

**DEPARTMENT OF INSURANCE
CONSERVATION & LIQUIDATION OFFICE**

P.O. Box 26894
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**MEMORANDUM**

To: All Superior National Employees
All Parties Interested In the Conservation and
Rehabilitation of the Superior National Insurance
Companies in Conservation

From: Richard G. Krenz
Special Deputy Insurance Commissioner

Date: June 28, 2000

Re: Rehabilitation Plan Proposals and June 30, 2000
Overbid Hearing

On June 27, 2000, the Conservation & Liquidation Office of the California Department of Insurance filed with the Los Angeles Superior Court and distributed to all interested parties the attached *Identification of "Winning Bidder" and Overbid and Confirmation Procedures* (the "Winning Bidder Notice"). The Winning Bidder Notice advised the Superior Court and interested parties that the Conservator of the Superior National Insurance Companies in Conservation had received and was recommending Court approval of a comprehensive and binding rehabilitation plan proposal that had been submitted by the Kemper Insurance Companies, including Lumbermens Mutual Casualty Company ("Kemper"). The Kemper proposal is attached as Exhibit B to the Winning Bidder Notice.

The Conservator's recommendation of the Kemper proposal is subject to an "Overbid" hearing that is scheduled to commence in the Superior Court in Los Angeles at 9:00 a.m. on Friday, June 30, 2000. At the Overbid Hearing, any qualified party may submit a competing proposal to participate in a rehabilitation plan. The purpose of the Overbid Hearing is to identify the qualified party submitting a binding rehabilitation plan proposal that provides the greatest level of benefits to the beneficiaries of the Superior National Insurance Companies, including claimants, policyholders, employees and other creditors and interested parties. At the conclusion of the Overbid Hearing,

the Commissioner anticipates entering into a binding letter of intent with the prevailing bidder. Ultimate consummation of any transaction is subject to approval at a final hearing on the Conservator's Motion for Approval of the Rehabilitation Plan, which should be held in mid-August.

The submission of the Winning Bidder Notice and the forthcoming Overbid Hearing marks the beginning of the formal and continuing process of rehabilitating the insurance businesses of the Superior National Insurance Companies. The Conservator anticipates that the Overbid Hearing will involve an active process that will continue to add significant value for the benefit of all interest parties and employees.

The Conservation & Liquidation Office greatly appreciates the patience and devotion of the Superior National employees to this transition process and will keep you advised as the process develops.

COPY

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8
 9 **IN THE SUPERIOR COURT OF THE STATE OF CALIFORNIA**
 10 **FOR THE COUNTY OF LOS ANGELES**

11 **INSURANCE COMMISSIONER OF THE STATE**
OF CALIFORNIA,
 12
 13 **Applicant,**
 14 **v.**
 15 **SUPERIOR NATIONAL INSURANCE COMPANY,**
 16 **Respondent.**
 17
 18 **AND CONSOLIDATED CASES**
 19

Case No.: BS 061974

Consolidated with:
 BS 061975
 BS 062171
 BS 062173

IDENTIFICATION OF "WINNING BIDDER" AND OVERBID AND CONFIRMATION PROCEDURES

Date: June 30, 2000
 Time: 9:00 a.m.
 Place: Dept. 28

20 **The Insurance Commissioner of the State of California as Conservator of Superior**
 21 **National Insurance Company, Superior Pacific Casualty Company, California Compensation**
 22 **Insurance Company, Commercial Compensation Casualty Company and Combined Benefits**
 23 **Insurance Company (hereinafter referred to as the "Conservator" of the "Conserved Companies")**
 24 **files this identification and description of the "winning bid," and explanation of the overbid and**
 25 **confirmation procedures.**

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IDENTIFICATION OF "WINNING BIDDER," AND OVERBID AND CONFIRMATION PROCEDURES

THE REQUEST FOR PROPOSAL AND DUE DILIGENCE PERIOD

On May 3, 2000 the Conservator issued and publicized his Request for Proposals to rehabilitate the insurance businesses of the Conserved Companies (the "RFP"). A copy of the RFP is attached as Exhibit A. The RFP was widely distributed within the insurance and reinsurance industry. At or before the overbid hearing described below, the Conservator will provide evidence and information detailing his dissemination of the RFP. On June 1, 2000 Lumbermans Insurance Company (hereinafter "Kemper") and other insurers and reinsurers notified the Conservator of their intention to enter into the RFP procedure and entered into confidentiality agreements that allowed them to begin an extensive due diligence process. This due diligence included review of thousands of documents maintained in a "data room" as well as elsewhere, visits to various regional offices and interviews of and meetings with numerous executives, managers, employees and producers.

THE WINNING BID

On June 27, 2000, Kemper submitted a final, binding proposal in response to the RFP process to participate in the rehabilitation of the Conserved Companies (the "Kemper Proposal"). A copy of the Kemper Proposal is attached as Exhibit B. The structure of the Kemper Proposal is complex, but it can be summarized by its four primary components. The Kemper Proposal provides for (1) the acquisition of the exclusive right to write renewal policies to the existing policyholders of the Conserved Companies; (2) an agreement to administer run-off claims under insurance policies issued by the Conserved Companies on behalf of the Conservator and the California Insurance Guarantee Association (hereinafter referred to as "CIGA"); (3) the purchase of certain operating assets required by Kemper to write renewal and new insurance policies and to administer claims; and (4) a proposal for the placement of retroactive reinsurance with Swiss Re on policies issued by the Conserved Companies. The first three components of the Kemper Proposal are integrated. The reinsurance component is severable.

1. Presumably, CIGA will independently evaluate this part of the bid and may enter into negotiations with Kemper and/or the Conservator. It is anticipated that CIGA will take an active role in the June 30th hearing.

2.

IDENTIFICATION OF "WINNING BIDDER" AND OVERBID AND CONFIRMATION PROCEDURES

1 The consideration to be Kemper includes (1) the payment of a 2% commission on
 2 all premiums written for renewal policies; (2) a 50% profit sharing for all renewal and new
 3 policies issued during a three year period following closing; (3) \$2,250,000 in cash; (4) an
 4 additional purchase price for certain fixed assets to be identified in the future. The Conservator
 5 is preparing financial models to estimate the potential amount that may be received by the estate
 6 under the commission and profit sharing provisions of the Kemper Proposal and will present
 7 evidence of such estimates at or before the hearing on June 30, 2000. The Kemper Proposal also
 8 includes indications that Kemper anticipates employing more than one-half of the current
 9 employees within California and approximately 20% of employees outside of California.
 10 Finally, the Kemper Proposal contemplates its participation in the resolution of holding company
 11 (Superior National Insurance Group, Inc.) issues.

12 For the reasons to be described in detail at the June 30, 2000 overbid hearing, the
 13 Kemper Proposal is acceptable to the Conservator and he has selected the Kemper Proposal as
 14 the "winning bid," subject to the overbid procedure described below.

15 **THE COURT MUST UTILIZE THE ABUSE OF DISCRETION STANDARD**
 16 **WHEN IT REVIEWS THE CONSERVATOR'S DECISION**

17 The Conservator's RFP process has been conducted under the authority set forth
 18 in Article 14 of the Insurance Code, including Insurance Code section 1043, which provides in
 19 relevant part that:

20 " In any proceeding under this article, the commissioner, as conservator or
 21 as liquidator, may, subject to the approval of said court, and subject to such liens
 22 as may be necessary mutualize or reinsure the business of such person or enter
 23 into rehabilitation agreements. . . ."

24 In compliance with Insurance Code section 1043, the Conservator therefore brings
 25 the instant application for approval of his selection of the Kemper Proposal, subject to any
 26 superior overbid, and for authority to enter into a rehabilitation agreement and other definitive
 27 agreements to document the rehabilitation plan.

