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13 in his Capacity as Conservator of CastlePoint  
National Insurance Company

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16 SUPERIOR COURT OF THE STATE OF CALIFORNIA  
CITY AND COUNTY OF SAN FRANCISCO

18 DAVE JONES, INSURANCE  
19 COMMISSIONER OF THE STATE OF  
CALIFORNIA,

20 Applicant,

21 v.

22 CASTLEPOINT NATIONAL INSURANCE  
23 COMPANY, and DOES 1-50, inclusive,

24 Respondents.

Case No.CPF-16-515183

**INSURANCE COMMISSIONER DAVE  
JONES' MEMORANDUM OF POINTS  
AND AUTHORITIES IN SUPPORT OF  
MOTION FOR ORDER APPROVING  
CONSERVATION AND  
LIQUIDATION PLAN FOR  
CASTLEPOINT NATIONAL  
INSURANCE COMPANY**

**Date: September 13, 2016  
Time: 9:30 a.m.  
Dept: 302  
Judge: Hon. Harold E. Kahn**

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**TABLE OF CONTENTS**

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

**Page**

I.	INTRODUCTION & SUMMARY OF THE PLAN .....	1
II.	FACTUAL BACKGROUND .....	5
A.	The Tower Group.....	5
B.	September 2014 – The Tower Group is Purchased by ACP Re .....	6
C.	The Tower Companies Continue To Struggle .....	7
D.	Development of the Plan and the Merger of the Tower Insurance Companies into CastlePoint.....	7
E.	The Need for Tax Deconsolidation and Restructuring of CastlePoint Under Internal Revenue Code Section 382(l)(5) .....	7
III.	THE CONSERVATION AND LIQUIDATION PLAN .....	9
A.	The Conservator’s Goals In Formulating The Plan .....	9
B.	Terms of the Conservation and Liquidation Plan .....	10
1.	Tax Deconsolidation and Restructuring Procedure.....	10
2.	Conservation Agreement Transactions .....	11
IV.	LEGAL STANDARD APPLICABLE TO THE CONSERVATION AND LIQUIDATION PLAN PROCEEDINGS.....	13
V.	ARGUMENT .....	14
A.	The Conservator Has The Authority To Formulate The Plan.....	14
B.	The Plan Adds Value to CastlePoint and Preserves Assets for the Benefit of Policyholders and Creditors .....	15
1.	The Plan Achieves The Objective of Deconsolidation Without Jeopardizing CastlePoint’s NOLs .....	16
2.	The Plan and Establishment Of A Trust Is The Best Alternative To Achieve Deconsolidation While Preserving CastlePoint’s NOLs .....	18
3.	The Transactions Provided For In The Conservation Agreement Are Beneficial To The CastlePoint Estate, Policyholders and Creditors.....	20
C.	The Conservator’s Goals Are Met By The Conservation and Liquidation Plan.....	21
D.	Risks Attendant To The Plan .....	22
E.	Conservator’s Recommendation .....	23
VI.	CONCLUSION .....	24

**TABLE OF AUTHORITIES**

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

**Page(s)**

**Cases**

*Caminetti v. Guaranty Union Life Ins. Co.*  
(1942) 52 Cal.App.2d 330.....15

*Carpenter v. Pac. Mut. Life Ins. Co.*  
of Cal. (1937) 10 Cal.2d 307 .....13, 14, 15

*Commercial Nat. Bank v. Superior Court*  
(1993) 14 Cal.App.4th 393 .....13

*Commissioner v. Tower*  
(1946) 327 U.S. 280..... *passim*

*In re Executive Life Ins. Co. v. Aurora Nat'l Life Assurance Co.*  
(1995) 32 Cal.App.4th 344 .....13, 15

*Picou v. C.I.R.*  
(May 22, 2006) T.C. Summ.Op. 2006-82, 2006 WL 1391391, U.S. Tax Ct.,  
(No. 10879-05S).....18

*United States Dept. of the Treasury v. Fabe*  
(1993) 508 U.S. 491, 113 S.Ct. 2202, 124 L.Ed. 2d 449 .....18

**Statutes**

11 U.S.C. § 109, subd. (b)(2).....17

15 U.S.C. §§ 1011-1015.....18

26 U.S.C. § 368, subd. (a)(3)(A).....17

26 U.S.C. § 382.....8

26 U.S.C. § 382, subd. (a).....16, 19

26 U.S.C. § 382, subd. (l)(5) .....9, 17-19

26 U.S.C. § 382, subd. (l)(5)(A) .....16

26 U.S.C. § 382, subd. (l)(5)(F).....17

26 U.S.C. § 831, subd. (b) .....19

United States Code title 11.....16, 17

California Insurance Code Article 14 .....17

1	California Insurance Code § 1010.....	17
2	California Insurance Code § 1011.....	1, 14, 17
3	California Insurance Code § 1011(d).....	14
4	California Insurance Code § 1033(a).....	11, 18
5	California Insurance Code § 1037.....	14, 15
6	California Insurance Code § 1043.....	14
7	California Insurance Code § 1057.....	17, 19
8	McCarran-Ferguson Act.....	18
9		
10	<b>Other Authorities</b>	
11	Internal Revenue Service Private Letter Ruling No. 9619051 (May 10, 1996)	
12	1996 WL 241508 .....	17, 19
13		
14		
15		
16		
17		
18		
19		
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I.

