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SUPERIOR COURT FOR THE STATE OF CALIFORNIA

COUNTY OF LOS ANGELES

JOHN GARAMENDI, Insurance Commissioner of the State of California, as Liquidator of the Estate of Fremont Indemnity Company, Plaintiff, v. LOUIS J. RAMPINO, JAMES A. McINTYRE, WAYNE R. BAILEY, JOHN A. DONALDSON, RONALD A. GRODEN, RAYMOND G. MEYERS, W. BRIAN O'HARA., Defendants.	Case No.: BC357691 **FIRST AMENDED COMPLAINT FOR BREACH OF FIDUCIARY DUTY** **Demand for jury trial**

John Garamendi, Commissioner of the California Department of Insurance, as liquidator of the Fremont Indemnity Company, states for his Complaint against the Defendants as follows:

I. PARTIES, VENUE AND JURISDICTION

1. California Insurance Commissioner John Garamendi and any successors in office are referred to herein as the "Commissioner". The Commissioner was appointed conservator of Fremont Indemnity Company ("Fremont Indemnity" or the "Company"), a California domiciled insurer, pursuant to court order entered on June 4, 2003 in Insurance Commissioner of the State of California v. Fremont Indemnity Company, Los Angeles Superior Court, Case No. BS083582 (the "Commissioner v. Fremont"). He was appointed liquidator pursuant to court order entered on July 2, 2003 in that same case. The Commissioner has all those powers enumerated in such orders and provided under the California Insurance Code, including Sections 1037 and 1057. The Commissioner brings this action on behalf of Fremont Indemnity in liquidation and all of Fremont Indemnity's policyholders and other creditors.

2. The Defendants are all individuals who, during 1998 and 1999 (referred to herein as the "Relevant Period"), or some portion thereof, served as directors and officers of Fremont Indemnity.

3. During the Relevant Period, Fremont Indemnity was a California domiciled insurer engaged in the business of writing workers compensation insurance in California and other states. During the Relevant Period, Fremont Indemnity had its corporate headquarters in Glendale, California.

4. Defendant James A. McIntyre was a director and Chairman of the Board of Fremont Indemnity during the Relevant Period. On information and belief, Mr. McIntyre is a resident of Los Angeles, California. Mr. McIntyre held board positions and served as Chairman on the board of each of the entities listed in paragraph 15, *infra*, during the Relevant Period.

5. Wayne R. Bailey was a director of Fremont Indemnity and served as Vice President and Treasurer of Fremont Indemnity during the Relevant Period. On information and belief, Mr. Bailey is a resident of Calabasas, California. Mr. Bailey also held board positions with each of the entities listed in paragraph 15, *infra*, during the Relevant Period. Mr. Bailey also served as Vice President and Treasurer of each of the entities listed in paragraph 15, *infra*, during the Relevant Period.

6. John A. Donaldson was a director of Fremont Indemnity and served as Vice President of Fremont Indemnity during the Relevant Period. On information and belief, Mr. Donaldson is a resident of Los Angeles, California. Mr. Donaldson also held board positions with FCIC, FIIC, and FICNW during the Relevant Period. (See par. 15, *infra*.) Mr. Donaldson also served as Vice President of FEIC, FICNW, FCAS, FCIC, and FPIC during the Relevant Period. (See par. 15, *infra*.)

7. Ronald A. Groden was a director of Fremont Indemnity, and served as Executive Vice President, Chief Financial Officer and Assistant Treasurer of Fremont Indemnity during the Relevant Period. On information and belief, Mr. Groden lives in Los Angeles, California. Mr. Groden also held board positions with each of the entities listed in paragraph 15, *infra*, during the Relevant Period. Mr. Groden also served as Chief Financial Officer, Executive Vice President, and Assistant Treasurer of each of the entities listed in paragraph 15, *infra*, during the Relevant Period.

8. Raymond G. Meyers was a director of Fremont Indemnity and served as Vice President of Fremont Indemnity during the Relevant Period. On information and belief, Mr. Meyers lives in Agoura, California. Mr. Meyers also held board positions with FCIC, FIIC, and FICNW during the Relevant Period. (See par. 15, *infra*.) Mr. Meyers also served as Vice President of FEIC, FICNW, FCAS, FCIC, and FPIC during some portion of the Relevant Period. (See par. 15, *infra*.)

9. W. Brian O'Hara was a director of Fremont Indemnity, and served as Executive Vice President of Fremont Indemnity during the Relevant Period. On

information and belief, Mr. O'Hara's last known address is in Los Angeles, California. Mr. O'Hara also held board positions with each of the entities listed in paragraph 15, *infra*, during the Relevant Period. Mr. O'Hara also served as Executive Vice President of each of the entities listed in paragraph 15, *infra*, during the Relevant Period.