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1 **A. The Conservator's Action Was Clearly An Appropriate Use of His Discretion**

2 The California Supreme Court long ago described these Insurance Code
3 conservation proceedings by stating in *Carpenter v. Pacific Mutual Insurance Company* (1937)
4 10 Cal.2d 307, at page 329, that:

5 "... Sections 1010 et seq. of the Insurance Code deal with rehabilitation
6 and liquidation of insurance companies in financial difficulties, and with the
7 reinsurance of their business. This phase of state control is extremely important.
8 Insurance is a public asset, a basis of credit, and a vital factor in business activity.
9 Obviously, if an insurance company gets into financial difficulties, something
10 must be done to remedy the situation. Either the company must be liquidated, and
11 its assets distributed to creditors, thus immeasurably injuring many of its
12 policyholders who are thus deprived of insurance protection or the business must,
13 if possible, be rehabilitated. The public has a grave and important interest in
14 preserving the business if that is possible. Liquidation is the last resort. [Citations
15 omitted]." (Emphasis added)

16 The Conservator proposes entering into a transaction with Kempér, or a successful
17 overbidder, which will allow, if possible, Conserved Companies' insurance business to continue
18 to exist. This transaction contemplates that the Conservator will receive the value of the
19 "franchise" which he can apply to the payment of existing claims. Therefore, the Conservator
20 should be authorized to document the proposed transaction and to proceed with a noticed hearing
21 on his motion for approval of a comprehensive rehabilitation plan for the Conserved Companies.

22 In its opinion in the case entitled *In Re Executive Life Insurance Company* (1995)
23 32 Cal.App.4th 344, the Court of Appeal explained this court's review of the actions of the
24 Commissioner when acting pursuant to Insurance Code section 1043:

25 "The Commissioner is an officer of the state (*Caminetti v. Pac. Mutual L.*
26 *Ins. Co.* (1943) 22 Cal.2d 344, 354 [139 P.2d 908]) who, when he or she is a
27 conservator, exercises the state's police power to carry forward the public interest
28 and to protect policyholders and creditors of the insolvent insurer. (*Carpenter v.*

1 Pacific Mut. Life Ins. Co. (1937) 10 Cal.2d 307, 330-331 [74 P.2d 761].” (*Id.* at
2 p. 356.)

3 The court then went on to explain that:

4 “In exercising this power, the Commissioner is vested with broad
5 discretion. (Commercial Nat. Bank v. Superior Court, supra, 14 Cal.App.4th at p.
6 402.) This discretion is subject to statutory limitations (see *id.* at p. 409) and the
7 requirement that the exercise of discretion be neither arbitrary nor improperly
8 discriminatory. (Carpenter v. Pacific Mut. Life Ins. Co., supra, 10 Cal.2d at p.
9 329.) The Commissioner as conservator of the insolvent insurer is also a trustee
10 for the benefit of all creditors and other persons interested in the insolvency estate.
11 (§ 1057.)” (*Id.* at p. 356; emphasis added.)

12 The Court went on to hold that:

13 “. . . The trial court reviews the Commissioner’s actions under the abuse
14 of discretion standard (Commercial Nat. Bank v. Superior Court, supra, 14
15 Cal.App.4th 393, 398): was the action arbitrary, i.e. unsupported by a rational
16 basis, or is it contrary to a specific statute, a breach of the fiduciary duty of the
17 conservator as trustee, or improperly discriminatory.” (*Id.* at p. 358.)

18 Clearly, the Conservator’s proposed acceptance of the Kemper Proposal is
19 rational, as it seeks to maintain a fragile but valuable asset. Further, his action does not violate
20 any statutes, but instead, is one clearly contemplated and allowed by statute (i.e., Insurance Code
21 section 1043). Since the Conservator is acting to protect all individuals and entities in any way
22 involved with Conserved Companies, the Conservator’s actions do not breach his fiduciary duty,
23 but instead, are an execution of his fiduciary duties. Finally, there is nothing “discriminatory”
24 about the acts for which the Conservator now seeks approval. Therefore, there would be no
25 grounds by which the Court of Appeal could overturn the Conservator’s sound exercise of his
26 statutory authority as described herein.

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OVERBID HEARING

On June 30, 2000 this Court will hold a hearing to determine if there is any person who may wish to make a competing bid to materially enhance the value that would be delivered under the Kemper Proposal. During this process the Conservator will review the overbids and exercise his discretion to determine which is the best bid. In exercising his discretion the Conservator will review and consider, among other factors, the competing plans' financial effect on the conservations, the bidders' credit worthiness, business reputation and business plan and its ability to provide service to policyholders and claimants, and the impact on the Conserved Companies' employees. At the conclusion of the hearing the Conservator will exercise his discretion, subject to review by this Court, and will recommend approval of the best final proposal.

At the conclusion of the June 30, 2000 overbid hearing, the Conservator anticipates that the Court will have identified and approved: (1) the prevailing bidder; and (2) the structure of the final proposal that will form the foundation of a comprehensive rehabilitation plan. No further proposals will be accepted or considered after the hearing.

FUTURE PROCEEDINGS

Following the June 30, 2000 overbid hearing, the Conservator will draft and negotiate with the prevailing bidder final definitive agreements, including a rehabilitation agreement and other ancillary documents necessary to carry out the rehabilitation transactions. Based on prior experience, the Conservator believe that this process will take approximately two weeks and should be completed on or before July 15, 2000.

The Conservator will then prepare a detailed motion for approval of a comprehensive rehabilitation plan for the Conserved Companies ("Rehabilitation Motion"). That motion will be included or summarized in a notice package that will be distributed to all interested parties that the Conservator determines are entitled to or should receive notice of the rehabilitation proceedings. The Rehabilitation Motion will be set for hearing approximately 30 days following the completion of the definitive agreements.

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In addition, subsequent to the June 30 overbid hearing the Conservator will continue his efforts to resolve any disputes between the Conservator, the prevailing bidder and others, including Superior National Insurance Group, Inc. If such disputes are not resolved, and have implications no the transaction proposed by the prevailing bidder, litigation may be required to resolve these issues prior to or at the hearing on the rehabilitaton motion..

THE REHABILITATION MOTION HEARING

At the hearing on the Conservator's Rehabilitation Motion, any final objections to or comments on the definitive agreements and the final rehabilitation plan will be heard. At the conclusion of the hearing, the Conservator will request that the Court approve (or modify) the definitive agreements and authorize the implementation of the rehabilitation plan.

DATED: June 27, 2000

BILL LOCKYER
Attorney General
RICHARD W. BAKKE
Supervising Deputy Attorney General
MARK P. RICHELSON
ELISA WOLFE
Deputy Attorneys General



MARK P. RICHELSON

Attorneys for Applicant Insurance Commissioner
of the State of California

\\ALL\RICHELSON\BIDDER-ID-FINAL

EXHIBIT A

**DEPARTMENT OF INSURANCE
CONSERVATION & LIQUIDATION OFFICE**

P.O. Box 26894
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**REQUEST FOR PROPOSALS**

To: Parties Interested in Financial Participation in a Superior National Insurance Companies Rehabilitation Plan

Re: General Statement of Objectives and Terms of the Development of a Rehabilitation Plan for the Superior National Companies

Date: May 3, 2000

1. In General

On March 6, 2000, Chuck Quackenbush, Insurance Commissioner for the State of California, was appointed Conservator (the "Conservator") for four California domiciled insurance companies: The Superior National Insurance Company ("SNIC"), California Compensation Insurance Company ("CALCOMP"), Combined Benefits Insurance Company ("CBIC") and Superior Pacific Casualty Company ("SPCC") (collectively, the "Superior National Companies" or the "Companies"). It is currently anticipated that New York domiciled Commercial Compensation Insurance Company ("CCIC") will be merged into a fifth California domiciled affiliate of the Companies and the merged company will then join the group of conserved companies and would be included in the definition of the "Companies." Until the date of the conservation proceedings, the Companies functioned as subsidiaries of the Business Insurance Group, Inc. ("BIG"), itself a wholly owned subsidiary of Superior National Insurance Group, Inc. ("SNIG"). On the same date the Conservator appointed a Deputy Conservator of the Companies, Richard G. Krenz, Esq., Special Deputy Insurance Commissioner and Chief of Operations of the Conservation & Liquidation Office of the California Department of Insurance (the "CLO").

