FEMA should be involved.

OIG Evaluation: We consider FEMA's comments responsive to our recommendation. The recommendation is resolved and open pending our receipt of FEMA's internal reviews of (1) current monitoring activities and whether these activities should be more formal, and (2) interactions with the Captive regarding FEMA's level of involvement in the procurement process. We will evaluate this information and determine whether it complies with the intent of this recommendation.

Appendix A

Purpose, Scope, and Methodology

We conducted this review of the WTC Captive Insurance Company's operations and responsibilities in response to Congressman Jerrold Nadler's concerns about the "possible mishandling of claims brought by individuals who have suffered deleterious health effects as a result of their rescue and recovery work at the WTC site."⁶ In his July 26, 2006 letter, Congressman Nadler posed two principal questions:

- 1) Why has the WTCC (World Trade Center Captive) chosen to use a \$1 billion federal fund to litigate all 8,000 claims instead of settling whenever possible and appropriate?
- 2) Why have no procedures been established to receive, review and pay medical, hospital, surgical and disability benefits to injured persons, and funeral and death benefits to dependents, beneficiaries or personal representatives of persons who were killed?

We considered the Congressman's first question as a compliance issue, examining not only the reasoning that supports the Captive's role in ongoing litigation, but also the extent to which that role is consistent with relevant laws and grant documents. Regarding the Congressman's second question, we determined the extent to which a claims administration process has been developed and implemented, and ascertained what criteria exist to evaluate claims. We also reviewed the Captive's expenditures, investments, and internal controls, and assessed FEMA's monitoring efforts concerning the Captive's adherence to the grant agreement, and the status of its holdings.

We analyzed *Public Law 108-7* and the accompanying House Conference Report 108-10, as well as other applicable federal, state, and local laws. We also reviewed the grant agreement between FEMA and New York State, the subgrant agreement between New York State and New York City, the agreement between New York City and the Captive, and the Captive's operational documents. We reviewed submissions from New York City and New York State to FEMA regarding insurance for the city and private contractors who removed debris from the WTC site; correspondence from congressional, New York State, New York City, and FEMA officials concerning the establishment and funding of a captive; and applicable court documents concerning

⁶ Congressman Nadler's letter appears in full in Appendix C.

Appendix A

Purpose, Scope, and Methodology

related litigation in the Second Circuit Court of Appeals and the U.S. District Court for the Southern District of New York.

We also interviewed officials at FEMA's headquarters in Washington, DC and from its Region 2 office in New York City. Our fieldwork in New York City included interviews with Captive officers, and current and former board members, as well as with staff from select service contractors. We interviewed representatives of New York State and New York City, including the New York State Insurance Department, the New York City Office of Management and Budget, and the New York City Law Department. In addition, we held teleconference interviews with the New York State Emergency Management Office and with plaintiffs' attorneys.

Our fieldwork began in January 2007, and concluded in June 2007. Our review was conducted under the authority of the *Inspector General Act of 1978*, as amended, and according to the *Quality Standards for Inspections* issued by the President's Council on Integrity and Efficiency.

We would like to offer our appreciation to officials from FEMA, the Captive, New York State, New York City, and the private firms and individuals with whom we spoke for their cooperation and courtesies extended to our staff during this review.

Appendix B Management Comments to the Draft Report

U.S. Department of Homeland Security
500 C Street, SW
Washington, DC 20472



Richard L. Skinner
Inspector General
Office of Inspector General
U.S. Department of Homeland Security
Washington, DC 20528

Dear Mr. Skinner:

I write to express my appreciation for the draft report, *A Review of the World Trade Center Captive Insurance Company*, and to provide comments of the Federal Emergency Management Agency (FEMA) thereto. As this report makes clear, FEMA implemented the Congressional directive in P.L. 108-7 by working with the State and City of New York to establish an insurance company to insure and defend the City of New York and its debris removal contractors from claims arising from the debris removal operations following the September 11th terrorist attacks. FEMA did not provide funding to establish a victim's compensation fund, and the World Trade Center Captive Insurance Company "by legislative design" has not been operated as such.

The creation and operation of a captive insurance company with nearly \$1 billion in Federal funds is a highly complex matter for which FEMA had no previous experience. However, all parties involved in the creation and operation of the Captive, including FEMA, the State and City of New York, and the contractors, worked together to ensure the Captive would operate with strong financial controls. As the OIG's report states, "the Captive's internal control manual . . . include[s] adequate processes and procedures to comply with the applicable OMB circulars."