10. Louis J. Rampino was a director of Fremont Indemnity, served as the President and Chief Executive Officer of Fremont Indemnity during the Relevant Period. On information and belief, Mr. Rampino lives in Long Beach, California. Mr. Rampino also held board positions with each of the entities listed in paragraph 15, *infra*, during the Relevant Period. Mr. Rampino served as Vice President, President and Chief Executive Officer of FEIC, FICNW, FCAS, FCIC, and FPIC during the Relevant Period. (See par. 15, *infra*.) Mr. Rampino also served as Executive Vice President of FIIC during the Relevant Period.

11. Venue of this action is proper in this Court pursuant to California Code of Civil Procedure ("CCP") § 395 because one or more defendants resides in Los Angeles County. This Court has jurisdiction over this action pursuant to Insurance Code § 1058.

II. OVERVIEW

12. This case arises out of a scheme by directors and officers of Fremont Indemnity during 1998 and 1999 to cause the Company to engage in an inappropriate underwriting scheme that caused injury to the Company. The scheme consisted of obtaining excess of loss reinsurance covering per claim losses above $50,000 but below $1,000,000, then changing the company's underwriting practices – both with respect to the amount of premium charged and the nature of the business that could be underwritten – in an attempt to increase disproportionately the amount of risk borne by those reinsurance layers. That scheme was not disclosed to the reinsurers.

13. Fremont Indemnity's reinsurers at layers between $50,000 and $1,000,000 per claim discovered the scheme and took steps to rescind or commute their treaties. In the resulting settlements of those disputes, Fremont Indemnity lost over $200 million in reinsurance. Those losses represent a substantial harm to the estate of Fremont Indemnity in liquidation. The scheme was a substantial factor in causing those losses.

14. All of the defendants named herein either knew of the scheme or had a duty to know of it, and acted recklessly in allowing the scheme to take place. Each of them breached their fiduciary duty to Fremont Indemnity by allowing the scheme to take place. They are all equally liable for the harm suffered by the Company as a result of the scheme.

III. DEFENDANTS' CONDUCT SUPPORTING LIABILITY

A. Business of Fremont Indemnity

15. "Fremont Indemnity", as used herein, refers to Fremont Indemnity Company prior to its merger with Fremont Industrial Indemnity Company on August 31, 2001 ("original Fremont Indemnity") and to the resulting post-merger entity, also named Fremont Indemnity Company. Unless otherwise specified herein, "Fremont Indemnity" also refers to each of the following entities to which the current Fremont Indemnity is a successor in interest:

- Fremont Employers Insurance Company (FEIC) (merged into the original Fremont Indemnity Company October 31, 2000).
- Fremont Indemnity Company of the Northwest (FICNW) (merged into the original Fremont Indemnity Company on October 31, 2000).
- Fremont Industrial Indemnity Company (FIIC) (the original Fremont Indemnity Company was merged into FIIC on August 31, 2001, and the surviving entity was re-named Fremont Indemnity Company).

- Fremont Casualty Insurance Company (FCAS)(merged into Fremont Indemnity March 31, 2002).
- Fremont Compensation Insurance Company (FCIC) (merged into Fremont Indemnity May 31, 2002).
- Fremont Pacific Insurance Company (FPIC) (merged into Fremont Indemnity May 31, 2002).

16. During the Relevant Period, Fremont Indemnity was engaged in writing workers compensation insurance coverage in California and other states. Fremont Indemnity had underwriting offices in various cities in California, including Glendale, San Francisco, and Fresno. It also had offices in Seattle, Washington; Chicago, Illinois; and other locations around the United States.

B. Underwriting and Reinsurance

17. The California Workers Compensation Insurance Rating Bureau ("WCIRB") assigns class codes to hundreds of different types of businesses. Each of those classes is also assigned a "hazard grade." Information is collected and made available regarding the statistical likelihood that a company in a given hazard grade will generate claims of a given frequency or severity. In California, the WCIRB assigns classes to hazard grades A through I. Nationwide, the National Council on Compensation Insurance ("NCCI") assigns companies to hazard grades 1-4, with hazard grades 3 and 4 tending to have most severe claims.

18. When deciding whether to issue a policy and how much premium to charge for it, underwriters at the ceding company are required to consider whether the premium charged will be adequate to meet all the covered losses likely to be incurred under that policy, plus the costs of claims handling, commissions, taxes, and a level of profit for the company itself. Underwriters at Fremont Indemnity were assisted in this task by underwriting guidelines, worksheets, and other tools created by the Company. Those tools used the system of industrial classifications and hazard grades referenced above.