This Request for Proposals ("RFP") and the responses thereto, arise out of and are a part of four judicial conservation proceedings for the Companies, which the Conservator expects to have administratively consolidated into Case No. BS 061974, entitled Insurance Commissioner of the State of California v. The Superior National Insurance Company, California Compensation Insurance Company, Combined Benefits Insurance Company and Superior Pacific Casualty Company, filed in the Superior Court of the State of California for the County of Los Angeles (the "Court").

The Conservator has determined that rehabilitation of the Companies' insurance businesses is feasible and should be accomplished in the shortest time reasonably possible. In furtherance of the development of a Rehabilitation Plan, the Conservator has set forth a process to reach an Agreement in Principle to sell certain assets and transfer certain liabilities of the Companies and provide for retroactive reinsurance on existing insurance liabilities of the Companies. The Conservator requests that parties make proposals for the

rehabilitation of the Company in accordance with the structure contemplated by the Request for Proposal as outlined herein.

This RFP will outline the Rehabilitation Plan as contemplated for the Companies by the Conservator and describe the manner in which interested parties may make proposals to participate in such a plan.

2. Goals of the Rehabilitation Plan

The goals of the rehabilitation effort require a carefully crafted approach to realize the most value for the Companies' policyholders, creditors and shareholders while also protecting the interests of those professionals and staff providing service to the Companies:

- (a) The first goal of the Rehabilitation Plan is to obtain the best possible protection of the policyholders of the Companies.
- (b) The Rehabilitation Plan should also, to the greatest extent possible provide for the maintenance of the continued employment of those professionals and staff providing service to the Companies and preserve those operations located in the State of California and elsewhere.
- (c) The Companies have certain claimants whose claims, if proven, would be general creditor claims. After the policyholders are protected, the Rehabilitation Plan should, to the greatest extent possible, protect the rights of this class of creditors.
- (d) The Rehabilitation Plan should, to the greatest extent possible, appropriately protect all other constituent groups. Shareholders in an insurance company have rights subordinate to policyholder and general creditor rights. The Rehabilitation Plan should ensure that whatever assets remain following full policyholder and creditor protection are returned to the shareholders.
- (e) Through year-end 1998, the Companies' statutory financial statements showed a surplus as regards policyholders. The statutory statements for the Companies as of December 31, 1999 are still in the process of being prepared and will be made available to interested parties as part of the process. These statements may show a deficit as regards policyholders for some or all of the Companies. The conservation effort has revealed facts that suggest that a careful examination of the Companies' actual financial condition is warranted. The Rehabilitation Plan should be structured to function successfully even if the Companies' financial condition proves worse than current projections.
- (f) The obligation of the California Insurance Guarantee Association ("CIGA") under California Insurance Code sections 1063, et. seq., is to provide protection for covered claims of California policyholders in the event of the entry of a formal order of liquidation and a judicial finding of insolvency. The Rehabilitation Plan should, to the extent possible, minimize the net exposure to CIGA and, as applicable, any other guaranty funds (collectively, the "Guarantee Funds") should a liquidation become necessary.
- (g) The Conservator may also establish other criteria and goals for this process as he determines are appropriate.

3. How the Proposed Rehabilitation Plan Would Work

The Rehabilitation Plan for the Companies ultimately will proceed under the rehabilitation and liquidation statutes of the State of California (California Insurance Code sections 1010, et. seq.). Generally speaking, the Rehabilitation Plan will consist of the transfer of new and renewal business and certain assets and liabilities of the Companies to a successful party participating in the process outlined herein. This transfer may include, among other things, the customer lists, historical data, independent agency network, and to the greatest extent possible, both the leases for the existing facilities and equipment, including information systems, used by the Companies and the professionals and staff engaged in the provision of services to the Companies. Additionally all premium and associated liabilities for policies written by the Companies on or after April 5, 2000 will be transferred. After the transfer, the historical and in-force insurance liabilities along with assets to support these liabilities will remain in the Companies and be put into runoff. Notwithstanding the above, the Conservator will also consider any proposals to purchase the equity of one or more of the Companies.

As part of any response to this RFP, interested parties should include in their proposals a Third Party Administration (“TPA”) term sheet to administer, under the supervision of the CLO, the claims runoff associated with the historical and in-force liabilities to be retained by the Companies. With respect to this TPA, the Conservator will give preference to those plans that include the utilization of those persons associated with SNIG’s subsidiaries that are currently providing services to the Companies. It is expected that the ultimate negotiated TPA agreement will include appropriate incentives to insure that the policyholder claims will be processed in a manner congruent with the goals of the rehabilitation.

After the transfer contemplated above, the Companies will not write new and renewal business, except in instances where the equity of one or more of the Companies has been purchased. The historical and in-force liabilities will be run off pursuant to the TPA agreement and any surplus in the Companies left after the payment of all policyholder claims and creditor claims, will belong to the shareholders of SNIG.

This RFP is also intended to serve notice that the Companies are seeking retroactive protection on their loss and allocated loss adjustment expense reserves for all policies written prior to April 5, 2000. This protection could take the form of a retroactive or assumption reinsurance contract, which attaches above, at or below current reserves, or a loss portfolio transfer.

As discussed further in Section 4 below, during the interim period prior to adoption of a plan of rehabilitation, the Conservator has caused and intends to cause the Companies to enter into one or more interim reinsurance agreements designed to maximize policyholder safety. This reinsurance would be reinsurance of policy liabilities of the Companies on new and renewal policies incepted after the Conservation but before the final adoption and implementation of the Rehabilitation Plan, and would contain cut-through endorsements permitting direct access to the reinsurer by policyholders in the event of the Companies’ liquidation and insolvency. Interim cut-through reinsurance shall be subject to recapture by the Companies and cession to the successful participant upon adoption of the Rehabilitation Plan, less a risk charge to the interim reinsurer. The successful proposal must assume this reinsurance, ab initio, as a part of the overall transaction.

It is anticipated that any retroactive reinsurance together with the assets of the Companies will not be sufficient to cover all liabilities of the Companies. This will then necessitate the Guarantee Funds to cover the remaining liabilities of the Companies upon the entry of a liquidation order with a finding of insolvency. Minimization of the Guarantee Funds’ liability and postponement of any involvement by the Guarantee Funds in the payment of claims liability will be important criteria in evaluating any retroactive reinsurance proposal.

4. Current Status of the Conservation

On April 5, 2000, the Conservator entered into an Interim Cut-Through Reinsurance Agreement (No. SC-LMC 00-001) (“Cut-Through Agreement”) with Lumbermans Mutual Casualty Company, a member of The Kemper Companies (“Kemper”), to provide “cut-through” reinsurance such as is discussed above. Kemper will be permitted to submit a further proposal in accordance with this RFP and the provisions of the Cut-Through Agreement. The terms of this reinsurance may affect the process outlined in this memorandum. Interested parties are strongly advised to review the terms of the Cut-Through Agreement as part of their due diligence review of the Companies

5. Structure and Types of Proposals

It is currently contemplated that the Conservator will entertain two types of proposals:

- A) Proposals to purchase the assets chosen for transfer, and assumption of liabilities, and provide services to administer the orderly run off of the existing policyholder claims retained by the Companies.
- B) Proposals to provide retroactive reinsurance on existing insurance liabilities of the Companies.

Interested Parties may submit proposals in either category A or category B, or both. An important consideration in choosing a successful proposal for either A or B will be the financial strength rating of the party submitting the proposal. Other criteria are as contained in this memorandum, however, if two proposals are equal, the Conservator has indicated a preference to accept a proposal which encompasses both A and B above.

6. Outline of the Process for Submitting Proposals

- a) Interested parties should contact the Conservator’s financial advisor, Marsh & McLennan Securities (“MMSC”) and indicate whether they are interested in a purchase of assets, the provision of retroactive reinsurance, or both. Specifically, interested parties should contact MMSC Associate Geoffrey S. Sweitzer at 212-345-2785. Interested parties will be asked to enter into an appropriate confidentiality agreement covering proprietary information regarding the Companies obtained in the due diligence process, and a disclaimer agreement with the Companies independent actuaries (the Companies’ actuaries).
- b) To be considered, all interested parties must also provide a detailed written disclosure to the Conservator’s representatives disclosing i) details regarding all investors, principals, shareholders of and advisors to the interested party; ii) the source and amount of any investment capital; and iii) whether any further principals or consultants may be added to the proposed transaction. In addition, all interested parties must provide a written statement of the proposed management team to be used after the transaction and provide a written agreement not to contact agents or insureds of the Companies without written permission of the Conservator.

