expense and research and development expenditures, respectively. Paragraphs (e)(4) through (e)(8) of this section contain rules with respect to the allocation of certain other deductions. Paragraph (e)(9) of this section lists those deductions which are ordinarily considered as not being definitely related to any class of gross income. Paragraph (e)(10) of this section lists special deductions of corporations which must be allocated and apportioned. Paragraph (e)(11) of this section lists personal exemptions which are neither allocated nor apportioned. Paragraph (e)(12) of this section contains rules with respect to the allocation and apportionment of deductions for charitable contributions. Examples of allocation and apportionment are contained in paragraph (g) of this section.

* * * * *

(12) [Reserved]. For further guidance, *see* § 1.861–8T(e)(12).

* * * * *

(g) *General examples.* * * *

*Example 18.* * * * (i)(A) * * *

(i)(B) In addition, X incurs expenses of its supervision department of $1,600,000.

* * * * *

■ **Par. 3.** Section 1.861–8T is amended as follows:

■ 1. Add new paragraph (e)(12).

■ 2. Add a new second sentence to paragraph (h).

The additions read as follows:

**§ 1.861–8T Computation of taxable income from sources within the United States and from other sources and activities (temporary).**

* * * * *

(e) * * *

(12) *Deductions for certain charitable contributions*—(i) *In general.* The deduction for charitable contributions that is allowed under sections 170, 873(b)(2), and 882(c)(1)(B) is definitely related and allocable to all of the taxpayer's gross income. The deduction allocated under this paragraph (e)(12)(i) shall be apportioned between the statutory grouping (or among the statutory groupings) of gross income and the residual grouping on the basis of the relative amounts of gross income from sources in the United States in each grouping.

(ii) *Coordination with § 1.861–14T.* A deduction for a charitable contribution by a member of an affiliated group shall be allocated and apportioned under the rules of this section and § 1.861–14T(c)(1).

(iii) *Treaty provisions.* [Reserved]

(iv) *Effective date.* (A) The rules of paragraphs (e)(12)(i) and (ii) shall apply to charitable contributions made on or after July 28, 2004. Taxpayers may apply the provisions of paragraphs (e)(12)(i) and (ii) to charitable contributions made before July 28, 2004 but during the taxable year ending on or after July 28, 2004.

(B) The applicability of this section expires on or before July 27, 2007.

* * * * *

(h) * * * However, *see* paragraph (e)(12)(iv) of this section and § 1.861–14T(e)(6)(ii) for rules concerning the allocation and apportionment of deductions for charitable contributions.

* * *

■ **Par. 4.** Section 1.861–14T is amended by revising the section heading and adding paragraph (e)(6) to read as follows:

**§ 1.861–14T Special rules for allocating and apportioning certain expenses (other than interest expense) of an affiliated group of corporations (temporary).**

* * * * *

(e) * * *

(6) *Charitable contribution expenses*—(i) *In general.* A deduction for a charitable contribution by a member of an affiliated group shall be allocated and apportioned under the rules of § 1.861–8T(e)(12) and paragraph (c)(1) of this section.

(ii) *Effective date.* (A) The rules of this paragraph shall apply to charitable contributions made on or after July 28, 2004 and, for taxpayers applying the second sentence of § 1.861–8T(e)(12)(iv)(A), to charitable contributions made during the taxable year ending on or after July 28, 2004.

(B) The applicability of this section expires on or before July 27, 2007.

* * * * *

**Mark E. Matthews,**

*Deputy Commissioner for Services and Enforcement.*

Approved: July 20, 2004.

**Gregory Jenner,**

*Acting Assistant Secretary of the Treasury.*

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## DEPARTMENT OF THE TREASURY

### 31 CFR Part 50

**RIN 1505–AB08**

### Terrorism Risk Insurance Program; Litigation Management

**AGENCY:** Departmental Offices, Treasury.

**ACTION:** Final rule.

**SUMMARY:** The Department of the Treasury (Treasury) is issuing this final rule concerning litigation management as part of its implementation of Title I of the Terrorism Risk Insurance Act of 2002 (Act). That Act established a temporary Terrorism Insurance Program (Program) under which the Federal Government will share with commercial property and casualty insurers the risk of insured losses from certified acts of terrorism that occur on or before the date the Program ends, on December 31, 2005. This final rule is the latest in a series of regulations that Treasury has issued to implement the Program and finalizes a proposed rule concerning litigation management related to insured losses under the Program.

**DATES:** This final rule is effective August 27, 2004.

**FOR FURTHER INFORMATION CONTACT:** David Brummond, Legal Counsel, or C. Christopher Ledoux, Senior Attorney, Terrorism Risk Insurance Program, (202) 622–6770 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

## I. Background

*A. Terrorism Risk Insurance Act of 2002*

On November 26, 2002, the President signed into law the Terrorism Risk Insurance Act of 2002 (Pub. L. 107–297, 116 Stat. 2322). The Act was effective immediately. The Act's purposes are to address market disruptions, ensure the continued widespread availability and affordability of commercial property and casualty insurance for terrorism risk, and to allow for a transition period for the private markets to stabilize and build capacity while preserving State insurance regulation and consumer protections.

Title I of the Act establishes a temporary federal program of shared public and private compensation for insured commercial property and casualty losses resulting from an act of terrorism, which as defined in the Act is certified by the Secretary of the Treasury, in concurrence with the Secretary of State and the Attorney General. The Act authorizes Treasury to administer and implement the Terrorism Risk Insurance Program, including the issuance of regulations and procedures. The Act provides that the Program ends on December 31, 2005. The Act also provides Treasury with certain continuing authority to take actions as necessary to ensure payment, recoupment, adjustments of compensation, and reimbursement for insured losses arising out of any act of terrorism (as defined under the Act) occurring during the period between November 26, 2002, and December 31, 2005.

Each entity that meets the definition of ''insurer'' (well over 2000 firms) must participate in the Program. The amount of federal payment for an insured loss resulting from an act of terrorism is to be determined based upon insurance company deductibles and excess loss sharing with the Federal Government, as specified by the Act and the implementing regulations. An insurer's deductible increases each year of the Program, thereby reducing the Federal Government's share prior to expiration of the Program. An insurer's deductible is calculated based on a percentage of the value of direct earned premiums collected over certain statutory periods. Once an insurer has met its individual deductible, the federal payments cover 90 percent of insured losses above the deductible, subject to an annual industry-aggregate limit of $100 billion.

The Program provides a federal reinsurance backstop for three years. The Act provides Treasury with authority to recoup federal payments made under the Program through policyholder surcharges, up to a maximum annual limit. The Act also prohibits duplicative payments for insured losses that have been covered under any other federal program.

The mandatory availability or ''make available'' provisions in section 103(c) of the Act require that, for Program Year 1, Program Year 2, and, if so determined by the Secretary of the Treasury, for Program Year 3, all entities that meet the definition of insurer under the Program must make available in all of their property and casualty insurance policies coverage for insured losses resulting from an act of terrorism. This coverage cannot differ materially from the terms, amounts and other coverage limitations applicable to losses arising from events other than acts of terrorism. On June 18, 2004, the Secretary of the Treasury announced his determination to extend the make available requirements through Program Year 3.

As conditions for federal payment under the Program, insurers must provide clear and conspicuous disclosure to policyholders of the premium charged for insured losses covered by the Program and the Federal share of compensation for insured losses under the Program. In addition, the Act requires that insurers submit claims and make certain certifications to Treasury. Treasury has recently published in the **Federal Register** a final rule concerning claims for Federal payment under the Program. See 69 FR 39296 (June 29, 2004).