19. An excess of loss reinsurance treaty is an agreement pursuant to which one insurance company (the "reinsurer") agrees to pay another insurance company (the "ceding company") in respect of losses paid by the ceding company on any claims above a certain level, or between two agreed upon levels (the reinsurance "layer"). A treaty may apply to all business written by the ceding company, or to a defined category of such business. In return, the ceding company pays the reinsurance company a percentage of the total premium collected by the ceding company on all policies covered by the treaty. All reinsurance referred to in this Complaint is excess of loss reinsurance.

20. In negotiating the percentage of premium to charge under a treaty, reinsurers obtain data from the ceding company regarding the company's underwriting philosophy and guidelines, including the classes and hazard grades in which the company solicits business, and those it avoids. Data regarding the extent to which a ceding company writes business in any given class or hazard grade can be used to predict the statistical likelihood that policies covered by a treaty will generate claims implicating a given level of reinsurance. Reinsurers also obtain data regarding the company's claims experience on its existing book of business, including the extent to which claims have implicated the reinsured layer in the past.

C. The Scheme

21. Prior to 1998, Fremont Indemnity had reinsurance treaties that generally applied to losses in excess of $1 million per claim. The vast majority of claims made under Fremont Indemnity policies would not exceed $1 million, and therefore those reinsurance treaties would not apply.

22. In late 1997 and early 1998, Fremont Indemnity underwent a dramatic change in its reinsurance program. On or about December 1997, it entered into a treaty with TIG Re (later named Odyssey America Reinsurance Corporation ("Odyssey")) and Zurich Re (later named Converium Reinsurance (North America), Inc. ("Converium")) to provide reinsurance for losses on claims between $250,000

and $1 million (referred to as the "750 xs 250 layer"). By March 6, 1998, it had also entered into a treaty with Reliance Re to provide reinsurance for losses on any claim between $100,000 and $250,000 (the "150 xs 100 layer").

23. During the period March through June, 1998, Fremont Indemnity negotiated a third treaty to cover the 50 xs 50 layer. That coverage was bound with Constitution Re (later named Gerling Re) by June 11, 1998. The treaties applicable to the three layers between $50,000 and $1,000,000 per claim are referred to collectively herein as "the Treaties." Each of the Treaties applied to all policies written by Fremont Indemnity between January 1, 1998 through December 31, 1999.

24. In negotiating the Treaties, Fremont Indemnity used the services of Sedgwick Re (later merged into Guy Carpenter, but referred to herein as "Sedgwick") as broker. Sedgwick acted as the agent for Fremont Indemnity, contacting reinsurers on its behalf, forwarding information to them, and making representations to them on Fremont Indemnity's behalf.

25. Beginning in March, 1998, after the 150 xs 100 and 750 xs 250 layers had been bound and while the 50 xs 50 layer was still being negotiated, Fremont Indemnity began changing its underwriting practices. Those changes were as follows:

a. As early as March 1998, underwriters were directed to give pricing discounts to insureds whose risk profile indicated that their losses would fall disproportionately on the reinsurers under the new Treaties. Those included large deductible policies, retrospectively rated policies where insureds sought a loss limitation of $100,000 or more, and guaranteed cost policies where a substantial percentage of the losses in prior years were in connection with claims that would fall within the Treaties.

b. In setting the premium level on "loss rated policies" (i.e., policies underwritten by using prior loss experience as a guide to set premium), underwriters were directed to "cap" the prior losses, so as to disregard prior losses on claims over $50,000, which would be covered by the Treaties. This resulted in failing to charge premium sufficient to cover the losses likely to be borne by reinsurers under the Treaties.

c. Underwriters were directed to aggressively go after higher severity accounts in NCCI hazard grades 3 and 4, and the equivalent California hazard grades, because the increased "severity" losses likely to result from such business would be borne disproportionately by the Treaties, not by Fremont Indemnity itself.

26. The above scheme constituted a dramatic shift in the underwriting philosophy at Fremont Indemnity. The previous policy had been to set premium without regard to whether anticipated losses would be covered by reinsurance, and to avoid high severity risks such as those in hazard grades 3 and 4.

27. The dramatic change in underwriting philosophy is illustrated by the fact that in August 1998, Fremont Indemnity officially revised its underwriting guidelines regarding which industrial classifications underwriters were allowed to write. In light of the existence of reinsurance, the Company changed 139 high hazard grade or otherwise risky business classifications from "prohibited" to "allowed."