- c) Upon execution of the confidentiality agreement and the disclaimer agreement, interested parties will receive a Confidential Information Memorandum (“CIM”) describing the process and the Companies, the most recent annual statutory statements of the Companies, and an actuarial review of the Companies’ reserves as well as certain underlying data supporting the actuarial review. The information provided and/or the content of a confidentiality agreement may differ depending on what role the interested party has indicated it would like to pursue.
- d) Interested parties will be asked to submit a non-binding indication of interest that includes a potential price for the transfer of the selected assets and liabilities of the Companies or the premium to provide retroactive reinsurance to the Companies. Such non-binding indication of interest may take the form of a range of values and should include any material conditions the interested party would place on the acquisition or provision of retroactive reinsurance. The indication of interest must contain a purchase price or applicable reinsurance premium and a detailed description of the proposed transaction structure, including the form of consideration. If more than one transaction structure is proposed, a purchase price for each transaction structure must be identified.
- e) The indication of interest must also disclose the principal terms (by term sheet) of the proposed purchase contract. Any regulatory issues that would need to be resolved in connection with a successful closing plus any consents the interested party may require and the timetable therefor must also be clearly addressed. Indications should state whether or not the ultimate offer would be subject to the ability to obtain financing. Strong preference will be given to proposals that are not contingent to obtaining financing. Any indication of interest that contains provisions that would vary (including as to the consideration offered) depending upon the terms of another potential purchaser’s indication (including the consideration offered) or external or future conditions will not be considered. Any interested party should also include a demonstration that it has the experience and financial strength to operate a carrier writing workers’ compensation and property and casualty business in California and elsewhere; has a management team with sufficient character, expertise and experience to satisfy the Conservator; and has sufficient commitment and ability to adhere to the goals set out in Section 2.
- f) The Conservator will review all indications of interest submitted by interested parties, and some of the interested parties may be selected to attend management presentations and visit the Data Room, discussed in Section 7 below, after the Conservator and his advisor have reviewed the indications. Interested parties that have been selected by the Conservator to visit the Data Room will be given access to the Companies’ records and materials prepared by the Companies as well as their independent actuaries, independent auditors and the outside legal advisors during the Data Room portion of their visit.
- g) Following the management presentation and visit to the Data Room, interested parties will be asked to submit a formal, binding and irrevocable offer for purchasing the assets and the associated liabilities or providing reinsurance, or both. Additional guidelines and procedures will be distributed at that time.
- h) The Conservator reserves the right to modify these instructions and procedures at any time and reserves the right to reject any and all proposals without providing any reason if such proposals are, at the sole discretion of the Conservator, determined to be unsatisfactory.
- i) At the conclusion of the process outlined above, which, by order of the Court must be no later than June 30, 2000, unless extended by the Court, the Conservator will enter into an agreement with the successful interested party or parties and submit that agreement to the Court for approval and authority to enter into a transaction or transactions. At that time, it is anticipated that the Court will conduct an overbid process as required by law, at the conclusion of which the Conservator will make a recommendation to the Court that

it select and approve the proposal that the Conservator determines to be in the best interests of the beneficiaries of the Companies. To the extent that the Court conducts an overbid process, the Conservator will request that the Court only permit participation by those parties who submit good faith proposals in response to this RFP.

7. Data Room

The Conservator has established a Data Room at the Companies' premises in Calabasas, California into which relevant data, documents and other information have been and will continue to be placed in order to permit qualified interested parties to have access to such items in order to determine whether to formulate a proposal to participate in the rehabilitation of the Companies.

Access to the Data Room shall be provided at such times and on such dates to be determined by the Conservator based upon the number of interested parties and the space and time demands. Any copies made of documents in the Data Room (to the extent that copying is permitted) will be made at the expense of the interested party, and all copies taken from the Data Room must be returned or destroyed at the request of the Conservator upon completion of the selection process. Additional procedures with respect to the Data Room may also be utilized at the Conservator's sole discretion.

8. Non-Conforming Proposals:

Experience in other rehabilitations has suggested that the Rehabilitation Plan structure described above is the most feasible and the most likely structure to accommodate and preserve the rights of the various interested parties, including the policyholders, the general creditors and the shareholder.

Proposals that do not conform to the structure referred to herein may be made, but shall be deemed non-conforming proposals. The fact that a proposal is, in the Conservator's sole opinion, materially non-conforming may be grounds for rejection on that basis alone; however, the Conservator reserves the right to accept a non-conforming proposal. Further, the Conservator reserves the right to reject all proposals in the event he determines none are acceptable.

Interested parties may make joint proposals provided they collectively submit a single, unified proposal.

9. Deadlines and Contacts for Interested Parties:

All proposals must be delivered to the Conservator no later than 4:00 p.m. PST, June 1, 2000 at the offices of the Companies at 26541 Agoura Road, Calabasas, CA 91302 or by facsimile transmission at (818) 871-0515 or such other location as shall be determined by the Conservator.

Late proposals will be accepted only at the sole discretion of the Conservator. All proposals are submitted in confidence and "under seal." The terms and conditions of proposals will not be disclosed prior to the Conservator's selection of the preferred proposal. Thereafter, the Conservator will announce the selected proposal and will file appropriate papers with the Court to provide for a judicially supervised overbid process and/or such other proceedings as the Conservator, in his sole discretion, deems reasonable and necessary to implement the Rehabilitation Plan.

EXHIBIT B

Kemper Insurance Companies
One Kemper Drive
Long Grove, IL 60049-0001
(847) 320-5245

June 28, 2000

By Hand

Confidential

Richard G. Krenz
Deputy Conservator
Superior National Insurance Companies
26541 Agoura Road
Calabasas, CA 91302

Re: Proposal for Superior National Insurance Companies

Dear Mr. Krenz:

On behalf of the Kemper Insurance Companies, including Lumbermens Mutual Casualty Company (together, "Kemper"), we are pleased to submit the following binding proposal ("Proposal") in response to the "Request for Proposals" dated May 3, 2000 regarding the Superior National Insurance Company, California Compensation Insurance Company, Combined Benefits Insurance Company, Superior Pacific Casualty Company and Commercial Compensation Casualty Company (collectively, the "Superior Companies" or "Superior"). As set forth more fully below, this Proposal is for substantially all of Superior's assets or operations.

Initially, we wish to address our attention to the unsigned letter dated June 22, 2000 advising us of the deadline to submit binding proposals. In some respects, the letter appeared to modify the Request for Proposals or to affect the rights of Kemper under that certain Cut-Through Reinsurance Agreement as respects the bid procedures. While we appreciate the guidance set forth in the June 22 letter, our own planning and development of a proposal were

not such that we could incorporate or be sensitive to all of the ramifications of the changes and, to the extent they purport to modify any contractual rights Kemper had, we do not accept them. In particular, as you know, we have declined the invitation to negotiate definitive agreements with you prior to Monday, June 26, 2000. Unfortunately, we simply lacked the time to do both that and to prepare the business components of our Proposal. Second, as is set forth below, this offer is open for 21 days, but only in accordance with the specific deadlines already established. Consistent with the bid procedures that have already been approved by the Conservation Court, it is a condition that this Proposal be named the high bid and approved as the high bid in accordance with the Court-approved bid procedures by June 30, 2000. There are other milestones that we describe below. Third, our Proposal addresses the four separate components that would, together, comprise a comprehensive solution to the fullest extent a third-party bidder could. However, except in one respect, contrary to the request in the June 22 letter, those components are not separable. To the contrary, they are greatly interdependent. We advised you that Kemper's bid would contain interdependent component parts at our meeting on June 20, 2000 and, with one exception which we address below, you acknowledged that our bid should express that interdependence in order to meet the Conservator's objective of a seamless, comprehensive solution.