**INTRODUCTION & SUMMARY OF THE PLAN**

On July 28, 2016, the Court granted California Insurance Commissioner Dave Jones' (the "Commissioner's") application for an order appointing him as statutory conservator ("Conservator") of CastlePoint National Insurance Company ("CastlePoint") pursuant to Insurance Code section 1011 based on the Commissioner's determination that the further conduct of CastlePoint's business outside of statutory conservation would be hazardous to the company's policyholders, creditors, and the public. In anticipation of his appointment as Conservator of CastlePoint, the Commissioner has been working with CastlePoint's management, the other U.S. insurance regulators of CastlePoint's predecessors, and other interested parties on a comprehensive plan to address the conservation and ultimate liquidation of CastlePoint. As the Conservator of CastlePoint, the Commissioner has now promulgated and adopted his *Plan of Conservation & Liquidation for CastlePoint National Insurance Company* (the "Plan").<sup>1</sup> The Plan has been finalized and documented, and the Conservator now seeks the Court's approval of the Plan so that the Plan may be fully adopted and implemented by the Conservator.<sup>2</sup>

As explained in the *Verified Application for Ex Parte Order Appointing Insurance Commissioner as Conservator*, CastlePoint is the successor by merger with nine other affiliated insurance company members of the Tower Group that were domiciled in five other states (collectively, the "Tower Insurance Companies").<sup>3</sup> (*See* Supplemental Declaration of David E. Wilson in Support of Motion for Order Approving Conservation and Liquidation Plan for

<sup>1</sup> The Commissioner filed his Motion for Order Approving Conservation and Liquidation Plan for CastlePoint National Insurance Company on July 29, 2016 (the "Motion"). On the same date, the Court granted the Commissioner's *ex parte* application setting a hearing date for the Motion and establishing a briefing schedule for this Memorandum and other pleadings relating to the Motion.

<sup>2</sup> A complete copy of the Plan is attached as Exhibit A to the Declaration of David E. Wilson In Support of Motion for Order Approving Conservation and Liquidation Plan for CastlePoint National Insurance Company ("Wilson Decl.") filed by the Commissioner on July 29, 2016.

<sup>3</sup> The nine other insurers that merged with and into CastlePoint are: Tower Insurance Company of New York, Tower National Insurance Company, Hermitage Insurance Company, CastlePoint Florida Insurance Company, North East Insurance Company, Massachusetts Homeland Insurance Company, Preserver Insurance Company, York Insurance Company of Maine, and CastlePoint Insurance Company. A tenth company, Kodiak Insurance Company, was dissolved several years ago, but its residual insurance liabilities were assumed by CastlePoint. (Supp. Wilson Decl., ¶ 6.)

1 CastlePoint National Insurance Company (“Supp. Wilson Decl.,” ¶ 6), which is being filed  
2 contemporaneously herewith.) The Tower Insurance Companies had been operated on a  
3 consolidated basis, with all of their insurance liabilities and premiums “pooled” and reallocated  
4 pursuant to an intercompany reinsurance pooling program. (*Id.*, ¶ 7.) In addition, substantially  
5 all of the companies’ policy and claims administration work was performed on a consolidated  
6 basis. (*Ibid.*) As a result of this pooling arrangement and the thoroughly integrated manner in  
7 which the Tower Insurance Companies were operated, the deterioration of the financial condition  
8 of the companies over the past several years adversely impacted all ten companies. (*Ibid.*) The  
9 financial impairment of the Tower Insurance Companies gave rise to the distinct possibility that  
10 insurance regulators in six states would be required to commence ten individual receivership  
11 proceedings to protect policyholders. (*Ibid.*) During the past seven months, the Conservator has  
12 worked closely with fellow regulators in the other states and with company management to  
13 develop a more efficient and orderly alternative. (*Ibid.*) The Plan is the result of those efforts.

14 The Plan contemplates a four-step process for the efficient and orderly runoff and eventual  
15 liquidation of the Tower Insurance Companies:

- 16 1) Consolidation by Merger and Conservation: The first step, which was undertaken  
17 prior to and in anticipation of conservation, was to consolidate the ten insurance  
18 companies into a single company – CastlePoint – and then place that insurer into  
19 conservation. (Supp. Wilson Decl., ¶ 9(a).) By consolidating the Tower Insurance  
20 Companies, the regulators avoided the delay, confusion and potential waste that  
21 would have resulted from ten separate legal proceedings in six states. (*Ibid.*)
- 22 2) Restructuring of CastlePoint Under Internal Revenue Code section 382(l)(5): In  
23 an attempt to preserve CastlePoint’s tax attributes, including hundreds of millions  
24 of dollars in net operating loss carryforwards (also known as “NOLs”), to protect  
25 CastlePoint from exposure to any future tax liabilities of the non-insurance  
26 company members of the consolidated taxpayer group in which CastlePoint is  
27 currently a member, and to facilitate the valuable Conservation Agreement  
28 transactions described in the third step described immediately below, the Plan

1 provides for the restructuring of CastlePoint’s equity ownership in a way that is  
2 intended to conform to federal tax law, specifically Internal Revenue Code section  
3 382(l)(5). (Supp. Wilson Decl., ¶ 9(b).) The tax restructuring provisions of the  
4 Plan are intended to ensure that CastlePoint’s NOLs are preserved and that the  
5 CastlePoint estate is not inappropriately subjected to federal income tax liabilities  
6 during its conservation and liquidation, and so that policyholder and other creditor  
7 recoveries may be maximized to every extent possible. (*Ibid.*)