28. The impact of this scheme on a reinsurer is as follows: If a ceding company historically has written business in which x percent of all loss falls in the reinsured layer, and the reinsurer negotiates to receive y percent of all premium from the ceding company, the reinsurer has made a bargain to take a certain level of risk in exchange for an agreed upon percentage of premium. If thereafter the ceding company changes its underwriting practices, soliciting more hazardous "severity"

business in which a higher percentage of losses fall in the reinsured layer, the reinsurer will suffer more loss than it bargained for per dollar of premium.

29. The scheme also involved "net line underwriting." Net line underwriting is the practice by which the ceding company sets premium at a level such that the percentage of the premium the ceding company keeps (after paying the reinsurer its share) is sufficient to cover the ceding company's losses (i.e., its "net" losses, not covered by reinsurance) plus commissions, taxes, and profit for the ceding company. However, in net line underwriting, the ceding company does not factor into the premium calculation a sufficient amount to cover all of the losses likely to arise under the policy, including those that will fall in the reinsured layer.

30. The scheme at Fremont Indemnity involved both of the above described features: the Company changed its underwriting practices to solicit and write higher severity risks, and then set the premium for those risks at a level that was not calculated to cover losses likely to fall within the Treaties.

31. One by one, the reinsurers discovered the existence of the scheme and sought to rescind or commute the Treaties. Reliance, which had the 150 xs 100 layer, began an audit of Fremont Indemnity underwriting practices in January 2000 and reached an agreement to commute its Treaty on or about February 28, 2000. Pursuant to the terms of that commutation agreement, Fremont Indemnity renounced the right to obtain future benefits under the Treaty, constituting a shortfall of at least $75 million, and probably much more, compared with what Fremont Indemnity would have obtained had the treaty not been commuted.

32. Gerling Re (successor to Constitution Re), which had the 50 xs 50 layer, initiated an audit in June 2002. On September 11, 2002 it forwarded a demand for arbitration to Fremont Indemnity. The Gerling dispute was settled on or about December 16, 2004 by a commutation of the Gerling Treaty. Pursuant to that commutation, Fremont Indemnity suffered a shortfall of over $70 million.

33. Converium Re and Odyssey Re, the reinsurers with the 750 xs 250 layer, also disputed their obligations under their Treaty. In September, 2004, that dispute was also settled, resulting in a shortfall to Fremont Indemnity of over $59 million.

34. Thus, in total, the commutation of the Treaties, under the cloud of the above described scheme, caused Fremont Indemnity to lose reinsurance coverage totaling in excess of $200 million.

35. The scheme was a substantial factor in causing the above economically unfavorable settlements and commutations, and the resulting reinsurance losses. Moreover, the scheme was also a substantial factor in causing the issuance of numerous policies for high hazard accounts on which Fremont Indemnity suffered losses separate and apart from the loss of reinsurance.

D. Duties of Defendants as Directors and Officers of Fremont Indemnity

36. As directors, each of the defendants occupied a position of trust with respect to Fremont Indemnity as defined under California law. As such they owed the companies of which they were directors duties of loyalty, due care, and good faith. Defendants were required to perform their duties as directors in good faith. They were required to perform their duties in a manner each of them believed to be in the best interests of the corporation and its shareholders. They were required to perform their duties with such care, including reasonable inquiry, as an ordinary prudent person in a like position would use under similar circumstances. As directors they were not allowed to engage in acts involving a reckless disregard for their duty to the corporation or its shareholders in circumstances in which they were aware, or should have been aware, in the ordinary course of performing their duties, of a risk of serious injury to the corporation. They were not allowed to engage in acts or omissions amounting to an unexcused pattern of inattention amounting to an

abdication of their duties as directors. They were not allowed to engage in acts from which they derived an improper personal benefit.

37. The above defendants were also corporate officers of Fremont Indemnity or one or more of the Companies. As a result, they were also fiduciaries of the companies of which they were officers, and owed such companies a duty to use due care in the conduct of its business, a duty of loyalty, and a duty of good faith, as well as duties related specifically to the particular offices and responsibilities assigned to each of them as officer.

E. Breach of Duty of by Defendants

Defendant's knowledge of the scheme

38. Defendant W. Brian O'Hara was intimately involved in the creation and implementation of the scheme.

a. Mr. O'Hara was a participant in early discussions with the senior underwriting staff during which the scheme was conceived of and developed.

b. Mr. O'Hara participated in at least one meeting during which the underwriters' performance in implementing the scheme was favorably reviewed with senior management.

c. Mr. O'Hara was copied on important directives and guidelines to the underwriting staff laying out the scheme in detail.

d. Mr. O'Hara was the recipient of a memorandum in August, 1998 from the lead underwriter at Fremont Indemnity advising that 139 high hazard company class codes that were previously not permissible to write could now be written as a result of the Company obtaining reinsurance coverage pursuant to the Treaties.