Section 107 of the Act also contains specific provisions designed to manage litigation arising out of or resulting from a certified act of terrorism. If the Secretary determines that an act of terrorism under section 102 has occurred, section 107 establishes an exclusive Federal cause of action and remedy for property damage, personal injury, or death arising out of or relating to the act of terrorism. Section 107 also preempts certain State causes of action and provides that amounts awarded in actions for property damage, personal injury, or death that are attributable to punitive damages shall not count as ''insured losses'' (and thus shall not be paid) under the Program. The Act also gives the United States the right of subrogation with respect to any payment or claim paid by the United States under the Program. In connection with the implementation of the litigation management provisions of the Act, the President directed the Secretary to use his authority under the Act to propose a rule that would require insurers to obtain Treasury's advance approval before settling certain Federal causes of action described in section 107 of the Act. See 38 Weekly Comp. Pres. Doc. 2097 (Nov. 25, 2002); 2002 WL 14548111 (Dec. 2, 2002) (also accessible at *http://www.treasury.gov/trip*).

Throughout the implementation of the Program, Treasury has been guided by several goals. First, Treasury strives to implement the Act in a transparent and effective manner that treats comparably those insurers required to participate in the Program and provides necessary information to policyholders in a useful and efficient manner. Second, in accord with the Act's stated purposes, Treasury seeks to rely as much as possible on the State insurance regulatory structure. In that regard, Treasury has coordinated the implementation of aspects of the Program with the National Association of Insurance Commissioners (NAIC). Third, to the extent possible within statutory constraints, Treasury seeks to allow insurers to participate in the Program in a manner consistent with procedures used in their normal course of business. Finally, given the temporary and transitional nature of the Program, Treasury is guided by the Act's goal that insurers develop their own capacity, resources, and mechanisms for terrorism insurance coverage when the Program expires.

*B. Previously Issued Regulations*

To assist insurers, policyholders, and other interested parties in complying with immediately applicable requirements of the Act, Treasury issued interim guidance to be relied upon by insurers until superseded by regulations. These notices of interim guidance have now been superseded by final regulations. The scope of the Program, key definitions, and other provisions laying the groundwork for Program implementation are at Subparts A, B, and C of 31 CFR part 50 (68 FR 41250; 68 FR 59720). Treasury's final rule applying provisions of the Act to State residual market insurance entities and State workers' compensation funds is at Subpart D of 31 CFR Part 50 (68 FR 59715). The final rule setting forth procedures for filing claims for payment of the Federal share of compensation for insured losses is at Subpart F of 31 CFR part 50, and Subpart G of 31 CFR part 50 contains the final rule concerning information to be retained as related to the handling and settlement of claims to enable Treasury to perform financial and claim audits (both at 69 FR 39296).

*C. The Proposed Rule (Litigation Management)*

Treasury published a proposed litigation management rule in the **Federal Register** at 69 FR 25341 on May 6, 2004 to implement the provisions in section 107 of the Act. The proposed litigation management rule required insurers to seek Treasury's advance approval of settlements of certain Federal causes of action involving insured losses and proposed clarifications of litigation management aspects related to the Program.

## II. Summary of Comments and Final Rule

Treasury received four comments about the proposed rule; however, one of these comments was jointly submitted by an *ad hoc* industry working group that included insurance industry organizations, insurance companies, and property-casualty insurance industry trade associations and their member companies.[1] Comments were also received from a large commercial property-casualty insurance company; a large market of London-based insurers and reinsurers; and a real estate industry association. In addition, Treasury received a copy of a published Procedural Order from the Judicial Panel on Multidistrict

[1] The trade associations are: American Insurance Association (''AIA''), the American Association of State Compensation Insurance Funds (''AASCIF''), Council of Insurance Agents & Brokers (''CIAB''), The Financial Services Roundtable (''FSR''), Independent Insurance Agents & Brokers of America (''IIABA''), National Association of Mutual Insurance Companies (''NAMIC''), National Association of Professional Insurance Agents (''PIA''), Property Casualty Insurers Association of America (''PCI''), Reinsurance Association of America (''RAA''), and Surety Association of America (''SAA'').

Litigation, which adopted certain procedures for litigation under the Act.

In general, the proposed rule was received quite favorably by the real estate industry trade group, which commented that the rule would screen proposed settlements against litigation abuse and fulfill Congress's intent that taxpayer funds are not used to pay punitive damage claims. In contrast, the joint comment from the *ad hoc* industry working group criticized aspects of the proposed rule as described more fully below and urged that the settlement approval provisions be dropped, or alternatively, that changes be made to them in the final rule. Two other commenters provided suggested changes and clarifications to certain aspects of the proposed rule.

After review and careful consideration of all comments, Treasury has decided to promulgate a final rule with several modifications and clarifications as discussed below.

*A. Exclusive Federal Cause of Action and Remedy (Section 50.80)*

Section 107(a)(1) states that ''[i]f the Secretary makes a determination pursuant to section 102 that an act of terrorism has occurred, there shall exist a Federal cause of action for property damage, personal injury, or death arising out of or resulting from such act of terrorism, which shall be the exclusive cause of action and remedy for claims for property damage, personal injury, or death arising out of or relating to such act of terrorism, except as provided in paragraph (b).'' Section 107(b) provides that nothing in the litigation management provisions of section 107 shall in any way limit the liability of any government, organization, or person who knowingly participates in, conspires to commit, aids and abets, or commits any act of terrorism certified as such under the Act. Section 50.80 of the proposed rule was based on these provisions of the Act.

Section 50.80(a) of the proposed rule provided that ''[u]pon certification of an act of terrorism pursuant to section 102,'' there shall exist a Federal cause of action. The *ad hoc* industry working group raised a concern that the proposed language differed from that of the Act. The comment expressed concern that the proposed rule's use of the word ''upon'' instead of ''if'' could be interpreted to mean that the exclusive Federal cause of action accrues at the time of certification rather than at the time of occurrence of the event later certified.

In response to this comment Treasury is slightly modifying section 50.80 of the final rule to clarify intent and to more closely mirror the statutory language by changing the word ''upon'' to ''if'' in section 50.80(a) of the final rule.

The *ad hoc* industry working group also addressed section 50.80(b) of the proposed rule, which was based on section 107(e). Section 107(e) provides that the litigation management provisions of section 107 only apply to actions for property damage, personal injury, or death that arise out of or result from acts of terrorism that occur or occurred during the effective period of the Program. Section 50.80(b) of the proposed rule described the effective period of the Program ''as set forth in section 108 of the Act.'' Section 108(a) establishes only the Program's termination date and not the ''effective period.'' The *ad hoc* industry working group expressed concern that the proposed rule may create uncertainty as to whether the Secretary has authority to certify after the termination date an act that occurs on or before the termination of the Program. After considering this comment, Treasury made a technical correction to section 50.80(b) of the final rule to conform to the precise language of the Act.

*B. Preemption of State Causes of Action (Section 50.81)*

Section 107(a)(2) preempts all State causes of action for property damage, personal injury, or death arising out of or resulting from an act of terrorism that are otherwise available under State law, except as provided in paragraph (b) of the Act (*i.e.*, not affecting the liability of any government, organization, or person who knowingly participates in, conspires to commit, aids and abets, or commits any act of terrorism). The *ad hoc* industry working group pointed out that the language of the proposed rule differed from that in the Act. Section 107(a)(2) states that ''[a]ll State causes of action of any kind for property damage, personal injury, or death arising out of or resulting from an act of terrorism that are otherwise available under State law are hereby preempted, * * *.'' Tracking the time at which the exclusive Federal cause of action comes into existence, section 50.81 of the proposed rule stated that ''upon certification'' of an act of terrorism, all State causes of action for property damage, personal injury, or death arising out of or resulting from an act of terrorism were preempted. The comment explained that the Act itself preempts State causes of action.