8 3) Conservation Agreement Transactions: Following the tax deconsolidation, the  
9 Plan provides for CastlePoint to close on a series of integrated transactions and  
10 agreements set forth in the *CastlePoint National Insurance Company*  
11 *Conservation Agreement* (the “Conservation Agreement”)<sup>4</sup> entered into by the  
12 Conservator with a group of aligned parties that participated in an earlier effort in  
13 September 2014 to salvage the Tower Insurance Companies. (Supp. Wilson Decl.,  
14 ¶ 9(c).) Under the Conservation Agreement, \$200 million (net of certain advances  
15 already made, as more specifically described in section 5.2 of the Conservation  
16 Agreement) will be injected into CastlePoint by several parties to the Conservation  
17 Agreement. (*Ibid.*) This infusion will provide CastlePoint with much needed  
18 liquidity to ensure that policy claims and benefits will continue to be paid during  
19 the conservation period while the Conservator prepares for the eventual liquidation  
20 of CastlePoint and the resulting transfer of all claims to the appropriate state  
21 insurance guaranty associations (“IGAs”). (*Ibid.*) In consideration for the  
22 injection of this \$200 million, (a) the Conservator will cause CastlePoint to  
23 commute (terminate) several existing reinsurance agreements between and among  
24 several Parties to the Conservation Agreement, and (b) all insurance policies  
25 issued by CastlePoint after September 15, 2014, which were already 100% quota-  
26 share reinsured (the “Fronted Policies”), will be assigned and assumed by two  
27

28 <sup>4</sup> A copy of the Conservation Agreement, including its ancillary agreements, is attached as Exhibit B to the Wilson Declaration dated July 29, 2016.

1 solvent insurers so that to every extent possible these policyholders are not  
2 disadvantaged by CastlePoint's conservation and liquidation. (*Ibid.*) The  
3 Conservation Agreement also provides for CastlePoint to receive run-off  
4 administration services (policy administration and claims administration) free of  
5 charge for up to two years, at an estimated value to CastlePoint of as much as  
6 \$40 million. (*Ibid.*)

7 4) Orderly Liquidation and Transition of Claims to IGAs: Finally, the Plan  
8 anticipates that at such time as the Conservator determines is appropriate and in  
9 the best interests of policyholders, he will apply to the Court for entry of an Order  
10 of Liquidation for CastlePoint and a finding that CastlePoint is legally insolvent.  
11 (Supp. Wilson Decl., ¶ 9(d).) Those two events, a liquidation order and a finding  
12 of insolvency, will trigger the statutory duties of the IGAs to step in and assume  
13 the administration and payment of CastlePoint's remaining claims. (*Ibid.*) During  
14 the conservation period prior to entry of a liquidation order, the Conservator will  
15 work closely with the IGAs to facilitate a smooth transition of claims  
16 administration and payment responsibilities in order to reduce disruption and  
17 inconvenience to policyholders and claimants. (*Ibid.*) The Conservator will also  
18 work to assign the right to receive any remaining free run-off administration  
19 services to be provided under the Conservation Agreement to any of the IGAs that  
20 are willing and authorized to use those free services. (*Ibid.*)

21 The Conservator's Motion requests the Conservation Court's approval and ratification of  
22 the Plan and entry of an order expressly authorizing the Conservator to implement, close, and  
23 effect all of the transactions described in the Plan. The Plan has clear and valuable benefits to the  
24 policyholders and creditors of CastlePoint and is a reasonable and prudent exercise of the  
25 Conservator's broad discretion to wind up the affairs of an impaired insurer in a manner that  
26 protects the interests of and maximizes the recovery for all policyholders, claimants, and other  
27 creditors.

28 ///

1 For the reasons set forth in more detail below, the Conservator respectfully requests that  
2 the Court grant the Motion, approve the Plan, authorize the Conservator to perform and close the  
3 transactions described in the Plan and the Conservation Agreement, and to take such other actions  
4 as are necessary to implement the Plan forthwith.

## 5 II.

### 6 FACTUAL BACKGROUND

#### 7 A. The Tower Group

8 CastlePoint and its predecessors were owned by a publicly traded insurance holding  
9 company group known as Tower Group International, Ltd. (“Tower Group”). (Supp. Wilson  
10 Decl., ¶ 5.) The Tower Group was formed and then grew over time through a series of  
11 acquisitions of smaller property and casualty insurers. (*Ibid.*) Collectively, the Tower Insurance  
12 Companies were admitted in all 50 states and wrote a variety of multi-line property & casualty  
13 insurance, with an emphasis on workers’ compensation and commercial multi-peril, as well as a  
14 significant personal lines business. (*Ibid.*)

15 Although the ultimate causes of the Tower Group and Tower Insurance Companies’  
16 eventual failure has not yet been fully investigated, the problems appear to have arisen from a  
17 combination of factors, including management instability, poorly executed integration of the  
18 insurers acquired by the Tower Group, poor underwriting practices that resulted in bad risk  
19 selection and inadequate premiums, and inferior and poorly integrated data systems. (Supp.  
20 Wilson Decl., ¶ 10.) As a result of these and other factors, financial problems started to emerge  
21 for the Tower Insurance Companies during 2013. (*Ibid.*)