39. Defendant Ronald Groden had a special responsibility for the Company's reinsurance relationships, including the acquisition of the Treaties. He

participated in meetings and audits with the reinsurers in 1998 in setting up the reinsurance relationships. In addition:

a. He received internal emails putting him on notice of the existence of the scheme from underwriters.

b. He was one of those who received the memorandum in August, 1998 advising that 139 high hazard company class codes that were previously not permissible to write could now be written as a result of the Company obtaining the Treaties.

c. He is reflected in meeting notes as having participated in at least one high level executive meeting regarding the scheme, along with Brian O'Hara and Louis Rampino.

d. He was present on more than one occasion when Mr. Rampino improperly told underwriters at Fremont to "use the treaties" when underwriting policies.

40. Moreover, Mr. Groden's involvement in the scheme was culpable in that, despite knowing of the existence of the scheme, he represented to the reinsurers, through communications with Sedgwick, that Fremont was not engaged in any form of net line underwriting, at a time when he knew the opposite to be the case. He participated in meetings with reinsurers at which the existence of the scheme was concealed.

41. Defendant Louis Rampino was a director of Fremont Indemnity before he took over as president and CEO on or about June 5, 1998. Mr. Rampino took over as president and CEO as the scheme was being developed, and the 50 xs 50 layer was being finalized. Mr. Rampino was the prime mover behind the push for Fremont Indemnity to increase its business dramatically in 1998 and 1999. On information and belief, he told underwriters at Fremont Indemnity that he wanted the Company to grow from a $600 million premium company to a $1 billion premium company by January 1999.

42. Mr. Rampino was also at the same high level meeting referred to in paragraph 39c above, with Mr. O'Hara and Mr. Groden, at which the scheme was discussed.

43. Like Mr. Groden, Mr. Rampino was involved in defending Fremont's underwriting practices to the reinsurers at the very time the scheme was going on. At one such meeting, Mr. Rampino was reported as giving "a very passionate talk about net v. gross line underwriting" which was intended to and did convinced the reinsurer that Fremont was not using their reinsurance as a means to write "bad business," even though the opposite was the case.

44. At the same time Mr. Rampino knew about the scheme and encouraged it as a way to grow the Fremont Indemnity business during a soft market. He improperly advised underwriters on more than one occasion to "use the treaties" when pricing policies.

45. In addition, based on Mr. Rampino's position as president and CEO of Fremont Indemnity, it is a fair inference that he must have known of the scheme given its importance to the business of Fremont Indemnity in 1998-1999. It is inconceivable that, as president of the company, he was not aware, for example, that Fremont Indemnity had radically changed its underwriting practices to allow 139 previously prohibited classes of business to now be written, or that this significant change in the company's business model was motivated and justified by the fact that a disproportionate share of the losses likely to be incurred on those accounts would fall on the Treaties.

46. Between June 5, 1998 and the end of 1999, the Fremont Indemnity board of directors consisted of the above three named defendants, plus four others: James McIntyre, Raymond Meyers, John Donaldson, and Wayne Bailey.

47. The Commissioner alleges on information and belief that each of those individuals was aware of the existence of the scheme based on the following:

a. The decision to enter into the Treaties, lowering the attachment point for Fremont Indemnity's reinsurance program from $1 million to $50,000, was a dramatic change in the Company's business.

b. The Treaties were an extremely important part of Fremont Indemnity's business model in 1998 and 1999. The Treaties cost Fremont Indemnity approximately 20% of its premium, and covered a large percentage of its liabilities.

c. The bylaws of Fremont Indemnity recognize the importance of reinsurance by authorizing the establishment of a Reinsurance Committee of the board.

d. Fremont Indemnity made a decision as early as December 1998 to pursue renewal of the Treaties. That decision must have had board approval.

e. Fremont Indemnity's financial statements for year end 1998 revealed to each of the board members that the business being written by Fremont Indemnity was unprofitable, and that Fremont was only making money because a disproportionate amount of the losses were being borne by the reinsurers under the Treaties, who were losing money. As a result, it was highly unlikely Fremont's reinsurers would choose to renew the Treaties on the same terms, if at all.