Treasury agrees that the Act preempts all State causes of action for property damage, personal injury, or death ''arising out of or resulting from an act of terrorism,'' but such causes of action can only be identified as ''arising out of or resulting from an act of terrorism'' after an act is certified by the Secretary as an ''act of terrorism.'' Because the certification is inextricably linked to the classification of the causes of action to which the preemption applies, the proposed rule described the preemption as being dependent upon the certification of an act of terrorism by the Secretary. After considering the comment, Treasury determined to revise section 50.81 to mirror the language in section 107(a)(2).

*C. Program Procedures for Notifying the Judicial Panel on Multidistrict Litigation*

Section 107(a)(4) provides that for each act of terrorism certified by the Secretary pursuant to section 102, the Judicial Panel on Multidistrict Litigation (Judicial Panel) shall designate one district court or, if necessary, multiple district courts of the United States that shall have original and exclusive jurisdiction over all actions for any claim (including any claim for loss of property, personal injury, or death) relating to or arising out of an act of terrorism. The Act also provides that the Judicial Panel is to designate the district court or courts not later than 90 days after the occurrence of an act of terrorism.

In the proposed rule, Treasury recognized that it is the Secretary's certification of an act of terrorism that triggers the existence of the exclusive Federal cause of action and the need for the Judicial Panel to designate a district court or courts for the consolidation of actions. Treasury expressed an intent to notify the Judicial Panel as soon as practicable following any certification of an act of terrorism and invited comments on other appropriate operational procedures.

On June 1, 2004, the Judicial Panel issued a Procedural Order in *In re Terrorism Risk Insurance Act of 2002 Litigation,*—F.R.D.—, 2004 WL 1252476 (Jud. Pan. Mult. Lit. June 1, 2004) (also accessible at *http://www.treasury.gov/trip*). As reflected in its Order, the Panel stated that the 90-day period for the Judicial Panel to designate the court or courts, as prescribed in section 107(a)(4) of the Act, begins on the date the Secretary certifies the act of terrorism. Also, pursuant to its cited rulemaking authority under 28 U.S.C. 1407(f) and in response to the proposed rule, the Judicial Panel adopted procedures for litigation under the Act. The Order directs all interested parties to notify the Judicial Panel of their suggestions regarding what district court or courts should be designated within 20 days of

the date of certification. In addition, the Judicial Panel orders the Secretary, on the date the Secretary certifies an act of terrorism, to notify: (1) The public about the Judicial Panel's Order (through general media channels, such as Internet and press releases to broadcast and print media, ''augmented by direct notice to the parties in any already existing litigation known to the Treasury Secretary'') and (2) the Clerk of the Judicial Panel that such public notice has occurred.

As the Judicial Panel's Order establishes the procedures Treasury and others are to follow once an act is certified as an act of terrorism, there is no need for Treasury to set out procedural requirements in the final rule.

*D. Failure To Litigate in Federal Court Pursuant to the Act*

In implementing the section 107(a) provisions concerning exclusive jurisdiction, Treasury solicited comment in the preamble to the proposed rule on whether it would be appropriate or necessary to promulgate a rule to facilitate the filing and transfer of civil actions involving Federal causes of action to the Federal district court(s) designated by the Judicial Panel. Such a rule could provide that any amounts awarded in any civil action relating to or arising out of an act of terrorism that are not awarded by the district court or courts designated by the Judicial Panel would be ineligible for compensation under the Program, regardless of whether the amounts awarded would otherwise be insured losses covered by commercial property and casualty insurance issued by an insurer.

The *ad hoc* industry working group commented that such a rule was unnecessary and suggested that cases pending in non-designated courts would be removed to Federal court or dismissed and any awards by non-designated courts would be a legal nullity. Another commenter representing a market of London-based insurers and reinsurers suggested that if such a rule where adopted, an exception be made for court awards made (and paid by insurers) prior to the certification of an act of terrorism and presumably before a Federal district court is designated. After considering the issue and comments, Treasury has decided not to address this issue at this time, but will continue to study the issue to determine if any further clarification or procedures are needed.

*E. Treasury's Advance Approval of Settlements (Section 50.82)*

Sections 50.82 and 50.83 of the proposed rule provided for the advance approval of settlements of certain Federal causes of action arising out of or resulting from certified acts of terrorism. As noted earlier, Treasury received a memorandum from the President related to this issue. The President's Memorandum directed the Secretary to propose a rule requiring insurers to obtain the advance approval of Treasury of any proposed settlements of causes of action described in section 107 of the Act arising out of or resulting from an act of terrorism.

The proposed rule required advance approval by Treasury of proposed settlements of certain causes of action described in section 107, to the extent liability for such causes of action is covered by or paid, in whole or in part, by an insurer pursuant to coverage for insured losses under the Program. As proposed, such settlements were only required to be submitted for advance approval if the insurer intends to submit the settlement as part of its claim for federal payment under the Program.

A real estate industry association supported the rule as proposed, which it described as important procedures for scrutinizing proposed settlements and ''excellent rules for implementing Congress's charge that TRIA funds are not used to fund punitive damage claims.'' As described below, other commenters disagreed.

1. Rulemaking Authority

As a threshold matter, the *ad hoc* industry working group contended that the advance approval of settlements requirement exceeded Treasury's rulemaking authority. They provided no specific support for this position. The working group comment advocated elimination of the settlement pre-approval requirements in their entirety or other alternatives described below.

For the reasons stated in the preamble to the proposed rule, Treasury believes that it has the requisite legal authority to promulgate this rule, including the settlement approval provisions. *See* 69 FR 25341, 25344. The Act authorizes Treasury to administer the Program, investigate and audit claims, and pay the Federal share of compensation for insured losses. (*see* section 104(a)). Under section 104(a)(2) the Secretary is authorized to prescribe regulations to administer and implement the Program effectively. More specifically, under section 103(b)(3), Treasury is authorized to prescribe reasonable procedures concerning insurers' processing of claims for insured losses. Treasury believes that the procedures that this rule adds to the insurers' claims process are necessary in order to administer and implement the Program effectively. Pursuant to its administrative authority under the Act and to protect the interests of the United States, Treasury is finalizing sections 50.82 and 50.83 of the proposed rule, but with modifications as described below.

2. General Objections to the Rule

One insurer that commented criticized the proposed rule (and the claims regulations found in Subpart F) generally as being a departure from the more traditional ''follow the fortunes'' (sometimes also referred to as ''follow the settlements'') approach employed by reinsurers. The *ad hoc* industry working group raised this point as well. That group stated that through the proposed rule, Treasury would be substituting its judgment for that of the insurer in settling claims while introducing tremendous complexities into the claims process and that the regulations governing claims procedures (Subpart F) provide sufficient safeguards and already expose insurers to the risk of having an already settled cause of action denied.

To fulfill the purposes of the Act and its role as administrator, Treasury expects to be notified of covered settlements, to review them, and to make its objections (if any) known to the insurer. Treasury has tried to tailor its review and requests for information, as much as possible and with some exceptions, to the type of information typically gathered by the insurer as part of the claims adjustment process.

The *ad hoc* industry working group also stated that the rule does not reflect reinsurance best practices and is not modeled after the customary business practices of insurers and reinsurers. As we have often stated, Treasury seeks to administer the Program in a manner consistent with procedures insurers use in the normal course of business to the extent possible within statutory constraints. Given the unique characteristics of this Federal Program, the settlement approval aspects of this rule are appropriate. Though the Program is often thought of as being similar to an excess-of-loss quota share reinsurer, the Program is truly a Federal financial backstop funded by public monies which, unlike a traditional reinsurer, does not share in premiums and can recoup its payments as prescribed in section 103(e)(7) of the Act. Reinsurers evaluate and choose the insurers they reinsure, consider the claims handling and loss experience of

their reinsureds, and reassess those relationships during renewal audits. Treasury does not have a similar private market relationship with insurers. Moreover, Treasury does not believe that it has strayed inappropriately from reinsurance practices. Treasury is aware that some reinsurance treaties contain claims-cooperation clauses that allow reinsurers to receive early notification and the discretionary right to associate in the control, defense, and litigation of claims.