22 On October 7, 2013, Tower Group announced that the Tower Insurance Companies’  
23 aggregate loss reserves for incurred policyholder liabilities and unearned premiums as of June 30,  
24 2013, were strengthened (increased) by approximately \$365 million and Tower Group was also  
25 recording a \$215 million goodwill impairment. (Supp. Wilson Decl., ¶ 11.) On November 14,  
26 2013, Tower Group announced that it would be restating its previously filed audited annual  
27 consolidated financial statements for 2011 and 2012, which included financial results for the  
28 Tower Insurance Companies, and the prior statements “should no longer be relied upon.” (*Ibid.*)

1 These events resulted in a rating downgrade by both AM Best and Fitch Ratings, and Tower  
2 Group's stock price declined from over \$21 per share to under \$4 in just three months. (*Ibid.*)  
3 Facing a significant drop in its stock price, material weaknesses in its accounting systems and  
4 controls, and ongoing doubt as to the sufficiency of the loss reserves for the Tower Insurance  
5 Companies, Tower International began considering options for a sale. (*Ibid.*)

6 **B. September 2014 – The Tower Group is Purchased by ACP Re**

7 On September 15, 2014, Tower Group and its subsidiaries, including the Tower Insurance  
8 Companies, were acquired by ACP Re, Ltd ("ACP Re"), a privately owned Bermuda-domiciled  
9 reinsurer that is beneficially owned by the Michael Karfunkel Family 2005 Trust ("Karfunkel  
10 Family Trust"). (Supp. Wilson Decl., ¶ 12.) Pursuant to this transaction, ACP Re immediately  
11 entered into several related post-closing transactions with AmTrust Financial Services, Inc.  
12 ("AmTrust"), a publicly traded Delaware insurance holding company; and National General  
13 Holdings Corp ("National General"), a publicly traded Delaware insurance holding company,  
14 under which certain operating assets of the Tower Insurance Companies were sold to AmTrust  
15 (commercial lines insurance assets) and to National General (personal lines insurance assets).  
16 (*Ibid.*) Also as part of the purchase transaction, the Tower Insurance Companies' aggregate  
17 policyholder loss reserves and unearned premium reserves as of September 15, 2014 were ceded  
18 to an affiliated Bermuda-domiciled reinsurer, CastlePoint Reinsurance Company, Ltd. ("CP Re"),  
19 and operating subsidiaries of AmTrust and National General took over claims administration for  
20 all claims and liabilities that were assumed by CP Re. (*Ibid.*) Finally, affiliates of AmTrust and  
21 National General entered into a \$250 million aggregate stop loss reinsurance agreement with CP  
22 Re, under which these reinsurers would (in exchange for a reinsurance premium of \$56 million  
23 payable in September 2019) agree to pay up to \$250 million in additional policyholder claims that  
24 remained unpaid after CP Re's payment of claims equal to the Tower Insurance Companies' loss  
25 reserves and unearned premium reserves as of September 15, 2014. (*Ibid.*) In turn, such  
26 reinsurers retroceded 100% of their liability under the stop loss reinsurance agreement to ACP Re  
27 pursuant to a stop loss retrocession agreement. All of the foregoing transactions closed on  
28 September 15, 2014. (*Ibid.*)

1 **C. The Tower Companies Continue To Struggle**

2 During the 15 months following the closing date, the distressed financial condition of the  
3 Tower Insurance Companies became increasingly apparent. (Supp. Wilson Decl., ¶ 13.) As of  
4 the closing date, the Tower Insurance Companies' aggregate loss reserves for insurance liabilities  
5 were, subject to further evaluation, recorded at approximately \$1.383 billion. (*Ibid.*) This  
6 amount already included approximately \$568 million of adverse development on accident years  
7 2013 and prior. (*Ibid.*) The Conservator is informed and believes that during 2015, the Tower  
8 Insurance Companies' consulting actuaries determined that such loss reserves should be increased  
9 again by more than \$400 million. (Supp. Wilson Decl., ¶ 14.) After further review, CastlePoint  
10 later increased its estimate of carried reserves by more than \$500 million as of year-end 2015.  
11 (*Ibid.*) This volatility and uncertainty surrounding the adequacy of the loss reserves, together  
12 with cash flow challenges, seriously impaired the efforts of ACP Re to oversee a solvent run-off  
13 of the Tower Insurance Companies. (*Ibid.*)

14 **D. Development of the Plan and the Merger of the Tower Insurance Companies into**  
15 **CastlePoint**

16 Early in 2016, the Tower Insurance Companies, along with Tower Group, ACP Re, and its  
17 affiliates, began working with the six domiciliary insurance regulators of the Tower Insurance  
18 Companies (in the states of California, Maine, Florida, New Jersey, New York and  
19 Massachusetts) to develop a plan to address the increasingly distressed financial condition of the  
20 Tower Insurance Companies in a manner that would best protect policyholders and other  
21 creditors. (Supp. Wilson Decl., ¶ 15.) After extensive discussions and the consideration and  
22 evaluation of alternative structures, the Plan was developed and all interested parties began  
23 working on documenting and implementing the Plan. (*Ibid.*)

24 The core features of the Plan are summarized in Section I above, and a complete copy of  
25 the Plan is attached as Exhibit A to the Wilson Declaration.