It must be emphasized that the Captive is an independent corporate entity and not a grantee under the grant agreement between FEMA and the State nor a sub-grantee under the sub-grant agreement between the State and the City. However, FEMA recognized immediately that the large amount of grant funding involved and the unique circumstances associated with the operation of such a corporate entity required a unique, on-going relationship between FEMA and the Captive. As such, FEMA receives regular reports from the Captive, participates in regular conference calls with Captive management, and attends Captive board meetings.

We agree with the OIG's report that more can be done with respect to internal controls:

www.fema.gov

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Recommendation 1: Develop a review process for Captive financial and performance reports that will provide assurance that funds are being used prudently and in accordance with provisions of the grant agreements.

We agree. The Disaster Assistance Directorate, Grant Program Directorate, and the Office of Chief Counsel all play a role in reviewing activities of the Captive. However, FEMA's present review process with respect to the Captive's financial and performance reports is somewhat informal and unstructured. Therefore, FEMA will establish an internal committee made up of staff from these three offices that will meet to discuss and then document their review of the Captive's reports. In addition, FEMA will develop a standard operating procedure to memorialize an appropriate review process to address the unique nature of monitoring an insurance company that may operate for at least 25 years.

Recommendation 2: Establish a system of coordination between the responsible program office and the Grants Management Branch to improve and facilitate monitoring activities for Captive's financial and performance reporting.

We agree. As stated above, FEMA will establish a committee with staff from the responsible offices that will meet regularly and summarize in writing their coordination and review process. This committee will meet at least quarterly upon receipt of the Captive's reports and it will utilize a formal standard operating procedure to guide its activities.

Recommendation 3: Work in conjunction with the Captive and the Grants Management Branch to ensure the financial reports submitted include explanations to facilitate an understanding of the information reported.

We agree. FEMA has worked closely with the Captive over the last three years to ensure the Captive provides all necessary financial reports in a manner that facilitates FEMA's review. The Captive has always been willing to accommodate FEMA in this regard. These reports can be complex and as part of the committee process described above, FEMA will re-engage on this issue internally and then communicate any additional reporting needs to the Captive.

Recommendation 4: Ensure that sufficient personnel with the appropriate level of expertise are assigned to perform substantive reviews of all Captive financial and performance reports, and subsequent attachments.

We agree. Not being a part of FEMA's ordinary mission, the number of personnel assigned to Captive monitoring has been small. However, we recognize the need to create a greater depth of expertise given the number of years FEMA may have to monitor the Captive's operations. FEMA will further develop the depth of experience of its staff through the committee process described above for the key offices within the Disaster Assistance Directorate, Grant Program Directorate and the Office of Chief Counsel.

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Recommendation 5: Develop a review process to verify the appropriateness of the Captive's solicitation, award, and renegotiation processes, and document the results.

We agree in part. The Captive is not a FEMA grantee or sub-grantee and it is highly unusual for an agency to become involved in the procurement activities of an independent entity such as the Captive. The Captive is not subject to FEMA's regulations at 44 CFR Part 13 with respect to grantee and sub-grantee procurement requirements. Nor is it FEMA's practice to become involved in the procurement activities of its grantees and sub-grantees, all of whom are expected to follow the applicable regulatory and policy guidance on procurement. As stated by the OIG report, there is no regulatory requirement that FEMA become so involved and in most instances we believe it would be ill-advised for a Federal agency to interject itself into an independent procurement process for which the agency may not have the necessary expertise. FEMA certainly does not have expertise in the area of procuring investment firms, coverage counsel, third party claims administrators and other professional service providers necessary to manage an insurance company.

Nevertheless, FEMA recognized during the creation of the Captive that it was critical that such a large amount of Federal funds be well-managed to include procurement processes that ensured the Captive receive bids and undertake a formal bid review process. Therefore, specific procurement processes were included as a requirement of the documents creating the Captive. As the OIG report states, to date the Captive has complied with these requirements.