The *ad hoc* industry working group comment also stated that the proposed rule would expose insurers to bad faith claims and/or violations of State unfair claims practices standards which generally require them to promptly settle claims. The working group comment contends that the rule as proposed could expose insurers to liability for extra-contractual obligations (*i.e.*, punitive or exemplary damages) and/or damages in excess of policy limits if imposed by a court due to the insurer's delay or failure to settle because of Treasury's actions under this rule. The comment also pointed out that, by operation of sections 50.50(a) and 50.5(e)(4)(ii) and (iii) of the claims procedures regulations, Treasury does not share in extra-contractual or excess of policy limits type damages. If Treasury promulgates a final rule, the *ad hoc* industry working group suggested that Treasury should also share in these damages; pay one hundred percent of any liability of the insurer above the amount the insurer proposed settling the cause of action; or grant insurers qualified immunity from state law claims standards.

Treasury believes the hypothetical scenario suggested by the *ad hoc* industry working group in its comment may be overstated. First, the rule envisions a settlement approval process that normally will occur within 30 days. The information sought is that typically assembled by the insurer's claim professionals in handling and adjusting claims and should not delay settlements. Settlements can still be effectuated promptly and the additional processes required by this rule seem unlikely to lead to the types of inordinate delays typically associated with bad faith damages being awarded or State regulatory actions being brought. Insurers could inform the State regulatory officials and court that they are following Federal regulation and nothing in this rule prevents an insurer from settling a cause of action without or despite Treasury's pre-approval, doing so only precludes compensation under the Program. Treasury declines to adopt the *ad hoc* working group's suggestions.

3. Thresholds for Pre-Approval of Certain Proposed Settlements

The proposed rule required an insurer to seek Treasury's advance, written approval where an insurer (directly or through its insured) intends to settle a Federal cause of action involving third-party claims (by a third-party against an insured and/or the insurer) for property damage, personal injury, or death arising out of or resulting from an act of terrorism when—

- All or part of the settlement amount is expected to be part of the insurer's claim for federal payment under the Program; and
- Any portion of the proposed settlement amount that is attributable to liability for personal injury or death is $1 million or more, or that is attributable to liability for property damage (including loss of use) is $5 million or more, regardless of the number of third-party claims being settled.

In the preamble to the proposed rule, Treasury specifically requested comments on these monetary thresholds. The real estate industry association supported the thresholds as proposed. Another suggested that the thresholds were too low and that they should be raised to $10 million for both property and casualty claims. Upon consideration of the views of the commenters and Treasury's further assessment of the administrative costs and operational issues associated with the advance approval of too large a number of settlements, Treasury has decided to adjust the monetary thresholds set out in paragraphs (a)(1) and (2) of section 50.82 of the final rule. As now finalized, insurers will be required to submit for advance approval by Treasury settlements where the amount attributable to the insured's liability for personal injury or death is $2 million or more, or that is attributable to liability for property damage is $10 million or more.

Treasury is setting these monetary thresholds (below which an insurer is not required to seek pre-approval by Treasury) pursuant to section 104(a)(2) of the Act which authorizes the Secretary to prescribe regulations to administer and implement the Program effectively. In balancing between the need to protect the interests of the United States with the effective administration of the Program, Treasury believes it appropriate to raise the thresholds. In addition, Treasury notes that settlements that are reviewed and approved (or deemed approved), or that are not required to be submitted for prior approval, are all still subject to later Treasury review, like any other claim, at the point of claim submission by the insurer or at the time of any audit (*see* Subparts F and G).

In raising the settlement thresholds in section 50.82(a) of the final rule, Treasury expressly retains the right to require insurers to submit for pre-approval any settlement of a Federal cause of action that comes to its attention, on a case-by-case basis, even if the settlement amount attributable to liability for property damage, personal injury, or death is below the applicable threshold. Accordingly, Treasury is modifying section 50.82 of the final rule to add a new paragraph (b) which states that Treasury may request that an insurer submit for review and advance approval proposed settlements of Federal causes of action for property damage, personal injury, or death, where the settlement amounts are below the monetary thresholds identified in section 50.82(a)(1) and (2).

Several commenters asked for clarification covering different, but related aspects concerning what is included in calculating the thresholds. In response, Treasury provides the following additional clarifications:

- Any portion of the proposed settlement amount that is attributable to an insured loss or losses is aggregated per third-party claimant, regardless of the number of causes of action or insured losses being settled (section 50.82(a)(1) and (2) are being revised to reflect the ''per third-party claimant'' qualification);
- The thresholds include self-insured retentions (no change to the rule is necessary);
- Defense costs are not included in the thresholds. They are reviewed as loss adjustment expenses under sections 50.50(a) and 50.5(e)(4) of the regulations; and
- The pre-approval process does apply to Federal causes of action settled before the insurer has exceeded its insurer deductible under the Act. *See* section 102(7); 103(e)(1)(A). This is because under the claims procedures rule, insured losses are submitted on an aggregate basis without identification as to which insured losses are assigned to meeting the insurer deductible. *See* section 50.51(a) of Subpart F.

One commenter, representing a market of London-based insurers and reinsurers commented that it read the proposed settlement pre-approval requirements as being limited to settlements of filed legal actions. As Treasury stated in the preamble to its proposed rule (69 FR at 25344–45), the

settlement pre-approval requirements, which are now being finalized, apply to Federal causes of action regardless of whether a lawsuit has actually been filed or an arbitration commenced with respect to the claim. This is because, as we explained in the preamble to the proposed rule, ''a 'cause of action' is a group of operative facts giving rise to one or more bases for one person to sue and obtain a remedy in court from another person.''

Commenters generally favored the proposed rule's limitation on the pre-approval requirements to causes of action brought by third-party claimants against insureds. As stated in the preamble to the proposed rule, the prior approval requirement extends only to settlements for insured losses arising from third-party claims against an insured for property damage, personal injury or death against a commercial insured. Coverage disputes involving contract rights are not included in the scope of the causes of actions requiring advanced settlement approval by Treasury. Such disputes involve causes of action that are based on contract law, not on property damage, personal injury, or death, and are not subject to prior approval by Treasury. Several commenters suggested that Treasury include this important distinction in the rule itself. After consideration of these comments, Treasury has clarified in section 50.82(a) of the final rule that the advance approval requirements apply to any proposed agreement to settle or compromise any Federal cause of action for property damage, personal injury, or death, asserted by a third-party or parties against an insured.

4. Factors To Be Reviewed by Treasury

In determining whether to approve a proposed settlement, section 50.82(b) of the proposed rule (now being re-designated in the final rule as subparagraph (c)) identified the factors (in addition to those listed in section 50.50 of Subpart F) that Treasury would consider. These factors included the nature of the insured loss, the facts and circumstances surrounding the loss, and, as applicable, other related factors, as well as any other information requested by Treasury. The real estate industry association stated that the proposed rule ''provides commendable detail in requiring specific information to be communicated in submissions of proposed settlement for pre-approval by Treasury.''

The *ad hoc* industry working group suggested that if the proposed rule is adopted, Treasury should limit the pre-approval of proposed settlements to a review that only would consider whether punitive damages were included in the settlement. Alternatively, the working group comment suggested eliminating section 50.83 and modifying section 50.82 to require insurers to provide Treasury ''notice'' that the settlement is not an *ex gratia* payment (*i.e.*, a payment not required under the terms of the insurance policy); does not include settlement of a claim for punitive damages; and is not the result of fraud, collusion, bad faith, or dishonesty. In addition, the working group comment suggested the insurer notify Treasury that the insurer has complied with applicable State laws governing claims practices; determined that liability of the insured is clear; and has agreed to settlement based on merits and terms and conditions of the policy, without regard to the submission as part of its claim for the Federal share of compensation. These factors are generally covered through application of the claims procedures rule. *See* section 50.50(a). Accordingly, Treasury has decided to not revise the rule as suggested.