26 **E. The Need for Tax Deconsolidation and Restructuring of CastlePoint Under Internal**  
27 **Revenue Code Section 382(l)(5)**

28 CastlePoint is currently a member of a consolidated taxpayer group that includes a number

1 of non-insurance company affiliates. (Supp. Wilson Decl., ¶ 16.) Having joined the tax group,  
2 pursuant to federal tax law, CastlePoint is jointly and severally liable for any tax liabilities of any  
3 member of the taxpayer group. (*Ibid.*) In addition, CastlePoint's individual tax attributes such as  
4 the NOLs that have been generated from the loss reserve increases described in the Motion can be  
5 adversely affected by the actions of other members of the group and the upstream owners of the  
6 Tower Group. (*Ibid.*)

7 During the negotiation of the transactions described in the Conservation Agreement, ACP  
8 Re notified the Commissioner of its need to either transfer its stock in Tower Group or claim a  
9 worthless tax deduction on its 2016 U.S. federal income tax return with respect to the stock.  
10 (Supp. Wilson Decl., ¶ 17.) ACP Re stated that this tax treatment of its Tower Group stock was  
11 an essential prerequisite to its willingness to enter into the Conservation Agreement and perform  
12 its portions of the transactions and agreements that will ultimately deliver \$90 and \$150 million in  
13 net new value into CastlePoint for the benefit of policyholders. (*Ibid.*) The Conservator has been  
14 advised that unless the Plan is properly structured to include a deconsolidation of CastlePoint that  
15 is designed to meet the requirements of Internal Revenue Code section 382(l)(5), either of ACP  
16 Re's proposed actions with respect to its Tower Group stock will significantly reduce and  
17 potentially eliminate CastlePoint's sizable NOL asset. (*Ibid.*)

18 The Conservator has also been advised and believes that based on the adverse  
19 developments of CastlePoint's loss reserves described above, CastlePoint's NOLs will have  
20 grown to approximately \$500 million as of year-end 2015, and that a sale, transfer, or worthless  
21 stock deduction by ACP Re with respect to its Tower Group stock might completely eliminate the  
22 carryforward value of CastlePoint's accrued NOLs and potentially subject CastlePoint to future  
23 avoidable tax liability, the payment of which would come directly at the expense of CastlePoint's  
24 policyholders. (Supp. Wilson Decl., ¶ 18.) As a result, it is essential to the viability of the Plan  
25 that the Plan include deconsolidation provisions that would affirmatively protect CastlePoint's  
26 extensive tax related assets. (*Ibid.* 26 U.S.C. § 382.)

27 Accordingly, to protect CastlePoint's policyholders and creditors, the Conservator has  
28 proposed the tax deconsolidation procedure set forth in the Plan. (Supp. Wilson Decl., ¶ 19.)

1 This tax deconsolidation procedure is intended to mitigate and manage CastlePoint’s exposure to  
2 potentially significant federal income tax liabilities in the future by preserving the NOLs in  
3 compliance with federal tax law. (*Ibid.*) The Plan establishes a procedure to ensure that  
4 CastlePoint’s deconsolidation from the Tower Tax Group occurs on terms that are intended to  
5 preserve CastlePoint’s NOLs for utilization on separate, stand-alone tax returns. (*Ibid.*)  
6 Specifically, the Plan provides for the transfer of the CastlePoint stock on terms that the  
7 Conservator intends to be consistent with the requirements of Internal Revenue Code section  
8 382(l)(5). (Supp. Wilson Decl., ¶ 20.) As part of this section 382(l)(5) process, CastlePoint’s  
9 immediate parent company, Specialty Underwriters Alliance, Inc. (“SUAI”), will surrender  
10 possession of all stock certificates issued by CastlePoint to the Conservator for cancellation and  
11 reissuance to a shareholder trust, which will hold the “New CastlePoint Stock” for the benefit of  
12 CastlePoint’s historical shareholders and creditors. (*Ibid.*) The express intent of the Plan is to  
13 effectuate the stock transfer in a manner that will qualify under section 382(l)(5) of the Internal  
14 Revenue Code so that such transfer will not jeopardize CastlePoint’s existing NOLs, which the  
15 Conservator is advised might otherwise be extinguished and rendered valueless. (*Ibid.*)

### 16 III.

#### 17 THE CONSERVATION AND LIQUIDATION PLAN

##### 18 A. The Conservator’s Goals In Formulating The Plan

19 The Conservator’s goals in formulating and seeking authorization to implement the Plan  
20 for CastlePoint are as follows:

- 21 a. Protection of CastlePoint policyholders and claimants and administration of their  
22 claims through a controlled, systematic runoff process and eventual liquidation;
- 23 b. Preservation of the safety-net protection provided by the IGAs, which will  
24 commence administration and payment of policyholder claims upon the Court’s entry of a  
25 liquidation order and a finding of insolvency;
- 26 c. Mitigation of CastlePoint’s exposure to potentially significant federal income tax  
27 liabilities by deconsolidating CastlePoint from the Tower Tax Group and establishing a plan  
28 consistent with Internal Revenue Code section 382(l)(5) to preserve CastlePoint’s sizable NOLs

1 by restructuring CastlePoint's ownership; and

2 d. Injecting immediate liquidity into CastlePoint to permit uninterrupted payment of  
3 policyholder claims while the Conservator and other regulatory authorities prepare for an orderly  
4 liquidation of CastlePoint's business, including by triggering IGAs.

5 **B. Terms of the Conservation and Liquidation Plan**

6 The Conservator has engaged in negotiations with the management of CastlePoint,  
7 AmTrust, National General, and other affected parties to structure a conservation and liquidation  
8 plan for CastlePoint that satisfies the foregoing goals. (Supp. Wilson Decl., ¶¶ 8, 9.) The  
9 Conservator, on behalf of CastlePoint, has promulgated and adopted the Plan and entered into the  
10 Conservation Agreement, subject to and conditioned upon Court approval and ratification. (See  
11 Wilson Decl., Ex. A.)