By our prior proposal dated June 1, 2000, we set forth in broad terms the outline of a proposed structure whereby Kemper and Swiss Reinsurance America Corporation ("Swiss Re America") would provide a comprehensive solution to the challenges presented by the conservation of the Superior Companies. We also described the extraordinary qualifications of Kemper and Swiss Re America to meet these unique challenges. The purpose of this letter is, following the due diligence that we have been given, to provide further definition and to make,

subject to the conditions set forth herein, a more specific and binding proposal for the acquisition of the Superior Companies' insurance business and related assets.

Our Proposal is as follows:

1. Bid Structure. There are four parts to Kemper's bid Proposal. First, Kemper will acquire the new and renewal business for the Superior Companies (including fronted business), all systems, software, and hardware currently used in connection with the Superior Companies, designated employees, designated real estate locations, and all trade names under which the Superior Companies are operating. Second, Kemper will perform both the claim administration and runoff (for "covered" policyholder claims only, all as defined below) and the policy and premium servicing and runoff, all as described below, subject to the supervision and oversight of the Conservation and Liquidation Office. Some portions of the policy runoff will be performed by MYND, pursuant to an agreement to be entered into by and between Kemper and MYND. MYND, a current business partner of Kemper, is a global provider of enterprise software and electronic commerce systems, related professional services, and business process outsourcing designed to meet the needs of the insurance and related financial services industries. Third, Kemper will remain on the risk under the Cut-Through Reinsurance Agreement, and will extend the Cut-Through for the period required to document, approve and consummate this transaction, all as set forth below. Fourth, Kemper has arranged for the provision of reinsurance by a Swiss Re entity pursuant to the terms and conditions attached hereto.

The first three components of the Proposal are interdependent and integrated. That is, the Conservator may not accept any one of the first three components of the Proposal

without accepting all three of them. As to the fourth component, the Conservator is free to accept or not to accept that component if the first three are accepted, but that part of the Proposal may not be accepted without accepting the first three components.

It is intended that the terms of this Proposal will apply even in the event of an order of liquidation for the Superior Companies, or any of them, such that the claim administration services and Policy-Run-Off Services described below will apply even in the event of an order of liquidation and the triggering of applicable guaranty association coverage.

2. Claim Administration/Run-Off Services. Kemper will administer all claims relating to the Run-Off Liabilities, as well as premium and policy servicing, pursuant to fee-for-service agreements with Superior and the applicable guaranty associations, subject to the oversight and supervision of the Conservation and Liquidation Office. Claim administration includes adjustment, salvage and subrogation, and tax reporting on claim payments, and excludes any allocated loss adjustment expense. Run-Off Liabilities are all claims under workers compensation policies issued by the Superior Companies to the extent they are entitled to the priority specified in section 1033(a)(2) of the California Insurance Code. The fees are as follows:

a. Open Claims. For workers compensation claims (including both indemnity and medical-only) open as of the Closing, the fee is a single fixed fee of \$60.3 million for cradle-to-grave services, payable as follows:

9/1/00	\$10.8 million
1/1/01	\$21.5 million
1/1/02	\$11.4 million
1/1/03	\$ 7.0 million

1/1/04	\$ 4.2 million
1/1/05	\$ 5.4 million

This fixed fee proposal is based upon an adjusted open claim inventory of 32,300 indemnity claims that fall within the definition of Run-Off Liabilities; the fixed fee will apply so long as the open claim inventory does not fluctuate by more than 5% at Closing. In the event it does, then we will have to reprice the fixed fee. The proposal and the claim count set forth above also assume (i) that the REM TPA will remain in place, although Kemper will manage that relationship and will accept expense and operational responsibility for claims (to the extent they are Run-Off Liabilities) that may be turned back pursuant to the terms of that agreement; (ii) the CalCo TPA will be repudiated and the claims subject to that TPA (to the extent they are Run-Off Liabilities) will be made part of the Kemper Run-off Liabilities; and (iii) the Keenen Associates TPA will remain in place, although Kemper will manage that TPA relationship.

b. Newly-Reported or Reopened Claims. For workers compensation claims that are a part of the Run-Off Liabilities and are either reported after the Closing or reopened after the Closing, the fee is \$1,450 per lost-time claim, and \$100 per medical-only (inclusive of notice-only) claim for cradle-to-grave services, payable upon the reporting or reopening, as the case may be. The per-claim fees will increase by 5% per year, starting January 1, 2002.

c. Policy Run-Off Services. Kemper will perform, for a period of ten (10) years after the Closing, policy and premium servicing for the runoff of all policies with an inception date that is no greater than 10 years before the Closing, for a fixed fee of \$20.1 million.

The fee is payable as follows:

9/1/00	\$ 6.0 million
1/1/01	\$11.0 million
1/1/02	\$ 1.4 million

1/1/03	\$.3
1/1/04	\$.3
1/1/05	\$.3
1/1/06	\$.2
1/1/07	\$.2
1/1/08	\$.2
1/1/09	\$. .1
1/1/10	\$.1

The services provided (collectively, the “Policy Run-Off Services”) in exchange for this fee consist of the following: premium processing and audit, underwriting policy administration, premium collection (other than any third-party charge) and bureau reporting, but excludes (i) reinsurance accounting and billing, and (ii) any general ledger or statutory accounting of the Superior Companies. Kemper would be willing to separately discuss and negotiate a fee for any of the excluded services. Kemper would also be willing to entertain a proposal under which the Conservation and Liquidation Office assumes responsibility for this aspect of the runoff.

d. Systems Charge. The foregoing fees exclude any charge for systems and associated support, including personnel and desk-tops. The Run-Off Liabilities and Run-Off Policy Services will be administered utilizing the same systems as Superior currently employs, by employees hired by Kemper and MYND. Kemper will negotiate an agreement with the Conservator that provides for charge the estates for systems on a straight pass-through of the direct charge, plus a management fee for managing and overseeing the process, all a subject to agreement by the Conservator.

e. Stay Bonuses. In addition, the foregoing charges are exclusive of any additional compensation required to be paid to personnel in this category to induce them to stay. In order to avoid excessive turnover, prior to Closing, Kemper and the Conservator will agree on a program necessary to induce select personnel to remain to perform run-off services.

f. Other Claims. At the request of the Conservator, Kemper is also prepared (i) to negotiate a fee for handling the runoff for the construction defect and the accident and health claims, although it is our expectation that, because of the different provisions for these claims under applicable guaranty association laws, these claims will best be handled by the guaranty association, or (ii) to enter into one or more agreements with the issuing carriers to administer the claims under policies reinsured by the Superior Companies. The effect of such agreements would be to spread the systems cost over a wider pool of claims and reduce the cost to the Superior Companies.

3. Acquisition of Assets. As discussed in the Proposal, Kemper will acquire, at Closing, the following assets (the “Acquired Assets”) from Superior (or from such entity that may have or assert ownership rights therein including, without limitation, the Holding Company, as defined below) free and clear of any lien, claim, encumbrance or adverse claim:

a. Real Estate Locations. The following leases will be assumed and assigned to Kemper at Closing: Fresno, CA (18,400 sq.ft), Ranch Cordova (37,241 sq.ft), Orange, CA (71,946 sq.ft), Pleasanton, CA (19,737 sq.ft) and Woodland Hills, CA (47,326 sq.ft) (collectively, the “Assigned Locations”). In the case of the Woodland Hills lease, our offer for that lease is contingent upon being able to renegotiate the rent to an acceptable level. In each case, our offer for any lease is subject to inspection to assure ourselves that the space is suitable for our intended purpose. Leases would be assigned with a Court determination that the applicable lease is fully enforceable in accordance with its terms and there are no pre-Closing breaches. In addition, leases would be transferred with all FF&E that we designate at the Assigned Location. (If the FF&E at any location is inadequate, we will have the right to

designate FF&E from another location to be moved, at Kemper's cost, to the Assigned Location.)