The real estate industry association wanted the factors expanded to include all information considered by the insurer's claims adjuster; that settlements also are reviewed for ''excessiveness''; and that Treasury should receive detailed statement explaining how any proposed settlement ensures that punitive damages are not included. Treasury believes the listed factors are sufficient. In addition, section 50.82(c)(5) allows Treasury to consider any other criteria that Treasury may consider appropriate, depending on the facts and circumstances surrounding the settlement. The commenter's suggestions are the type of additional information that could be requested (pursuant to 50.83(d)(12) of the final rule) and evaluated in certain circumstances, but certainly not all, and therefore, Treasury declines to add them by specific reference at this time.

Other comments were directed specifically to some of the factors, described below.

a. Ensuring That the Settlement Is an Insured Loss Covered Under the Insurance Policy (Section 50.82(c)(1))

Among the factors the proposed rule listed as relevant to Treasury's consideration of proposed settlements, section 50.82(c)(1) stated that Treasury would consider whether the proposed settlement compensates for a loss that is an insured loss under the terms and conditions of the underlying commercial property and casualty insurance policy. The *ad hoc* industry working group pointed out that this is already part of the claims review process under the claims procedures rule in Subpart F and doing a coverage analysis at the pre-approval stage may cause delay in insurers paying claims.

In consideration of this comment, Treasury is revising the final rule to state that Treasury will review whether the ''proposed settlement compensates for a third-party's loss, the liability for which is an insured loss under the terms and conditions of the underlying commercial property and casualty insurance policy, as certified by the insurer pursuant to § 50.83(d)(2).'' As a result, Treasury is changing section 50.83(d)(2) of the final rule to require the insurer to provide to Treasury as part of the approval submission process a certification by the insurer that the settlement is for a third-party's loss, the liability of which is an insured loss under the terms and conditions of the underlying commercial property and casualty insurance policy. The revisions clarify that the loss is that of a third-party, the liability for which is an insured loss, as suggested by an insurer who commented that the rule, left unchanged, could be misread to capture first-party settlements.

b. Ensuring That Settlement Amounts Shared With the Program Do Not Include Payment of Punitive Damages (Section 50.82(c)(2))

Section 107(a)(5) provides that any amounts awarded in actions under section 107(a)(1) of the Act (exclusive Federal cause of action for property damage, personal injury, or death arising out of or resulting from an act of terrorism) that are attributable to punitive damages shall not count as insured losses under the Act. Because section 107(a)(5) of the Act does not consider punitive damages ''insured losses'' under the Act, the Federal Government will not compensate an insurer for such damages. See also sections 50.5(e)(4)(i) of Subpart A (definition of ''insured loss'') and 50.50(a) of Subpart I.

Consistent with the claims procedures rule, this proposed rule stated that a factor Treasury would consider in approving a proposed settlement is whether the settlement excludes punitive damages, regardless of how the parties to the settlement agreement characterize the payment. An insurer shall be required to identify any portion of a proposed settlement amount that is attributable to punitive damages, or that is intended to compromise a claim or demand for punitive damages in a cause of action for which punitive damages

could be awarded. And Treasury will review proposed settlements to determine whether all or part of the settlement amount is intended to compromise an actual or threatened claim for punitive or exemplary damages, even if the settlement does not indicate that the payment includes punitive or exemplary damages.

The real estate industry association stated that, ''[o]ne of the best elements of the NPRM [Notice of Proposed Rulemaking] is its detailed discussion of steps that will be taken to ensure that settlements do not include indemnity for punitive damages claims.'' The *ad hoc* industry working group suggested that the proposed rule be modified to require the review of amounts ''attributable to an award of punitive or exemplary damages,'' presumably following the literal language of section 107(a)(5) of the Act. The working group stated that while claims for punitive damages are made routinely, actual awards are rare. Without the modification, the working group comment suggested, Treasury's review would be highly subjective, involve substantial legal and factual analysis, and create inordinate delay, yet would promise little value. After review of these comments, Treasury is finalizing the rule as proposed in order to ensure that punitive damages are not awarded through settlements.

Several commenters requested that Treasury explain how it would determine what portion of a proposed settlement might be attributable to a claim for punitive damages when the settlement does not indicate that the payment includes such damages. No methods of review were suggested by these comments. The real estate industry association, however, suggested that Treasury could require and receive a detailed statement from the insurer (under section 50.83) explaining how any proposed settlement ensures that punitive damages are not included. Treasury considered the comments and decided that a requirement for the insurer to identify any portion of a proposed settlement amount that is attributable to punitive damages (or that is intended to compromise a claim or demand for punitive damages) is sufficient.

c. Ensuring That Settlement Amounts Shared With the Program Have Accounted For Compensation Received by Third-Parties From Other Federal Programs (Section 50.82(c)(3))

Section 50.82(b)(3) of the proposed rule (now re-designated as paragraph (c)(3) in the final rule) stated that a factor Treasury would consider in approving a proposed settlement is whether the settlement amount offset amounts received from the United States pursuant to any other Federal program. Section 103(e)(1)(B) of the Act states, ''The Federal share of compensation for insured losses under the Program shall be reduced by the amount of compensation provided by the Federal Government to any person under any other Federal program for those insured losses. See also section 50.51(b) of Subpart I. The *ad hoc* industry working group objected to Treasury's consideration of this as part of the settlement approval process because, as explained by the working group, an insurer generally does not have the ability under the terms and conditions of a property and casualty insurance policy to reduce the value of a claim by such collateral source amounts. Treasury is adopting this requirement in the final rule because it is required under the Act to adjust the Federal share of compensation by these amounts, Treasury is in effect asking, as a practical versus contractual matter, whether the insurer has already taken collateral source payments into consideration in arriving at the settlement amount (*i.e.*, would the settlement have been higher but for the compensation from the other Federal Program?). Section 50.82(c)(3) of the final rule is finalized as proposed, without change.

d. Review of Impact of Professional Fees and Expenses on Settlement Amount (50.82(c)(4))

Another factor Treasury proposed to take into account in reviewing proposed settlements was the amount of attorneys' fees and other legal expenses paid out of the settlement proceeds. The proposed rule was based on Treasury's concern about inflated, unsupported insured losses. In order to address this concern, Treasury proposed to evaluate whether attorneys' fees and expenses in connection with the settlement were unreasonable or inappropriate, in whole or in part, and whether they caused the insured losses under the underlying commercial property and casualty insurance policy to be overstated.

Another commenter asked if review of attorneys' fees included review of defense attorneys' fees and expenses? Such costs would not be reviewed at the pre-approval stage but would be reviewed as part of the insurer's claim for loss adjustment expenses. See sections 50.50(a) and 50.5(e)(3).

In the preamble to our proposed rule, we described how Treasury would examine the appropriateness of attorneys' fees and expenses, generally by considering such factors as those weighed by Federal courts regarding the reasonableness of attorneys' fees and expenses. The real estate industry association praised this approach.

Many of the comments addressed this section of the proposed rule. The ad hoc industry working group contended that the review of attorneys' fees contained in the proposed rule was unnecessary because bar association ethics rules (prohibiting unreasonable fees) and procedural review by courts (presumably over settlements of filed legal actions) are a sufficient check on legal fees that may inflate the settlement amounts paid by insurers.