Moreover, FEMA does review the major procurements undertaken by the Captive. FEMA is made aware by the Captive of each such procurement it intends to undertake as noted in the agendas for the Board of Director meetings. FEMA is invited to attend all Captive Board of Directors meetings, and is provided with the minutes of each meeting. The minutes convey the Captive's report to its board including a briefing by the Captive staff regarding the need for such procurements and is followed by the issuance of a Request for Proposal (RFP) and an outreach, recruitment, and engagement strategy. All bidders are thoroughly reviewed by Captive staff and finalists are subject to oral interviews to determine the best qualified service providers. The whole process is shared with the Board of Directors, who approves each procurement and makes all final decisions. All of FEMA reviews, to date, have demonstrated the Captive has undertaken all of its procurements in a sound, professional manner, consistent with the procurement requirements set forth in the grant and sub-grant agreements.

To address the OIG report's concerns with respect to increased involvement, FEMA will review how it monitors the Captive's procurement activities and examine whether it can create more formality in the process to more carefully document its review. We will also work with the Captive to determine if there are more steps in the Captive's procurement process where FEMA should be involved.

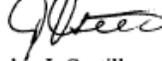
In conclusion, I would like to thank the OIG for the time it spent on examining what was an unprecedented undertaking by FEMA to address unique needs of the City of New

Appendix B
Management Comments to the Draft Report

Richard L. Skinner
Page 4

York and its debris removal contractors. We appreciate the OIG recommendations and will move quickly to implement changes that will strengthen and make more formal our agency's important oversight role. For your consideration, I am also attaching to this letter some minor technical corrections to the report which we believe will provide greater clarity.

Sincerely,



Carlos J. Castillo
Assistant Administrator
Disaster Assistance Directorate

Attachment

Appendix B Management Comments to the Draft Report

Attachment

General: Change all references to the "Recovery Division" to the "Disaster Assistance Directorate" and "Grants Management Branch" to "Grant Programs Directorate."

Page 1:

The ~~agency~~ City of New York, with funding provided by FEMA, established the World Trade Center Captive Insurance Company in July 2004.

Grant agreements between the Federal Emergency Management Agency, New York State, and New York City, ~~and the World Trade Center Captive Insurance Company~~ allow for payment of legal fees to defend insureds . . .

Page 4:

New York City was able to obtain \$500 million in marine insurance from Lloyds of London and \$79 million in general liability insurance from Liberty Mutual and London Market insurers for itself and its contractors.

With White House and congressional support, FEMA ~~drafted~~ participated in the drafting of legislation that authorized it to fund a captive insurance company.

Page 5:

After expending \$100,000 to hire insurance industry consultants to provide expertise on how captive insurance companies work, FEMA granted a \$999,900,000 ~~premium~~ to New York State. The state then transferred the funds through a sub-grant to the city which transferred the funds to the Captive as a premium, and the insurance company commenced operations.

In addition to the agreements between FEMA, New York State, New York City, and the Captive, the insurance company is further governed by its own bylaws, certificate of incorporation, ~~and~~ liability insurance policy and applicable New York State insurance law.

Page 14:

The company issued a ~~combined~~ audit report in April 2006⁵ for 2004, a report in April 2006 for ~~and~~ 2005, and ~~issued a second~~ a third report for 2006 in March 2007.

Page 15:

...oversight as it is required to provide financial and performance reports to the following entities:

Appendix B Management Comments to the Draft Report

- FEMA
- ~~House Appropriations Committee~~
- ~~Senate Appropriations Committee~~
- New York State Emergency Management Office
- New York State Insurance Department
- Office of the New York State Comptroller
- New York City

Page 16:

Specifically, the exclusion section of the Captive's liability insurance policy bars liabilities for punitive damages, workers' compensation, disability, retirement benefits, fines, sanctions or penalties, and liability for intentional acts by an insured's employee. Claims are also reviewed to determine if they fall within the geographic and temporal limits of the insurance policy. McDermott, Will & Emery also confers with the Captive for a final decision on coverage eligibility.

Page 18:

One settlement in 2006 partially reimbursed ~~an underlying~~ a private insurer after its own decision to settle with a plaintiff who had suffered a broken bone. In May 2007, Captive officers said the company similarly settled with an insured regarding five additional claims involving broken bones and cuts from workplace accidents that were supported by medical records.