f. In light of the above, all board members had a duty to inform themselves, and on information and belief did inform themselves, regarding the impact and significance of the reinsurance program on Fremont Indemnity's business, including (i) what effect the Treaties were having on Fremont Indemnity's sales, (ii) whether the Treaties were profitable for Fremont Indemnity, including whether the risk being transferred under the Treaties was greater or less than the cost of the premium being paid to the reinsurers, (iii) whether the reinsurers

were likely to renew the Treaties, in light of their experience (iv) whether the reinsurers had a basis to rescind or commute the Treaties, (v) the impact on Fremont Indemnity if the reinsurers were to rescind, commute or fail to renew the Treaties. Any reasonably diligent inquiry into the above subjects by the board would have resulted in the board finding out about the scheme.

g. The board had a duty to monitor and be informed about the profitability of the Company. Any presentation to the board on that subject while the scheme was underway would have to have included a discussion of the scheme.

h. The scheme changed Fremont Indemnity's business by encouraging and allowing underwriters to cover risks in higher hazard grades than before. The written policies of the company were amended to allow writing 139 classes of business which were prohibited before the scheme began, all of which were high hazard grade classes of business. Such change was explicitly justified in the Company's written policies by the existence of the Treaties. That was a fundamental change in the Company's policies and business model of which the board must be presumed to have been aware.

i. Three other board members, including the president and CEO (Rampino), the chief financial officer (Groden), and an executive vice president (O'Hara), all had proven actual knowledge of the scheme.

j. The remaining four board members of Fremont Indemnity were not independent outside directors who had only limited contact with the Company. Wayne Bailey was Vice President and Treasurer of Fremont Indemnity. McIntyre, Donaldson and Meyer all held senior officer positions with one or more of the direct or indirect parent entities that wholly owned Fremont Indemnity. All were elected to their board

positions by Fremont Indemnity's sole shareholder and parent entity. Each of them held officer positions with various Fremont companies, as set forth in paragraph 15 above.

k. Defendants had special experience and expertise which, combined with the above facts, must have put them on notice of the significance of the scheme to Fremont Indemnity. The board as a whole had familiarity with the duties owed by ceding companies to reinsurers due to the fact that Fremont Indemnity itself had a reinsurance company subsidiary. Several of the defendants, including McIntyre, Bailey, Donaldson and Rampino, held officer positions with Fremont Re. As a result, the board generally and those defendants in particular must have known that the scheme violated Fremont Indemnity's duties to its reinsurers. Moreover, that experience means they would have understood the significance of the press articles referred to in paragraph 51, below.

l. The defendants were all sophisticated business persons who were experienced at interpreting financial reports and understanding financial relationships. The existence of the scheme, and its impropriety, would have been apparent to them based on their experience and sophistication.

48. In light of the above, it is a fair inference that each of the remaining four defendants had actual knowledge of the existence of the scheme and its impropriety.

Failure of to respond to facts evidencing risk to the Company

49. The facts recited in paragraph 47 above constituted danger signs that put the defendants on notice of legal, economic and business risk to the Company. As board members and officers, being exposed to such danger signs, they had a duty to investigate to determine the extent of risk posed to the company and to make

a reasoned and conscious decision as to whether steps needed to be taken to control or minimize that risk.

50. One specific danger sign was that the reinsurers were suffering extreme and unsupportable loss ratios on the ceded business. The board was exposed to evidence from Fremont's own actuarial department that the reinsurers were suffering twice as high a level of losses per dollar of premium received as Fremont. That data indicated that, without the Treaties, Fremont's business would be unprofitable and unsustainable. It also indicated that the reinsurers would have every incentive to not renew the Treaties, and to get out of their obligations early if given the opportunity to do so.

51. In addition, articles appeared in the insurance trade press that should have alerted the board to a need to investigate Fremont's reinsurance relationships under the Treaties. An article in the industry trade press in October 1998 quoted workers compensation insurance industry representatives as stating that Fremont was using its new Treaties as an opportunity to cut prices on higher hazard business, and that this could leave insurers like Fremont "holding the bag" with "very underwater pricing and without reinsurance markets." Other articles expressed the view that such conduct could ultimately result in the loss of the reinsurance.

52. Board members of Fremont were aware of those articles. Mr. Groden specifically drafted language and arguments for use by Sedgwick in an attempt to rebut the implications of misconduct in those articles.

53. Those articles put the board members on notice of a risk that the reinsurers would assert that the conduct alleged in the articles constituted a basis to rescind the Treaties. Rescission of the treaties would cause even greater harm to the Company than mere non-renewal. If rescission were successful, the reinsurers would be entitled to walk away from their liability on all of the policies already written by Fremont during the period covered by the Treaties. If that happened the

disproportionate loss ratios being suffered by the reinsurers would immediately and retroactively become Fremont's liability.