12 The core components of the proposed Plan include (1) restructuring CastlePoint's  
13 ownership in an attempt to preserve CastlePoint's NOLs for use to offset potential future tax  
14 liabilities, particularly those that may arise from adjustments to its reserves; and (2) enhancing the  
15 value of the CastlePoint estate by executing on the transactions described in the Conservation  
16 Agreement. (Supp. Wilson Decl., ¶ 21.)

17 **1. Tax Deconsolidation and Restructuring Procedure**

18 The tax deconsolidation features of the proposed Plan will occur in the following steps:

19 Deconsolidation of CastlePoint from the Tax Group. First, upon approval of the  
20 Plan, the Conservator will restructure CastlePoint's ownership to effect a deconsolidation  
21 of CastlePoint from the Tower Tax Group. (Supp. Wilson Decl., ¶ 22(a).) As a member  
22 of the Tower Tax Group, CastlePoint presently shares joint and several liability for any  
23 tax liabilities incurred by another member of the group. (*Ibid.*) Deconsolidating from the  
24 Tower Tax Group allows CastlePoint to eliminate this risk of potential future liability  
25 during the course of the conservation proceedings by removing CastlePoint from the  
26 Tower Tax Group. (*Ibid.*) Moreover, the deconsolidation will permit CastlePoint to file  
27 stand-alone tax returns from 2016 forward. (*Ibid.*)

28 Termination of Existing Stock of CastlePoint. Second, on the Effective Date (the

1 date on which a final order is entered granting the Conservator's Motion and approving  
2 the Plan), or as soon thereafter as is practicable but not later than October 15, 2016, ACP  
3 Re will cause SUAI to deliver its stock in CastlePoint to the Conservator for cancellation.  
4 (Supp. Wilson Decl., ¶ 22(b).) The Conservator will cancel the existing stock and  
5 ownership of CastlePoint and transfer it to CastlePoint's historical creditors by way of re-  
6 issuance of new CastlePoint stock to the Commissioner, as trustee for the benefit of  
7 historical shareholders and creditors of CastlePoint. (*Ibid.*) The Plan allows for the  
8 transfer or sale of the capital stock of CastlePoint to occur in a way that is intended to  
9 preserve, pursuant to Internal Revenue Code section 382(l)(5), CastlePoint's sizable  
10 portfolio of NOLs generated by CastlePoint's operations. (*Ibid.*) These provisions of the  
11 Plan are intended to satisfy ACP Re's desire to divest its ownership of the Tower Group  
12 through a process that will comply with the requirements of Internal Revenue Code  
13 section 382(l)(5) by providing for the newly issued stock to be held by or for the sole  
14 benefit of historical shareholders and creditors of CastlePoint. (*Ibid.*)

15 Establishment of a Trust. Third, as part of the termination of existing CastlePoint  
16 stock, upon the Effective Date, the Conservator will execute the Trust Agreement to create  
17 the Trust that will hold the new CastlePoint stock. (Supp. Wilson Decl., ¶ 22(c).) The  
18 Trust will hold the reissued CastlePoint stock for the sole benefit of CastlePoint's  
19 historical shareholders and creditors, together with any other assets of CastlePoint that the  
20 Conservator determines can or should be managed in the Trust to ensure that maximum  
21 value is realized for the benefit of CastlePoint's policyholders and creditors. (*Ibid.*)

22 Administration of the Trust. Finally, the Plan provides that the Conservator will  
23 administer the Trust and distribute its assets in a manner that effectuates the priorities of  
24 payment set forth in Insurance Code section 1033(a). (Supp. Wilson Decl., ¶ 22(d).)

## 25 **2. Conservation Agreement Transactions**

26 The proposed Conservation Agreement with the Karfunkel Family Trust, AmTrust and  
27 related or affiliated parties, will generate substantial new value for CastlePoint by providing for  
28 the following beneficial transactions:

1                    Injection of \$200 Million in Additional Liquidity. The Karfunkel Family Trust will  
2 transfer or cause to be transferred \$200 million, net of advances already made, into the  
3 CastlePoint estate to be used in the payment of policyholder claims and other estate  
4 liabilities. (Supp. Wilson Decl., ¶ 23(a).) This injection of additional liquidity will allow  
5 for uninterrupted claim payments during the conservation period while the Conservator  
6 prepares for liquidation and the transfer of claims files to the IGAs. (*Ibid.*) The additional  
7 liquidity will enable a smooth transition of CastlePoint’s remaining liabilities to the  
8 appropriate IGAs upon the ultimate liquidation of the CastlePoint estate. (*Ibid.*)

9                    Run-Off Administration Services. The Conservation Agreement provides for  
10 affiliates of AmTrust and National General to enter into *Runoff Administration Services*  
11 *Agreements*, pursuant to which the administration of the runoff will be handled by those  
12 parties without charge to CastlePoint for up to two years. (Supp. Wilson Decl., ¶ 23(b).)  
13 AmTrust will administer the runoff of CastlePoint’s commercial lines business, while  
14 National General will administer the runoff of CastlePoint’s personal lines business. The  
15 benefit of these administration agreements is assignable to the IGAs at liquidation. (*Ibid.*)