Our designation of Assigned Locations corresponds to only those where Kemper intends to carry on business, and we have deliberately not included leases where there may be market value, but where we would not operate. Accordingly, implicit in our bid is a value to the estate from the retained value of those leases.

b. Systems. The following systems and related assets will be transferred to Kemper at Closing, such that Kemper will have the sole and exclusive right to the following: with respect to the following software or systems that are proprietary to the Superior Companies (or owned by any affiliate thereof), the exclusive right to such software or systems: WCCWIN, SWAMI (web and non-web), FROLI, Monthur, Prospect 32 and Automated Bureau Look-Up. Kemper intends to use the following designated systems for the run-off only, and not in connection with its ongoing business: SNAPI, ACT/APP, ACT/APP 32, SMS, CashTab Accounting, Audit System, and Unit Stat BIG. With respect to any licensed software or systems, Kemper will receive an assignment of the license at Closing, together with a finding that there is no pre-Closing breach of the license. This includes, without limitation, HR IS, Platinum Finance, FHPA and IBS, VisiFlow, Data Max, Abacus, Reflection, and Forest and Trees. With respect to any software or systems, the Acquired Assets will include any written materials, including manuals, warranties, code, operating instructions and systems, and written specifications or descriptions that pertain thereto. In addition, all systems-related hardware will be transferred at Closing. We envision that, during the Transition Period, as space is consolidated, the data center will be relocated to one or more Assigned Locations. All communications systems will be transferred at Closing, except for desk-top components at non-

Assigned Locations. With respect to all leased or licensed equipment and software, Kemper proposes that, after approval of the Plan, and during the Transition Period, it be given an opportunity to renegotiate certain terms of the license or leases; if those negotiations are not successful, then those leases or licenses would be rejected. If they are successful, then there would be a modification and assignment to Kemper at Closing.

c. Data. All books and records that pertain to the insurance policies or insurance business of the Superior Companies in any way or that is necessary or convenient for the ordinary conduct of the Superior Companies as they have been operated, in whatever form, whether written or electronic, including any and all information pertaining to customers and producers, all data, information, computer files, sales, promotional and training materials will be part of the Acquired Assets to be conveyed at Closing. This includes, without limitation, the following data bases: WCP, WCC, WCA, CashTab, ACT/APP, and Marian.

d. Renewal Rights. At Closing, Kemper will acquire the exclusive right to renew the Superior policies, including with respect to any “fronted” business.

e. Distribution Rights. At Closing, Kemper will acquire the sole and exclusive right to the distribution network.

f. Other Assets. At Closing, Kemper will acquire Superior’s rights to the managed care review contract with Reviewco, and any and all permits, licenses, to the extent transferable.

g. Names. At Closing, Kemper will acquire the sole and exclusive right to use any of the names or trade names, trademarks, service marks or logos under which the

Superior Companies or any of them currently does or has ever done business, excluding only SN Insurance Administrators and SN Insurance Services, Inc.

h. Excluded Assets. Assets not transferred at Closing and not part of the Acquired Assets will include (i) FF&E at locations not being acquired by Kemper (other than systems-related assets which will be relocated to an acquired location or designated for transfer to an Assigned Location); (ii) the domain name “Superior.com;” provided, however, that it may not be sold to any entity that will use it in connection with an insurance business; and (iii) any rights to inuring reinsurance.

4. Purchase Price. The purchase price for the Acquired Assets will be as follows:

a. Initial Payment. Kemper will pay, at Closing, \$2.25 million in cash.

b. Renewal Commission. Kemper will offer to pay a commission to Superior of 2% on all renewals for a three-year period on a quarterly basis based on direct written premium. For these purposes, renewals includes (i) renewal of any policy in force as of September 30, 2000, and (ii) renewal of any policy that (a) was in force as of April 5, 2000, (b) came up for renewal during the period covered by the Cut-Through Reinsurance Agreement, (c) was not renewed by Superior during that period, and (d) is subsequently bound by KEIC as a result of the business being placed by the same producer during the three-year period.

c. Underwriting Profit Participation. Kemper will also offer an underwriting profit participation equal to 50% on workers compensation renewals and any new workers compensation business written by any subsidiary of Kemper Employers Group (and exclusive of

other Kemper companies and business units) from agents of record of the Superior Companies at Closing, over the same three-year period, below a fully developed combined ratio of 100%. This profit participation will be measured on a cumulative basis over the three-year period, with interim payments made annually, six months after the end of each calendar year. The first payment will be made June 30, 2002, and will be based upon earned premium as of December 31, 2001. The final calculation and reconciliation will take place on June 30, 2009.

d. Additional Purchase Price for Assigned Location FF&E. Kemper will pay an additional amount, to be determined, for FF&E at or to be used at the Assigned Locations. It is our understanding that the Conservator has commissioned an appraisal of the FF&E. When that appraisal is completed, Kemper will make an offer that is based upon that appraisal. If that offer is accepted, then Kemper will pay the additional amount at Closing.

5. Employees. As set forth in the June 1 letter proposal, Kemper agrees to use its best efforts to employ existing Superior employees and to contract with current Superior agents. We currently anticipate that, immediately after the Closing, the overall employment levels in California will be over half of the current full time employees in California, although between 50 and 100 of those employees will be employed by MYND. We anticipate that the non-California employment levels will be approximately 50 at the outset. Prior to the Closing, Kemper will be permitted to interview and offer employment to existing employees such that, as of Closing, employees who receive and accept such offers will become employees of Kemper or MYND, as the case may be.

6. Renewal and New Business. Renewal and new originations will be issued under the names of the Kemper Insurance Companies, including Kemper Employers Insurance

Company (“KEIC”), a subsidiary of Kemper Employers Group, Inc. (“KEG”). KEG is a holding company subsidiary of Lumbermens Mutual Casualty Company (“Lumbermens”), the lead company of the Kemper Insurance Companies. KEIC is currently pending admission in California. As part of this transaction, KEG will relocate its headquarters and executive management to Southern California. KEIC currently has, and at Closing will continue to have, capital plus surplus of not less than \$10 million. KEG will cause KEIC to have, and maintain, at Closing, capital and surplus, consistent with regulatory guidelines, sufficient to support the expected business

7. Holding Company Issues. Our binding offer is conditioned upon Kemper receiving, at Closing, (i) orders from any court with jurisdiction over the assets specifying that Kemper has acquired clean title to the Acquired Assets, and (ii) the ability to retain an appropriate number of employees. “Acquired Assets” includes any assets that fall within the description of such assets irrespective of whether the particular asset is subject to a claim of ownership by the Holding Company (as defined below). It will also be a condition that there be ample protections preventing the Superior National Insurance Group, Inc. and its affiliates not in conservation (together, the “Holding Company”) and/or prior management of the Superior Companies from competing with Kemper (other than as Kemper may agree to following good faith negotiations with the Conservator in an effort to explore whether it is possible to allocate some role for the Holding Company to maintain a continuity of business in order to preserve some value for the net operating losses for the estate) or otherwise interfering with the contractual benefits Kemper receives. In addition, there will be a prohibition against the Holding Company, its management, shareholders or creditors suing Kemper for its involvement in the Cut-through Reinsurance or as a bidder.

Kemper acknowledges that the Conservator has begun discussions with the Holding Company in an effort to resolve the ownership issues raised by the Holding Company and agrees to participate in those discussions in the event that it is selected as the prevailing bidder.