Appendix C

Letter from Congressman Jerrold Nadler

JUDICIARY COMMITTEE
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RANKING MEMBER
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COMMERCIAL AND
ADMINISTRATIVE LAW

TRANSPORTATION AND
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Congress of the United States
House of Representatives
Washington, DC 20515

July 27, 2006

JERROLD NADLER
8TH DISTRICT, NEW YORK

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Web: <http://www.house.gov/nadler>

The Honorable Richard L. Skinner
Inspector General
U.S. Department of Homeland Security
Washington, DC 20528

Dear Mr. Skinner:

I am writing to request that your office immediately conduct an investigation of the World Trade Center Captive Insurance Company's (WTCC) possible mishandling of claims brought by individuals who have suffered deleterious health effects as a result of their rescue and recovery work at the World Trade Center (WTC) site.

In 2003, Congress provided the Federal Emergency Management Agency with \$1 billion to establish a captive insurance company, or other appropriate insurance mechanism, to handle claims arising from debris removal at the World Trade Center site. In March of 2003, the State and City of New York established the WTCC, but it appears that the company has never developed any procedures to award legitimate claims. Rather, every single claim is being litigated by the WTCC in court. As a result, approximately 8,000 individual claims have been submitted, but **zero** claims have been paid out. At the same time, more than \$20 million in federal funds have been spent on legal fees by the WTCC as it defends the City and other named insureds against these claims.

Certainly, a firefighter, police officer, or laborer who removed debris from the WTC site, and who now suffers adverse health effects, such as respiratory impairment or cancer, deserves to be compensated for lost wages and other related expenses. It is outrageous that millions of dollars in federal funds are being used to automatically dispute every single claim. At the very least, there should be a mechanism in place to process clearly legitimate claims without forcing every claimant to resort to protracted litigation.

Therefore, I respectfully request that your office conduct an investigation to determine why the WTCC has chosen to use a \$1 billion federal fund to litigate all 8,000 claims instead of settling whenever possible and appropriate? Why have no procedures been established to receive, review and pay medical, hospital, surgical and disability benefits to injured persons, and funeral and death benefits to dependants, beneficiaries or personal representatives of persons who were killed?

Appendix C
Letter from Congressman Jerrold Nadler

Clearly, it was not the Congressional intent to provide \$1 billion in federal taxpayers money simply to fight 9/11 heroes in court, without any provision for paying valid claims. Thousands of first responders and other workers served their country, and the people of New York, heroically in the days and months following the terrorist attacks of September 11, 2001. Many of these heroes are now sick, and some have even passed away, as a result of exposure to World Trade Center debris. Federal funds should be used not to fight those who served their country so admirably, but to provide those that need them with the benefits they deserve.

Thank you for your prompt attention this matter. If you have any questions, please do not hesitate to contact me.

Sincerely,



Jerrold Nadler
Member of Congress

cc: Christine LaSala, President & CEO
WTC Captive Insurance Company

Appendix D

World Trade Center Captive Insurance Company's Claims Administration Process

Initially, an insured under the Captive's policy receives a "summons with notice," alerting it to a forthcoming lawsuit, or a notice of an actual lawsuit from a plaintiff's attorney. The notice of a lawsuit is provided through a "check-off" complaint, which lists possible alleged injuries and defendants. Injuries and defendants' names are checked off based on the plaintiff's allegations. The plaintiffs often name multiple insureds as defendants in a single lawsuit.

- The insured provides these notices to the Captive's claims administrator, which reviews and classifies them as a summons with notice or "check-off" complaint. The claims administrator also separates complaints in a lawsuit into individual claims, which equals the number of named insureds or defendants.
- The claims administrator enters summonses with notice and "check-off" complaints into its electronic database. As of March 2008, the Captive had recorded lawsuits from 9,397 plaintiffs against nearly 90 insured WTC contractors and New York City. As of March 2008, the Captive also counted 413,337 claims, as individual plaintiffs are suing multiple insureds.
- For each lawsuit received, the claims administrator enters the plaintiff, defendants, nature of complaint, and alleged cause of injury into its database. The claims administrator compares new submissions to existing entries to avoid duplication. Possible duplicates are evaluated through a series of checks, including comparisons of case numbers and birth and exposure dates, before being entered as new claims.
- Attorneys at McDermott Will & Emery review each claim against the Captive's liability insurance policy to determine coverage eligibility. For a claim to be accepted, it must:
 - (1) Fall within the insuring agreement of the policy,
 - (2) Allege that exposure to the cause of injury occurred during the policy's exposure period, and
 - (3) Arise out of WTC site debris removal work.