16                    Transfer of Liability on Fronted Policies. The Conservation Agreement provides  
17 for the transfer and assumption of all of CastlePoint’s obligations on the Fronted Policies  
18 to the reinsurers that are already providing 100% quota share reinsurance for all claims  
19 under the Fronted Policies. (Supp. Wilson Decl., ¶ 23 (c).) Given that assumption by  
20 those reinsurers, any claims under the Fronted Policies will therefore not be transferred to  
21 the IGAs upon the liquidation of CastlePoint so long as the reinsurers are administering  
22 and paying those claims. (*Ibid.*)

23                    Commutation Of Existing LPT and Stop Loss Reinsurance Agreements. Also in  
24 exchange for the \$200 million infusion, administration services, and other consideration  
25 being provided by the Parties, the Plan provides for the commutation of the existing loss  
26 portfolio transfer (“LPT”) between CastlePoint and CP Re and the \$250 million aggregate  
27 stop loss reinsurance and retrocession contracts. (Supp. Wilson Decl., ¶ 23(d).) The stop  
28 loss reinsurance contract provided \$250 million in aggregate stop loss protection, but that

1 protection only attaches and begins to pay after \$1.383 billion or more in CastlePoint  
2 claims have been paid. (*Ibid.*) That milestone was not expected to be reached until 2018  
3 at the earliest, and perhaps later. (*Ibid.*) Moreover, absent a commutation CastlePoint has  
4 a \$56 million reinsurance premium obligation payable in September 2019 under the stop  
5 loss agreement. (*Ibid.*) Accordingly, the Conservator is informed and believes that an  
6 immediate injection of \$200 million into the estate, in addition to the administrative  
7 services and other valuable consideration provided by these parties under the  
8 Conservation Agreement, is substantially more valuable to the CastlePoint estate than the  
9 future net benefits available under the aggregate stop loss agreement. (*Ibid.*)

#### 10 IV.

#### 11 LEGAL STANDARD APPLICABLE TO 12 THE CONSERVATION AND LIQUIDATION PLAN PROCEEDINGS

13 In exercising his power as Conservator to administer the estate of a conserved insurer, the  
14 Conservator is vested with broad discretion. California Insurance Code<sup>5</sup> 1037(d) vests the  
15 Conservator with authority to enter into transactions for the sale or transfer of estate property with  
16 the conservation court's authorization. Further, the conservation court must approve the  
17 Conservator's plan absent an affirmative showing that its terms constitute an abuse of discretion  
18 because they either are unsupported by a rational basis or are arbitrary and improperly  
19 discriminatory. (*See In re Executive Life Ins. Co. v. Aurora Nat'l Life Assurance Co.* (1995) 32  
20 Cal.App.4th 344, 358 [the conservator's actions in rehabilitating a conserved insurer are reviewed  
21 under the abuse of discretion standard]; *Commercial Nat. Bank v. Superior Court* (1993) 14  
22 Cal.App.4th 393, 398 ["This [abuse of discretion] standard and the requirements of the statutory  
23 provisions governing insurance insolvency proceedings furnish the test against which a court  
24 must judge any plan of rehabilitation. If they are satisfied, the court should defer to the executive  
25 judgment of the Commissioner and approve the plan."] *See also Carpenter v. Pac. Mut. Life Ins.*  
26 *Co. of Cal.* (1937) 10 Cal.2d 307, 329 ["The only restriction on the exercise of this [police] power  
27 is that the state's action shall be reasonably related to the public interest and shall not be arbitrary  
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<sup>5</sup> Unless otherwise indicated, all of the following statutory references are to the California Insurance Code.

1 or improperly discriminatory.”))

2 A plan that provides benefits to policyholders and creditors equivalent to or greater than  
3 those they would have received in a straight liquidation is an appropriate exercise of discretion by  
4 the Conservator and satisfies the standard for approval under California law. (*See Carpenter v.*  
5 *Pac. Mut., supra*, 10 Cal.2d at p. 335-336 [a dissenter to a plan “has no legal cause for complaint  
6 simply because the commissioner determined to rehabilitate rather than liquidate” and in a  
7 conservation plan an interested party is entitled to “the equivalent of what he would receive on  
8 liquidation.”]) Thus policyholders receiving the same or superior benefits under their policies as  
9 they would in liquidation have no cause to complain about a conservation plan.

10 V.

11 **ARGUMENT**

12 **A. The Conservator Has The Authority To Formulate The Plan**

13 CastlePoint was placed into conservation pursuant to the Commissioner’s authority under  
14 section 1011, which authorizes conservation when the Commissioner determines that the insurer  
15 is “in a condition that makes its further transaction of business hazardous to its policyholders, or  
16 creditors, or to the public.” (§ 1011, subd. (d).) Under section 1011, title and possession of  
17 CastlePoint’s assets become vested in the Conservator, who is authorized to conduct  
18 CastlePoint’s business on its behalf to ensure the protection of CastlePoint’s policyholders,  
19 creditors, and the public interest. (§ 1011; and *see Carpenter v. Pac. Mut., supra*, 10 Cal.2d at p.  
20 331.)