In light of some of the comments and upon further consideration, Treasury has decided to revise section 50.82(c)(4) of the final rule to more clearly focus on the issue of whether insured losses have been inflated. Under the final rule, Treasury will consider whether the settlement amount has been inflated by such things as unjustified professional fees and expenses of attorneys, experts, and other professionals. The intent is to focus on whether such fees or other expenses have caused the settlement amount to exceed the value of the insured loss as compared to similar losses. In order to apply this revision to the pre-approval submission and in response to a request for clarification by a commenter, Treasury is also making a related revision to section 50.83(d)(7) to clarify that insurers are to submit to Treasury the net amount to be received by the third-party after the payment of professional fees and expenses. Section 50.83(d)(7) is revised to now require that insurers inform Treasury of ''[t]he amount to be paid that will compensate for any items such as fees and expenses of attorneys, experts, and other professionals for their services and expenses related to the insured loss and/or settlement and the net amount to be received by the third-party after such payment.''

Some commenters explained that insurers might not always be able to obtain this information. Treasury understands the possible difficulty in obtaining information but believes the insurer is in the best position to obtain this information and it is hoped that a third-party would provide such information to the insurer knowing that it is a requirement upon which Treasury's approval, and in turn the insurer's eventual agreement to finalize the settlement, may depend. Insurers should recognize that the factors listed in section 50.82(c) will be viewed as a whole, with different emphasis on different factors depending on the particulars of the cause of action. If an

insurer cannot obtain the information required by section 50.82(c)(4), it should simply indicate that fact to Treasury, as well as what attempts it made to discover the information. An insurer could also provide its best estimate based on its prior business experience of what professionals charge under the circumstances of the particular claim. Having provided such guidance, Treasury has decided to not change the rule.

5. Settlement Without Treasury's Approval

Under section 50.82(d) of the rule, if an insurer settles a cause of action after Treasury has rejected the proposed settlement, or if an insurer settles a cause of action without seeking Treasury's approval in advance, as required by section 50.82(a), the insurer will not be entitled to the Federal share of the amount paid as part of its claim for federal payment unless the insurer can demonstrate, to the satisfaction of the Treasury, extenuating circumstances. Also, the insurer shall not be entitled to include the paid settlement amount as an insured loss in its aggregate insured losses (whether or not those aggregate insured losses exceed the insurer deductible) for purposes of calculating the Federal share of compensation due to the insurer under the Program.

In its proposed rule, Treasury requested comments on how frequently claims are received by commercial property and casualty insurers under commercial liability policies where the insured settles directly with a claimant and then notifies the insurer after the settlement has been consummated. No one commented on the frequency of such situations or the size of claims usually involved. The ad hoc industry working group cited situations under the law of three states that may allow an insured to settle causes of action without the knowledge or consent of their insurer. The working group comment suggested one possible approach to address these situations is to specifically state in the rule that settlements without insurer consent are ''extenuating circumstances'' that will not preclude Federal compensation of the insurer's payment of the settlement or indemnification of the insured.

Although there may be situations where this does occur, perhaps under relevant State law, Treasury prefers to evaluate each situation when it occurs, based on the particular circumstances as presented by the insurer. Accordingly, Treasury is not changing the rule and adopts section 50.82(d), as proposed, as final.

*F. Procedures for Requesting Approval of Settlements (Section 50.83)*

Section 50.83 of the proposed rule set out a procedure for an insurer to submit proposed settlements for advance approval by Treasury. Generally, within 30 days after Treasury's receipt of a complete notice of the proposed settlement and an insurer's request that the proposed settlement be approved, Treasury may issue a written response and either approve or disapprove the proposed settlement, in whole or in part. If Treasury does not issue a written response within 30 days after its receipt of a complete notice (or within the time as extended in writing by Treasury), the request for advance approval of the settlement will be deemed approved under section 50.83(c). (The settlement will still be subject to review under the claims procedures rule.)

The majority of the comments either supported or did not object to the within 30-day pre-approval review process. The ad hoc industry working group suggested that 30 days is too long. Treasury emphasizes that the rule anticipates a decision by Treasury within 30 days, and through the ''deemer'' provision, no later than 30 days. While it is true, as a comment noted, that the ''deemer'' provision allows Treasury to extend the 30-day period, Treasury expects such instances to not be common. Treasury is aware of its responsibility to manage the Program effectively and efficiently and will employ its best efforts to administer the pre-approval process in an expedient manner. For reasons stated previously in the proposed rule preamble, Treasury is not changing the 30-day time period in the rule. See 69 FR 25341, 25346.

Several commenters pointed out that the process does not envision any type of expedited review of settlements where the agreements in principal may be reached shortly before a Federal cause of action is about to be tried. The commenters suggest Treasury consider approaches to accommodate such situations. Treasury has made no change to the proposed rule. Treasury expects that attorneys representing the insureds will advise the Federal district court about Treasury's approval role.

Section 50.83 of the proposed rule also outlined minimum information Treasury thought might be relevant and useful in considering whether to approve a proposed settlement. One comment was supportive of the proposed rule. Others, primarily representing or themselves insurers, believed the rule requested too much information which would be burdensome on insurers and cause substantial delay. Comments were received on the various items, some of which have resulted in some modifications, which are now discussed.

In careful consideration of the insurer's comments, Treasury has changed the section 50.83(d) of the final rule in the following ways in order to ensure that Treasury is preliminarily only seeking the minimum information required by Treasury:

- As explained earlier in the discussion of section 50.82(c)(1) (ensuring that the settlement is of an insured loss under the terms and conditions of the insurance policy), the final rule now adds a revised requirement at paragraph (d)(2) to 50.83, requiring a certification by the insurer that the settlement is for a third-party's loss, the liability for which is an insured loss under the terms and conditions of the underlying commercial property and casualty insurance policy. This revision is being made because Treasury needs less information since it will no longer be performing a complete review of the insurer's coverage analysis as part of the pre-approval process, as originally proposed;
- Paragraph (d)(4) of section 50.83 of the final rule now requires a statement from the insurer or its attorney in support of the settlement rather than a more onerous one recommending the settlement and requiring the basis for the recommendation;
- As explained earlier in the discussion of section 50.82(c)(4) and the proposed review of attorneys' fees and expenses, paragraph (d)(7) of section 50.83 of the final rule is revised to call for the amount to be paid out of the settlement proceeds that in turn will compensate professionals for their services and expenses related to the insured loss and/or settlement and the net amount to be received by the third-party claimant. In addition to conforming to the changes made to 50.82(c)(4), this paragraph now combines (and clarifies) section 50.82(d)(6) and (7) of the proposed rule;
- Relevant agreements called for in the proposed rule are now, under section 50.83(d)(10) of the final rule, only required to be submitted if requested by Treasury; and
- Paragraph (d)(12) of section 50.83 is clarified to assure insurers that Treasury will request and require only such other information that is related to the insured loss and that it deems necessary to evaluate the proposed settlement.

Treasury has decided not to adopt several of the other suggestions by the commenters, such as: Treasury receive the same information submitted to a

claims officer who approves the settlement on behalf of the insurer; a statement of risks and disadvantages of settlement with an assessment of the strengths and weaknesses of the claim; and a disclosure whether coverage is disputed and other coverage issues. It was also suggested that the submissions for approval be verified under oath. For the reasons stated earlier, Treasury declines to adopt the suggestions except that, for the reasons stated earlier, it will require certification of the insurer's coverage determination under section 50.83(a)(2) of the final rule.

Finally, the *ad hoc* industry working group commented that the proposed rule did not include provisions to protect confidential or privileged information submitted to Treasury under section 50.83. Any issues relating to the protection or disclosure of confidential or privileged information are adequately addressed through the procedures and exceptions (*e.g.*, exception (b)(4) and (5)) applicable under the Freedom of Information Act, 5 U.S.C. 552, and Treasury's FOIA regulations at 31 CFR part 1, subpart A. Insurers wishing to protect such information should follow those procedures, including labeling the information pursuant to those regulations.