8. Conditions Precedent. This Proposal is subject to the following conditions precedent:

a. acceptance of this bid by the Conservator and any other entity whose acceptance is required and an order entered by the Conservation Court awarding Kemper the bid pursuant to the terms hereof pursuant to the provisions of paragraph 20 of the Cut-Through Reinsurance Agreement no later than June 30, 2000;

b. execution of mutually acceptable definitive agreements containing terms, representations, warranties and conditions customary for transactions of this nature no later than July 15, 2000;

c. Entry of a final court order (and there being no appeal or stay) after notice to all interested parties including policyholders approving the definitive agreements for this Proposal and authorizing their immediate implementation in a form that is reasonably satisfactory to Kemper no later than August 15, 2000;

d. Preparation and dissemination of a policyholder notification package and rehabilitation certificate satisfactory to Kemper notifying policyholders about the terms of the rehabilitation plan and definitive agreements;

e. In the event the Conservator accepts the portion of the Proposal pertaining to reinsurance provided by Swiss Re America, Post-Closing adjustments for unearned premiums and net assets transferred;

f. In the event the Conservator accepts the portion of the Proposal pertaining to reinsurance provided by Swiss Re America, no material change in the market value of the net transferred assets or the unearned premiums from the estimates contained herein;

g. Full access to the books, records, agreements, plans, and systems of Superior;

h. Admission of KEIC in California;

i. Receipt of any necessary regulatory approvals or third-party consents;

j. Recognizing that Kemper does not intend, and the Conservator is not asking that Kemper participate in a prolonged dispute over the ownership of the Acquired Assets, there shall be, no later than July 15, 2000, either an agreement in principle reached with the Holding Company that is satisfactory to Kemper regarding the transferring of the Acquired Assets that are subject to an adverse claim by the Holding Company, or the Conservator has otherwise demonstrated to Kemper's reasonable satisfaction a reliable means of transferring and assigning all of the Acquired Assets in the name of those companies pursuant to the terms hereof at the Closing;

k. At Closing, satisfactory resolution of intercompany issues between Superior National Insurance Companies and their affiliates and senior management, including satisfactory resolution of asset ownership and control, employee retention, and the exclusion of

the affiliates and their management from any potentially competing business (other than as Kemper may agree to following good faith negotiations with the Conservator in an effort to explore whether it is possible to allocate some role for the Holding Company to maintain a continuity of business in order to preserve some value for the net operating losses for the estate), including indemnification by the Holding Company for any litigation or violation of the exclusion from competition; and

1. The Closing (the “Closing”) will take place no later than August 31, 2000.

9. Transition Plan. The reconfiguration of the business will be challenging and will require that Kemper and the Conservator work together to implement the following transition plan (the “Transition Plan”). The Transition Plan will have the following components: as soon as practicable after the Closing, all employees to whom Kemper or MYND has made an offer and who have accepted that offer will become employees of Kemper and MYND, respectively (the “Designated Employees”). After the Closing and pending the transition of the payroll, Kemper will forward to the Conservator the funds required to fund the payroll for the Designated Employees. The Conservator will provide the funds for and bear the responsibility for any and all payroll and other expenses associated with employees other than the Designated Employees. After the Closing, Kemper will pay the rent and associated costs only for the Assigned Locations and any and all assigned leases and licenses. The Transition Plan will provide that Kemper will assume responsibility for the cost associated with moving any Acquired Assets from a non-Assigned Location to an Assigned Location. The Conservator will not repudiate or assign any lease for a non-assigned Location unless or until Kemper has removed all the Acquired Assets therefrom pursuant to the Transition Plan. The Transition Plan will provide for a schedule for the removal of Acquired Assets from non-Assigned Locations that

is practical and cost-effective, but not all such removal will likely have taken place by the Closing. Kemper will cooperate in good faith with the Conservator to identify required assets as quickly as possible to permit the Conservator to repudiate unwanted leases. All lease payments for the non-Assigned Locations will be the responsibility of the Conservator, whether before or after the Closing. Kemper will commence issuing policies under its own name as of October 1, 2000, and the Transition Plan will be completed no later than December 1, 2000.

10. Cut-Through Reinsurance. So long as this Proposal is accepted by the Conservator and approved as the prevailing bid no later than June 30, 2000 in accordance with the bid procedures approved by the Court, and so long as each deadline and condition precedent set forth herein is satisfied, the Cut-Through Reinsurance Agreement will be extended through September 30, 2000 on the same economic terms and conditions as are set forth therein (but without any increase in the break-up or related claims).

11. Break-Up Claim. In the event that the condition precedent in paragraph 8.a hereof is satisfied, but one or more of the conditions precedent in paragraph 8.b, c, d, j or k is not satisfied, or is not satisfied on a timely basis, in each case for any reason other than Kemper acting in bad faith, then Kemper shall have the right, exercisable by it in its sole discretion, to terminate the Proposal. In such event, the Conservator shall pay Kemper a break-up fee of \$5 million, payable within thirty (30) days after such termination as an expense of administration from the Superior estates.

12. No Shopping. From and after the awarding of the bid to Kemper pursuant to the Conservation Court's bid procedures on June 30, 2000 (or such other date as to which Kemper may consent), the Conservator shall not solicit, entertain or encourage any competing

proposal for the assets or operations of the Superior Companies, and shall not provide access to Superior's assets or operations or any information concerning them for the purpose of permitting such a proposal to be formulated, verified or proposed, but shall vigorously pursue the consummation of the Kemper Proposal through the steps identified herein. In the event this Proposal is accepted without the reinsurance component offered by Swiss Re America, the Conservator will provide notice to Kemper of any discussions regarding reinsurance for the Run-Off Liabilities for the sole purpose of ensuring that any such reinsurance proposal is subject to the terms of the claim administration and policy administration services being performed by Kemper pursuant to the terms hereof.

13. Brokers' Fees. Kemper has not retained a broker in connection with the transaction and recognizes that the Conservator has retained Marsh McLennan Securities Corporation and Guy Carpenter & Company, Inc. The fees and expenses of Marsh McLennan and Guy Carpenter are solely the responsibility of the Conservator, and each party shall indemnify the other for any fees and expenses of a broker claiming through that party.

This Proposal is made pursuant to, and is entitled to the bid credits provided for in, paragraph 20 and Exhibit IV of that certain Interim Cut-Through Reinsurance Agreement No. SC-LMC 00-001 dated as of April 5, 2000 (and inclusive of any amendment or extension thereof), as approved by the Conservation Court, and pursuant to the bid procedures adopted by the Conservation Court.

This Proposal is confidential and is not to be released, without the consent of Kemper and Swiss Re America, to any person or entity, including, but not limited to, other parties who have expressed an interest in the Superior Companies, except for those persons

within the California Department of Insurance or its agents and representatives who are involved with Superior.

We are pleased to submit this Proposal and look forward to your response.

Very truly yours,

John G. Pasqualetto

Attach. (Swiss Re America Proposal)

cc. John K. Conway, Esq.
Michael D. Burke
Thomas E. Patterson, Esq.

***** SUPERIOR NATIONAL GROUP COMPANIES *****
LOSS PORTFOLIO COVER

REINSURER:	A Swiss Reinsurance Group carrier
COMPANY:	Superior National Group Companies
TYPE:	Loss Portfolio Transfer
EFFECTIVE DATE:	TBD
TERM:	The Agreement shall remain in force and the Term of the Agreement shall be from the Effective Date until exhaustion of the Aggregate Limit or the Commutation of the Agreement, whichever is earlier.
COVERAGE:	The Reinsurer shall indemnify the Company for Covered Losses paid by the Company.
SUBJECT BUSINESS:	Subject Business shall mean: (1) all business written by the Company on or prior to the effective date and classified as Workers Compensation business in the Company's Statutory Annual Statement;
SUBJECT LOSSES:	Subject Losses shall mean all Ultimate Net Loss paid by the Company on Subject Business on or after the Effective Date arising from losses occurring on or prior to the Effective date. In no event shall Subject Losses include any Ultimate Net Loss booked as paid by the Company prior to the Effective Date but unpaid as of the Effective Date.
COVERED LOSSES:	Covered Losses shall mean Subject Losses subject to the Aggregate Limit.
AGGREGATE LIMIT:	The Aggregate Limit for the sum of all Covered Losses indemnified under the Agreement shall be three-hundred-eighty-four-million dollars (\$384,000,000). In no event shall the Reinsurer pay more than this amount.
PAYMENT SCHEDULE:	The Reinsurer shall reimburse the Company for all loss payments subject to maximums noted in the following schedule:

<u>Year</u>	Percent <u>Paid</u>	Cumul. <u>Paid</u>	Incr. <u>Paid</u>
1	18.50%	71	71
2	47.50%	182	111
3	69.00%	265	83
4	80.00%	307	42
5	88.00%	338	31
6	93.00%	357	19
7	95.00%	365	8
8	97.00%	372	8
9	98.00%	376	4
10	98.50%	378	2
11	99.00%	380	2
12	99.50%	382	2
13	100.00%	384	2
Total			384

ULTIMATE NET LOSS: Ultimate Net Loss as used herein shall mean the actual sum paid or payable by the Company in settlement of losses or liability after making deductions for all recoveries, all salvage, and claims upon all other reinsurances, whether valid, collectible or not, and shall include Allocated Loss Adjustment Expenses.