54. The facts regarding unsupportable and disproportionate loss ratios for the reinsurers, coupled with allegations in the press of conduct that could support rescission of the Treaties, constituted notice to the board of legal, reputational and financial risk to Fremont. The board had a duty to investigate that risk.

55. Any reasonable investigation by the board or its delegees would quickly have uncovered the existence of the scheme. However, the board conducted no such investigation and received no reports from officers, board members, experts or committees of the board, or counsel, on that subject in response to being put on notice of that risk.

56. Defendants conduct in ignoring and failing to act on danger signs such as those listed in paragraphs 47 through 55 above constituted a breach of the duty of care, breach of the duty of loyalty, and breach of the duty of good faith owed by directors and officers to their corporation.

Failure to monitor and oversee the Company's reinsurance business

57. The Treaties constituted a dramatically new business model for Fremont Indemnity. They required Fremont Indemnity to pay the reinsurers 20% of all premium dollars collected, an enormous expenditure. In return, the reinsurers contractually agreed to pay for losses falling in the ceded layer, which were expected to constitute, and did constitute, a large portion of all liabilities of the Company. Whether this deal would turn out to be profitable or unprofitable for Fremont depended on a host of factors that could be predicted through actuarial techniques, however those predictions could be materially in error as a result of factors not entirely in the Company's control, including the number and nature of claims made by injured workers during the time period covered by the Treaties. A miscalculation with respect to those calculations could bankrupt the Company.

58. The Company policy regarding what type of business to write – high or low risk, high or low severity – was also vitally important to Fremont as an insurance company. A dramatic shift in underwriting philosophy toward or away from a given category of business was a significant enough event that the board should have informed itself about it and reviewed it.

59. In light of the above, the board of Fremont had a duty to ensure that information and reporting systems were in place reasonably designed to provide senior management and the board with timely, accurate information so that the board and management could reach informed judgments about the impact of the new reinsurance program and changed underwriting policies on the Company.

60. The board failed in this duty. It did not put systems in place reasonably designed to bring abuse of the reinsurance Treaties to the board's attention. It did not put systems in place reasonably designed to bring a dramatic shift in underwriting philosophy toward higher severity risks, which would be viewed by reinsurers as abusive, to the board's attention. It did not put systems in place reasonably designed to ensure that the board was aware of facts that could lead to nonrenewal or rescission of the Treaties.

61. The bylaws of Fremont Indemnity and each of the Fremont workers compensation companies authorized appointment of a reinsurance committee specifically tasked with monitoring and supervising the Company's crucial reinsurance relationships. Only Fremont Casualty had such a committee – none of the other Fremont companies appointed a reinsurance committee.

62. The Fremont Casualty Reinsurance Committee acted as a mere rubber stamp, receiving after the fact reports from Ronald Groden and one other Fremont employee regarding decisions already taken by Company management to purchase reinsurance, or renew it. The Reinsurance Committee conducted no investigations of its own, and took no steps to understand the truth about the Company's reinsurance relationships. It was established only because Illinois law required

insurers domiciled in that state to have such a committee, and Casualty was domiciled in Illinois.

63. The board of directors of Fremont did not take any meaningful steps to supervise or monitor the reinsurance business of the Company. Each of the defendants recklessly failed to exercise oversight over the business of Fremont Indemnity, including its reinsurance and underwriting operations.

64. To the extent any defendant did not know of the scheme, such defendant's failure to be aware of it and stop it constituted a breach of that defendant's duty of care, a failure to engage in reasonable inquiry, a reckless disregard of duty, and an unexcused pattern of inattention amounting to an abdication of duty as a director.

Defendants' self interest in perpetuating the scheme

65. In failing to curtail the improper scheme, defendants acted in their own self interest and contrary to the interests of Fremont Indemnity. At least five of the defendants – McIntyre, Rampino, Bailey, Donaldson and Meyers – were participants in an incentive compensation plan created by the parent entity of Fremont Indemnity, pursuant to which they were entitled to substantial bonus compensation if the net income before taxes of Fremont Indemnity's parent entity exceeded 120% of a $400 million "target" for the three year period ended December 31, 1998. During those years income generated by Fremont Indemnity constituted roughly three fourths of the net income earned by Fremont's parent. It was only by allowing the scheme to operate that defendants were able to exceed the target net income number by a hair more than the necessary number -- 120.96% -- and thereby trigger substantial bonus compensation to themselves.