*G. Right of Subrogation (Section 50.84)*

Section 107(c) provides that the United States shall have the right of subrogation with respect to any payment or claim paid by the United States under the Act. In section 50.85 of the proposed rule, Treasury proposed a requirement that insurers take steps to preserve the Federal Government's rights of subrogation under section 107(c).

The *ad hoc* industry working group claimed that the requirement to preserve the subrogation rights of the United States conflicts with claims procedures rule that allows insurers to use business judgment in deciding whether to pursue subrogation opportunities. See Section 50.51(a). Treasury believes there is no conflict. Under the claims procedures rule, when an insurer pursues subrogation opportunities, the outcome inures to the benefit of the United States through an adjustment to the Federal share of compensation. As we stated at 60 FR 39296, 39300 (June 29, 2004), if an insurer decides to forego subrogation, the United States itself can pursue those opportunities. This does not conflict with section 50.84 of the final rule, which is designed to ensure that insurers do not waive subrogation rights and to prevent the very situation the working group identified when it stated, ''waiver of subrogation rights often takes place in settlement.'' Treasury is not changing the rule on the basis of this comment. Given the language in section 107, insurers are prohibited from negotiating away the Federal Government's subrogation rights.

The group of London-based insurers and reinsurers pointed out that the proposed rule required insurers to ''take all steps necessary to preserve the subrogation rights of the United States.'' The commenter explains that it is not clear what affirmative steps insurers must take to preserve these rights. The commenter suggested revising the rule to instead require that insurers avoid taking action that would prejudice the Federal Government's right of subrogation. Treasury is accepting this commenter's suggestion and is changing the language of section 50.84 accordingly.

*H. Management of Pre-Certification Litigation and Related Issues*

Several commenters pointed out that the proposed rule does not address causes of action settled and/or paid after the occurrence of an event not yet, but later certified by the Secretary pursuant to section 102 of the Act as an ''act of terrorism.'' The comments raised issues that may warrant further study and consideration and Treasury has decided not to address this issue at this time.

*I. Time Between Occurrence and Certification of an Event as an Act of Terrorism*

The *ad hoc* industry working group raised the issue of the time it may take for the Secretary to certify an event as an act of terrorism pursuant to section 102 of the Act. As previously explained in the preamble to other regulations, Treasury believes it unwise and inappropriate to establish a set time frame within which the Secretary would be required to make a certification that an ''act of terrorism'' had occurred. See 68 FR 41250, 41252 (July 11, 2003). The ad hoc industry working group comment requested that Treasury promulgate a rule allowing for: (1) A ''conditional'' determination if the facts strongly lead to a conclusion of foreign or domestic involvement; or (2) a regulatory provision acknowledging the possibility of a delayed certification and urging state regulatory consideration of that possibility; or (3) qualified immunity where there is a delay in the certification process. Treasury declines to adopt these suggestions.

**III. Procedural Requirements**

*Executive Order 12866, ''Regulatory Planning and Review''*

This rule is a significant regulatory action for purposes of Executive Order 12866, ''Regulatory Planning and Review,'' and has been reviewed by the Office of Management and Budget (OMB).

*Regulatory Flexibility Act*

Pursuant to the Regulatory Flexibility Act, 5 U.S.C. 601 *et seq.*, it is hereby certified that this rule will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. The rule establishes requirements for advance approval of settlements when claims are to be submitted for insured losses. There is no impact on small insurers unless an act of terrorism occurs and federal compensation is sought by small insurers entitled to reimbursement for their insured losses. If an act of terrorism occurs and Federal payment is sought through a claim, the rule's impact on small insurers is likely to be minimal because most of the information that would have to be submitted in connection with Treasury approval of settlements largely duplicates information already contained in an insurer claim file or an attorney case file. Moreover, the $2 million and $10 million thresholds for the submission of settlements to Treasury for approval is likely further to minimize burdens on small insurers.

*Paperwork Reduction Act*

The collection of information contained in this rule has been approved by the OMB in accordance with the requirements of the Paperwork Reduction Act, 44 U.S.C. 3507(d) and assigned OMB Control Number 1505–0196. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by OMB.

The collection of information is the notice of proposed settlement in section 50.83 that insurers must submit to implement the settlement approval process prescribed by section 50.82. The information will be used by Treasury to evaluate the reasonableness of proposed settlements in order to approve them in advance. The submission of specified information in connection with a proposed settlement is mandatory for any insurer that seeks payment of a Federal share of compensation.

The burden associated with this collection of information is estimated to

be 4 hours with respect to each claim. Comments on the accuracy of this estimate and suggestions on how to reduce this burden should be sent to the Terrorism Risk Insurance Program, Room 2100, 1425 New York Avenue, NW., Washington, DC 20220 and to the Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, DC 20503.

**List of Subjects in 31 CFR Part 50**

Terrorism risk insurance.

**Authority and Issuance**

■ For the reasons set forth above, 31 CFR part 50 is amended as follows:

## PART 50—TERRORISM RISK INSURANCE PROGRAM

■ 1. The authority citation for part 50 continues to read as follows:

**Authority:** 5 U.S.C. 301; 31 U.S.C. 321; Title I, Pub. L. 107–297, 116 Stat. 2322 (15 U.S.C. 6701 note).

■ 2. Subpart I of part 50 is added to read as follows:

Sec.
50.80 Federal cause of action and remedy.
50.81 State causes of action preempted.
50.82 Advance approval of settlements.
50.83 Procedure for requesting approval of proposed settlements.
50.84 Subrogation.

## Subpart I—Federal Cause of Action; Approval of Settlements

### § 50.80 Federal cause of action and remedy.

(a) *General.* If the Secretary certifies an act as an act of terrorism pursuant to section 102 of the Act, there shall exist a Federal cause of action for property damage, personal injury, or death arising out of or resulting from such act of terrorism, pursuant to section 107 of the Act, which shall be the exclusive cause of action and remedy for claims for property damage, personal injury, or death arising out of or relating to such act of terrorism, except as provided in paragraph (c) of this section.

(b) *Effective period.* The exclusive Federal cause of action and remedy described in paragraph (a) of this section shall exist only for causes of action for property damage, personal injury, or death that arise out of or result from acts of terrorism that occur or occurred during the effective period of the Program.

(c) *Rights not affected.* Nothing in section 107 of the Act or this Subpart shall in any way:

(1) Limit the liability of any government, organization, or person who knowingly participates in, conspires to commit, aids and abets, or commits any act of terrorism;

(2) Affect any party's contractual right to arbitrate a dispute; or

(3) Affect any provision of the Air Transportation Safety and System Stabilization Act (Pub. L. 107–42; 49 U.S.C. 40101 note).

### § 50.81 State causes of action preempted.

All State causes of action of any kind for property damage, personal injury, or death arising out of or resulting from an act of terrorism that are otherwise available under State law are preempted, except that, pursuant to section 107(b) of the Act, nothing in this section shall limit in any way the liability of any government, organization, or person who knowingly participates in, conspires to commit, aids and abets, or commits the act of terrorism certified by the Secretary.

### § 50.82 Advance approval of settlements.

(a) *Mandatory submission of settlements for advance approval.* An insurer shall submit to Treasury for advance approval any proposed agreement to settle or compromise any Federal cause of action for property damage, personal injury, or death, asserted by a third-party or parties against an insured, involving an insured loss, all or part of the payment of which the insurer intends to submit as part of its claim for Federal payment under the Program, when:

(1) Any portion of the proposed settlement amount that is attributable to an insured loss or losses involving personal injury or death in the aggregate is $2 million or more per third-party claimant, regardless of the number of causes of action or insured losses being settled; or

(2) Any portion of the proposed settlement amount that is attributable to an insured loss or losses involving property damage (including loss of use) in the aggregate is $10 million or more per third-party claimant, regardless of the number of causes of action or insured losses being settled.