Allocated Loss Adjustment Expenses (“ALAE”) as used herein shall mean all expenses paid by the Company in connection with the investigation, settlement, defense or mitigation of any claim or loss which is the subject matter of Subject Business.

All salvages, recoveries or payments recovered or received subsequent to a loss settlement under the Agreement shall be applied as if recovered or received prior to the aforesaid settlement and all necessary adjustments shall be made by the parties hereto.

Nothing in this definition shall be construed to mean that losses are not recoverable hereunder until the Ultimate Net Loss of the Company has been ascertained.

REINSURANCE PREMIUM: The Reinsurance Premium shall equal three-hundred-and twenty-four-million dollars (\$324,000,000), and is due and payable by the Company to the Reinsurer within five (5)

business days after the Agreement is fully executed.

The Reinsurance Premium is net to the Reinsurer and includes no allowance for taxes, commissions, brokerage or other costs that may arise. Any such amounts are in addition to the Reinsurance Premium and remain the sole responsibility of the Company.

**REPORTS AND
REMITTANCES:**

Within forty-five (45) days after the end of each calendar quarter during the Term of the Agreement, the Company shall provide a Loss Report to the Reinsurer, in a format acceptable to the Reinsurer, including the following:

1. The amount of Subject Losses paid by the Company during that calendar quarter and on a cumulative basis from the Effective Date through the end of that calendar quarter, separately by accident year;
2. The amount of net loss and ALAE payable but unpaid by the Company on Subject Business as of the end of that calendar quarter, by accident year;
3. The Company's estimate of the net reserve for loss and ALAE, including Incurred But Not Reported losses, on Subject Business as of the end of that calendar quarter, by accident year;
4. Any commutations effected by or on behalf of the Company relating to the Company's assets and/or liabilities on Subject Business.
5. The amount of Covered Losses due from the Reinsurer for that calendar quarter and cumulative Covered Losses from the Effective Date through the end of that calendar quarter.

The Reinsurer shall pay any Covered Losses due to the Company within fifteen (15) days after receipt of the Loss Report.

COMMUTATION:

The Agreement may be commuted at the end of any calendar quarter only by mutual agreement of the parties hereto.

**COMMUTATION OF
SUBJECT BUSINESS:**

The Company shall obtain the Reinsurer's prior written approval of any commutation of the Company's liabilities under Subject Business with an aggregate settlement value greater than or equal to TBD in respect of any one insured or reinsured, such approval not to be unreasonably withheld.

COMMUTATION OF
INURING
REINSURANCE:

The Company shall obtain the Reinsurer's prior written approval of any commutation of liabilities of the Company's reinsurers, such approval not to be unreasonably withheld.

CHANGE IN
ADMINISTRATIVE
PRACTICES:

If any intentional or unintentional change in the processing or payment of claims by the Company materially increases the Reinsurer's liability under the Agreement from what that liability would have been if there had been no such change, the Reinsurer shall prepare, and the Company shall accept, an adjustment of the portion of claims which is reimbursable, or an adjustment of the Reinsurance Premium, or any adjustments which will make the Reinsurer's risk position equivalent to that which would have obtained under the Agreement if there had been no such change. The Reinsurer shall have the right to use auditing techniques, sampling techniques, or to otherwise investigate the nature and effect of any such change in administrative practices or of any possible compensatory adjustment therefor. Any dispute with respect to such adjustment shall be resolved by Arbitration as provided in the ARBITRATION Article of the Agreement.

The Company agrees to inform the Reinsurer in writing as soon as possible of any such intentional or unintentional change, so that the procedures of the paragraph above may be set in motion in a timely fashion.

Without prejudice to the foregoing, no liquidation or other insolvency event affecting the Company shall increase or accelerate any liability of the Reinsurer under the Agreement.

WARRANTY:

In order to provide that the Reinsurer's liability under the Agreement shall not be increased in any calendar year by a change in reinsurance ceded or recoverable by the Company, the Company warrants that all reinsurance arrangements, including treaties, facultative certificates and interpretations with respect to obligations thereunder, which were in effect on the Effective Date (including the quota share agreement between Superior National and US Life, in arbitration) of the Agreement shall continue in effect for purposes of all computations hereunder, except as may be agreed by the Reinsurer pursuant to the COMMUTATION OF INURING REINSURANCE section.

NET RETAINED LINES:

Application of Other Reinsurance Proceeds: The Agreement applies only to that portion of insurance or reinsurance which, after the application of all reinsurance other than the reinsurance hereunder, the Company retains

net for its own account. In calculating the amount of loss hereunder for which the Company shall be reimbursed, only the loss with respect to such retained portion shall be included.

Collection of Other Reinsurance Proceeds: The amount of the Reinsurer's liability hereunder shall not be increased by reason of the Company's inability to collect from any other reinsurers, whether specific or general, any amounts which may have come due from them, whether such inability arises from the insolvency of such other reinsurers, or otherwise.

EXCLUSIONS:

The Agreement shall not cover:

1. **Noncontractual Damages:** The Agreement does not cover Noncontractual Damages. Noncontractual Damages as used herein shall mean those liabilities of the Company or its affiliates, or their agents, brokers, or representatives, arising from actual or alleged misconduct in their handling of claims or losses, or in any of their dealings with their insureds or any other person. Such liabilities shall include, but are not limited to, punitive, exemplary, compensatory, and consequential damages. Such misconduct shall include, but is not limited to, failure to settle within the policy limit, negligence, fraud or bad faith in rejecting an offer of settlement or in the preparation of the defense or in the trial of any action or in the preparation or prosecution of any appeal consequent upon any action.
2. Dividends to policyholders.
3. Uncollectible reinsurance.
4. Unallocated Loss Adjustment Expenses.
5. Others to be agreed.

DISCLOSURES AND APPROVALS:

The Company represents and warrants with respect to the Agreement and the transactions hereunder, and with respect to any insurance and reinsurance written by the Company which is covered by the Agreement and all transactions thereunder, that all disclosures and approvals which are necessary or appropriate under any applicable law or regulation have been made or obtained, or will be made or obtained in a timely manner.

TAXES:

The Company shall be liable for all taxes, except income and profit taxes of the Reinsurer, on amounts paid to the

Reinsurer under the terms of the Agreement, and shall indemnify and hold the Reinsurer harmless for any taxes which the Reinsurer may become obligated to pay on the Company's behalf.

FEDERAL EXCISE TAX: In the event that any Federal Excise Tax is due with respect to any premiums due under the Agreement, the Company agrees to pay such tax in addition to any premiums due under the Agreement and agrees to remit such tax to the United States Internal Revenue Service and shall indemnify and hold the Reinsurer harmless for any such taxes which the Reinsurer may become obligated to pay on the Company's behalf.

SECURITY: Upon the Company's written request, the Reinsurer will establish and maintain funds held in Trust and/or Letter(s) of Credit in an amount equal to the Reinsurer's liabilities under the Agreement in excess of any positive Funds Withheld Balance. The cost of such security, if any, shall be borne by the company. (To be used only if reinsurance is placed with unauthorized reinsurer.)

OTHER: Subject to Due Diligence as respects the Claims Handling
Alignment of Interests
Access to Records
Agreement, Amendments, and Merger
Arbitration (Choice of Law: New York)
Counterparts
Currency
Errors and Omissions
Insolvency
Parties to the Agreement
Right of Offset
Salvage, Subrogation and Other Recoveries
Service of Suit (to be used only if reinsurance is placed with unauthorized reinsurer)
Others to be agreed

WORDING: To be agreed.