66. On information and belief, all defendants received substantial bonus and incentive compensation based on the Company's results in 1998 and 1999 while the scheme was in operation, including cash bonuses and grants of stock. It is a

reasonable inference that defendants were motivated to allow the scheme to continue by the desire to obtain such compensation.

Conspiracy

67. On information and belief, all seven defendants conspired and agreed with one another to effectuate the scheme and keep it hidden from persons outside Fremont, including reinsurers, Sedgwick, the press, and the Department of Insurance. As co-conspirators, each acted as the agent for the others, and the knowledge of and liability of each gained in the course of implementing the conspiracy is imputed to all.

F. Discovery of the Scheme and Statute of Limitations

68. The Commissioner was appointed conservator of Fremont Indemnity on June 4, 2003, and liquidator on July 2, 2003. Prior to those dates, the Company was controlled by defendants and persons working in concert with them, who had no incentive to assert the claims alleged herein because to do so would reveal their own improprieties and could result in their own liability. The Commissioner was not empowered to assert the present claims until he was appointed conservator.

69. The Commissioner was first made aware of the existence of the scheme at or about the time the Company was placed in conservation. At that time, the Commissioner became responsible for defending Fremont Indemnity against claims asserted it in an arbitration proceeding in which Gerling sought to rescind its Treaty. The allegations regarding the scheme were revealed to the Commissioner at that time by Fremont Indemnity.

70. On information and belief, after the commutation of the Reliance treaty, officers of Fremont Indemnity, including Mr. Bailey, met with agents of the Department of Insurance, including Norris Clark and Ramon Calderon, and represented to those individuals that the reason the Reliance treaty was commuted was solely because of concerns about the financial health and stability of Reliance. The allegations regarding net line underwriting made by Reliance, which were a

substantial factor in causing the commutation of that treaty, and consequent loss to Fremont Indemnity, were concealed from the Department at that time.

71. As a result of the affirmative efforts of the defendants to conceal the existence of the scheme, plaintiff was prevented from discovering the existence of the scheme, nor could it reasonably have been discovered through the exercise of reasonable diligence, prior to June 4, 2003.

72. This action is timely in that the four year statue of limitations applicable to claims for breach of fiduciary duty by corporate directors did not begin to run against the Commissioner as liquidator of Fremont Indemnity until he assumed control of the Company on June 4, 2003. Alternatively, the statute did not begin to run until agents of the Commissioner learned of the scheme, which also occurred on or about June 4, 2003. This action is being filed less than four years after that date.

FIRST CAUSE OF ACTION

BREACH OF FIDUCIARY DUTY

Against all defendants

73. Plaintiff incorporates by reference paragraphs 1 through 72 in this cause of action.

74. Each of the defendants named herein breached their fiduciary duties to Fremont Indemnity by causing or allowing the Company to engage in the scheme described above.

75. That scheme was a substantial factor in causing the commutation of Fremont Indemnity's reinsurance treaties at the 50 xs 50, 150 xs 100, and 750 xs 250 layers on terms that were economically unfavorable to Fremont Indemnity. In those commutations Fremont Indemnity suffered a shortfall of over $200 million. Those losses were proximately caused by the conduct of defendants in causing and allowing Fremont Indemnity to engage in a course of conduct which supported an argument by the reinsurers that Fremont Indemnity breached its duty toward the

reinsurers on the Treaties, and that therefore those reinsurers that they had a right to rescind the Treaties. Such conduct also has caused and may further cause reinsurance treaties with attachment points above $1 million per claim be commuted on less favorable terms that would be the case absent the scheme.

76. In addition, Fremont Indemnity suffered losses on certain policies written pursuant to the scheme separate and apart from the loss of reinsurance. Defendants' conduct in causing and allowing the Company to engage in the scheme was a substantial factor in causing the Company to issue those policies at the premiums in question. Defendants' conduct was a proximate cause of losses incurred on such policies.

PRAYER FOR RELIEF

77. Wherefore, plaintiff requests that judgment entered in his favor and against each defendant, as follows:

a. Jointly and severally against each defendant for damages suffered by Fremont Indemnity, its policyholders and creditors, as a result of such breaches, in an amount to be established at trial

b. Severally against each defendant, for damages equaling the unjust enrichment obtained by such defendant as a result of the above breaches, in an amount to be established at trial.

c. Exemplary and punitive damages against defendants Rampino, O'Hara and Groden.

d. Costs and such other relief as the Court deems appropriate.

DEMAND FOR JURY TRIAL

78. Plaintiff demands a trial by jury on all causes of action alleged in this Complaint.

Dated: October 12, 2006

THELEN REID & PRIEST LLP

By _____
Karl D. Belgum
Attorneys for Plaintiff

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