(b) *Discretionary review of other settlements.* Notwithstanding paragraph (a), Treasury may require that an insurer submit for review and advance approval any proposed agreement to settle or compromise any Federal cause of action for property damage, personal injury, or death, asserted by a third-party or parties against an insured, involving an insured loss, all or part of the payment of which the insurer intends to submit as part of its claim for Federal payment under the Program where the settlement amounts are below the applicable monetary thresholds identified in paragraphs (a)(1) and (2) of this section.

(c) *Factors.* In determining whether to approve a proposed settlement, Treasury will consider the nature of the loss, the facts and circumstances surrounding the loss, and other factors such as whether:

(1) The proposed settlement compensates for a third-party's loss, the liability for which is an insured loss under the terms and conditions of the underlying commercial property and casualty insurance policy, as certified by the insurer pursuant to § 50.83(d)(2);

(2) Any amount of the proposed settlement is attributable to punitive or exemplary damages intended to punish or deter (whether or not specifically so described as such damages);

(3) The settlement amount offsets amounts received from the United States pursuant to any other Federal program;

(4) The settlement amount does not include any items such as fees and expenses of attorneys, experts, and other professionals that have caused the insured losses under the underlying commercial property and casualty insurance policy to be overstated; and

(5) Any other criteria that Treasury may consider appropriate, depending on the facts and circumstances surrounding the settlement, including the information contained in § 50.83.

(d) *Settlement without seeking advance approval or despite disapproval.* If an insurer settles a cause of action or agrees to the settlement of a cause of action without submitting the proposed settlement for Treasury's advance approval in accordance with paragraph (a) or (b) of this section, and in accordance with § 50.83 or despite Treasury's disapproval of the proposed settlement, the insurer will not be entitled to include the paid settlement amount (or portion of the settlement amount, to the extent partially disapproved) in its aggregate insured losses for purposes of calculating the Federal share of compensation of its insured losses, unless the insurer can demonstrate, to the satisfaction of Treasury, extenuating circumstances.

### § 50.83 Procedure for requesting approval of proposed settlements.

(a) *Submission of notice.* Insurers must request advance approval of a proposed settlement by submitting a notice of the proposed settlement and other required information in writing to the Terrorism Risk Insurance Program Office or its designated representative. The address where notices are to be submitted will be available at *http://www.treasury.gov/trip* following any

certification of an act of terrorism pursuant to section 102(1) of the Act.

(b) *Complete notice.* Treasury will review requests for advance approval and determine whether additional information is needed to complete the notice.

(c) *Treasury response or deemed approval.* Within 30 days after Treasury's receipt of a complete notice, or as extended in writing by Treasury, Treasury may issue a written response and indicate its partial or full approval or rejection of the proposed settlement. If Treasury does not issue a response within 30 days after Treasury's receipt of a complete notice, unless extended in writing by Treasury, the request for advance approval is deemed approved by Treasury. Any settlement is still subject to review under the claim procedures pursuant to § 50.50.

(d) *Notice format.* A notice of a proposed settlement should be entitled, ''Notice of Proposed Settlement—Request for Approval,'' and should provide the full name and address of the submitting insurer and the name, title, address, and telephone number of the designated contact person. An insurer must provide all relevant information, including the following, as applicable:

(1) A brief description of the insured's underlying claim, the insured's loss, the amount of the claim, the operative policy terms, defenses to coverage, and all damages sustained;

(2) A certification by the insurer that the settlement is for a third-party's loss the liability for which is an insured loss under the terms and conditions of the underlying commercial property and casualty insurance policy;

(3) An itemized statement of all damages by category (*i.e.*, actual, economic and non-economic loss, punitive damages, etc.);

(4) A statement from the insurer or its attorney in support of the settlement.;

(5) The total dollar amount of the proposed settlement;

(6) Indication as to whether the settlement was negotiated by counsel;

(7) The amount to be paid that will compensate for any items such as fees and expenses of attorneys, experts, and other professionals for their services and expenses related to the insured loss and/or settlement and the net amount to be received by the third-party after such payment;

(8) The amount received from the United States pursuant to any other Federal program for compensation of insured losses related to an act of terrorism;

(9) The proposed terms of the written settlement agreement, including release language and subrogation terms;

(10) If requested by Treasury, other relevant agreements, including:

(i) Admissions of liability or insurance coverage;

(ii) Determinations of the number of occurrences under a commercial property and casualty insurance policy;

(iii) The allocation of paid amounts or amounts to be paid to certain policies, or to specific policy, coverage and/or aggregate limits; and

(iv) Any other agreement that may affect the payment or amount of the Federal share of compensation to be paid to the insurer;

(11) A statement indicating whether the proposed settlement has been approved by the Federal court or is subject to such approval and whether such approval is expected or likely; and

(12) Such other information that is related to the insured loss as may be requested by Treasury that it deems necessary to evaluate the proposed settlement.

**§ 50.84 Subrogation.**

An insurer shall not waive its rights of subrogation under its property and casualty insurance policy and preserve the subrogation right of the United States as provided by section 107(c) of the Act by not taking any action that would prejudice the United States' right of subrogation.

Dated: July 23, 2004.

**Wayne A. Abernathy,**

*Assistant Secretary of the Treasury.*

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## DEPARTMENT OF DEFENSE

### Office of the Secretary

### 32 CFR Part 199

**RIN 0720–AA78**

## TRICARE; Individual Case Management Program; Program for Persons With Disabilities; Extended Benefits for Disabled Family Members of Active Duty Service Members; Custodial Care

**AGENCY:** Office of the Secretary, DoD.

**ACTION:** Final rule.

**SUMMARY:** The Department is publishing this final rule to implement requirements enacted by Congress in section 701(g) of the National Defense Authorization Act for Fiscal Year 2002 (NDAA–02), which terminates the Individual Case Management Program. The Department withdraws its proposed rule published at 66 FR 39699 on August 1, 2001, regarding the Individual Case Management Program. This rule also implements section 701(b) of the NDAA–02 which provides additional benefits for certain eligible active duty dependents by amending the TRICARE regulations governing the Program for Persons with Disabilities. The Program for Persons with Disabilities is now called the Extended Care Health Option. Other administrative amendments are included to clarify specific policies that relate to the Extended Care Health Option, custodial care, and to update related definitions.

**DATES:** Termination of the Individual Case Management Program (§ 199.4(i)) became effective December 28, 2001. The remainder of this rule is effective July 1, 2004.

**ADDRESSES:** TRICARE Management Activity, Medical Benefits and Reimbursement Systems, 16401 East Centretech Parkway, Aurora, CO 80011.

**FOR FURTHER INFORMATION CONTACT:** Michael Kottyan, Medical Benefits and Reimbursement Systems, TRICARE Management Activity, telephone (303) 676–3520. Questions regarding payment of specific claims should be addressed to the appropriate TRICARE contractor.

**SUPPLEMENTARY INFORMATION:**

### I. Background

*The Individual Case Management Program (ICMP).* Under the provisions of section 704(3) of the NDAA–93 [Pub. L. 102–484], 10 U.S.C. 1079(a)(17) was enacted which allowed the DoD to establish the ICMP, also known as the Individual Case Management Program for Persons with Extraordinary Conditions (ICMP–PEC). This allowed a reasonable deviation from the restrictive statutory coverage of health services for patients who had exceptionally serious, long-range, costly and incapacitating conditions. The ICMP was officially implemented in March 1999 as a waiver program that provided coverage for care and services that were normally restricted from coverage under the Basic Program. Specifically, when a beneficiary was determined to meet the TRICARE definition of custodial care, coverage under the Basic Program was limited to one hour of skilled nursing care per day, twelve physician visits per year related to the custodial condition, durable medical equipment and prescription medications. The Department recognized that the exclusion of coverage when a family member is deemed to be a custodial care patient is both a financial and emotional burden. Consequently, the Department used the ICMP/ICMP–PEC authority to cover medically necessary care and to