Appendix D

World Trade Center Captive Insurance Company's Claims Administration Process

- A claim is then compared to the exclusion section of the policy, which bars liabilities for punitive damages, workers' compensation, disability, retirement benefits, fines, sanctions or penalties, and intentional acts by an insured's employee. In submitting the claim, the insured must have complied with "conditions precedent to coverage," which requires a timely, nonprejudiced submission of claims to the Captive.
- McDermott Will & Emery recommends acceptance, acceptance with reservation of rights, deferral, or denial.

Acceptance of a claim for coverage brings the insured under the Captive's umbrella for purposes of defending against the lawsuit. Claims may be accepted with reservation of rights, in which case a claim may or may not fall under the scope of coverage. In any event, it must be initially included in any legal defense under New York State law.⁷

Deferrals result from lawsuits that do not have sufficient information to determine coverage eligibility. GAB Robins managers said that it does not send summonses with notice to McDermott Will & Emery. Instead, coverage decisions on these claims are automatically deferred. GAB Robins managers said that even some decisions on "check-off" complaints have been deferred due to insufficient information.

Lastly, claims may be denied should information in a suit warrant such a decision. For example, claims may not fall within the insuring agreement of the policy or the injury may not have occurred at any of the WTC-related sites. Attorneys at McDermott Will & Emery said that the Captive's coverage eligibility criteria are very broad and give insureds the benefit of the doubt.

⁷ The Captive grants the "acceptance with reservation of rights" determination when the origin of a claimant's injury or illness cannot be immediately determined. If, for example, an individual worked the WTC site as well as a non-WTC-related site over a particular time period and subsequently became ill from work at either site, the cause of which is unknown, the Captive must by law accept the claim for coverage and defend the insured from suit. Further analysis, including any court-driven discovery, should reveal the origin of the injury and basis for the claim.

Appendix D

World Trade Center Captive Insurance Company's Claims Administration Process

- The Captive's general counsel reviews McDermott Will & Emery's recommendations and authorizes acceptance, acceptance with reservation of rights, deferral, or denial.
- McDermott Will & Emery posts the decision on an online database, E-Room. E-Room allows coverage counsel to pass information to the claims administrator on claims recently decided, as well as on any changes to existing entries that may have occurred. Staff members in GAB Robins' WTC Unit receive daily email updates from E-Room on recent changes or additions to the database. These updates lead GAB Robins to send notification letters on a coverage decision to each insured, reporting the status of recently submitted claims.
- If the claim is accepted, the claims administrator issues a defense retention letter to Patton Boggs, the lead defense firm hired by the Captive to represent its insureds in court.
- Deferrals are held until more information is submitted to the Captive and the claims administrator. Any claims denied for coverage may be resubmitted with additional information.

Appendix F

Site Locations for World Trade Center Recovery Operations

In addition to the immediate World Trade Center site, commonly known as “Ground Zero” after the September 11, 2001, terrorist attacks, other sites in lower Manhattan, Brooklyn, and Staten Island were used throughout recovery operations for additional debris processing before final disposal. The Captive’s liability insurance policy allows for claims arising from work at each location, identifying all sites involved in the clean-up as the “World Trade Center Site.”

Below, we present those sites identified in the Captive’s insurance policy that are considered the “World Trade Center Site.” We adopted this list when referring to multiple sites involved in the recovery effort.

- (a) The secured area in New York City bounded by Broadway on the east, Albany Street and Thames Street on the south, Chambers Street on the north and the Hudson River on the west;
- (b) The loading areas in New York City at the West Side Highway and Chambers Street, as well as Pier 92 and the Heliport at 59th Street and Hamilton Avenue;
- (c) The Brooklyn Marine Transfer Stations where trucks dropped off debris and debris was loaded onto barges;
- (d) Barges in transit on the Hudson River and other waterways, together with adjacent piers, on which such barges operated;
- (e) Trucks in transit between the World Trade Center and any location involved in the transportation of debris including such locations in Brooklyn and Staten Island;
- (f) Debris loading and unloading areas, including those in Brooklyn and Staten Island; and
- (g) Debris sorting/sifting areas at Staten Island.

Appendix G
Major Contributors to this Report

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