21 The Commissioner, as Conservator, has broad authority to carry on and conduct the  
22 business affairs of CastlePoint. (§§ 1037, 1043.) Specifically, section 1043 authorizes the  
23 Conservator to enter into rehabilitation related agreements subject to court approval. In addition,  
24 1037(a) authorizes the Conservator to take all actions “necessary or expedient to collect, conserve  
25 or protect [the conserved company’s] assets, property, and business, and to carry on and conduct  
26 the business and affairs of [the company].” The Conservator may attempt to rehabilitate the  
27 insurer by entering into, with court approval, either reinsuring or rehabilitation agreements.  
28 (*Carpenter v. Pac. Mut., supra*, 10 Cal.2d at p. 331.) Liquidation is authorized if rehabilitation

1 proves futile. (*Ibid.*; see also *Executive Life Ins. Co.*, *supra*, 32 Cal.App.4th at p. 356 [“The  
2 public has a grave and important interest in preserving the business of the insolvent insurer if that  
3 is possible. Hence while the Commissioner as conservator has the power to either rehabilitate the  
4 insolvent insurer or to liquidate it, liquidation is a last resort.”] (Internal citations and quotations  
5 omitted).) Section 1037 also provides that the Conservator’s authority under the section is not  
6 limited to those powers or actions enumerated in the section. (§ 1037 [“The enumeration, in this  
7 article, of the duties, powers and authority of the commissioner in proceedings under this article  
8 shall not be construed as a limitation upon the commissioner, nor shall it exclude in any manner  
9 his or her right to perform and to do such other acts not herein specifically enumerated, or  
10 otherwise provided for, which the commissioner may deem necessary or expedient for the  
11 accomplishment or in aid of the purpose of such proceedings.”]; *Caminetti v. Guaranty Union  
12 Life Ins. Co.* (1942) 52 Cal.App.2d 330, 333 [finding that it is Commissioner’s duty to take  
13 possession of insurer’s assets and to conduct its business as conservator if insurer conducts  
14 business in manner that risks or results in loss].)

15 The Conservator has negotiated and developed the Plan specifically to benefit the  
16 policyholders and creditors of CastlePoint and to improve on the financial results they would  
17 have obtained through a multi-state, multi-company liquidation process. Simply put, the Plan is a  
18 far superior alternative. Based upon his review of this matter and the advice of professional tax  
19 advisors and counsel, the Conservator has determined that the Plan is in the best interest of the  
20 CastlePoint estate. The Plan (1) is rational, not arbitrary, and geared toward maximizing the  
21 estate’s value by efficiently winding up the affairs of CastlePoint; (2) is not contrary to statute;  
22 and (3) does not breach the Conservator’s fiduciary duty or improperly discriminate. (*In re  
23 Executive Life Ins. Co.*, *supra*, 32 Cal.App.4th at p. 358.) The court should therefore approve the  
24 Plan.

25 **B. The Plan Adds Value to CastlePoint and Preserves Assets for the Benefit of**  
26 **Policyholders and Creditors**

27 The Plan is designed to maximize the assets of the CastlePoint estate for the benefit of  
28 CastlePoint’s policyholders and creditors. The restructuring of CastlePoint’s ownership under the

1 Plan will enable CastlePoint to sever its ties with the Tower Tax Group, without losing the value  
2 of its accrued NOLs and other tax attributes. The Plan is also intended to eliminate the  
3 uncertainty regarding future liabilities as a result of any tax liabilities incurred by another member  
4 of the Tower Tax Group.

5 **1. The Plan Achieves The Objective of Deconsolidation Without Jeopardizing**  
6 **CastlePoint's NOLs**

7 To accomplish the above-stated goals of protecting the NOLs and cutting off potential  
8 future liability from the Tower Tax Group, and to ensure that the Conservation Agreement  
9 transactions can close, CastlePoint must be deconsolidated from the Tower Tax Group by  
10 October 15, 2016. The Plan is designed to effect the transfer of the CastlePoint stock in a manner  
11 that preserves the value of CastlePoint's NOLs by transferring ownership of CastlePoint from  
12 SUAI to CastlePoint's historical creditors under terms that are intended to qualify for the  
13 exemption provided in Internal Revenue Code section 382(l)(5).

14 Generally, under Internal Revenue Code section 382(a), a transfer of CastlePoint's stock  
15 could extinguish CastlePoint's existing NOLs, as such stock transfer could constitute an  
16 ownership change in the company. (26 U.S.C. § 382, subd. (a).) At present, the Conservator  
17 estimates that CastlePoint has accumulated upwards of \$500 million in NOL carryforwards since  
18 September of 2014. These NOLs should be available to carry forward to offset future operating  
19 income generated by CastlePoint.

20 However, Internal Revenue Code section 382(l)(5) provides an exception to the general  
21 rule that a stock transfer constitutes an ownership change in the company which could thereby  
22 extinguish the company's then-existing NOLs. Under that section, an ownership change does not  
23 trigger the extinguishment of a corporation's NOLs if (1) the corporation prior to the ownership  
24 change is under the jurisdiction of a court in a title 11 bankruptcy or similar case, and (2) the  
25 historical shareholders and creditors of the corporation immediately before the ownership change  
26 own at least fifty percent of the corporation's stock immediately after the ownership change. (26  
27 U.S.C. § 382, subd. (l)(5)(A).)

28 The transfer of CastlePoint's ownership from SUAI to the Trust is designed to satisfy the

1 requirements of section 382(l)(5) of the Internal Revenue Code, thus protecting and preserving  
2 the value of CastlePoint's NOLs to offset future taxable operating income. First, CastlePoint is  
3 under the jurisdiction of a court in a "title 11 or similar proceeding," a phrase that means "(i) a  
4 case under title 11 of the United States Code, or (ii) a receivership, foreclosure, or similar  
5 proceeding in a Federal or State court." (26 U.S.C. § 368, subd. (a)(3)(A); 26 U.S.C. § 382, subd.  
6 (l)(5)(F) ["For purposes of this paragraph, the term 'Title 11 or similar case' has the meaning  
7 given such term by section 368(a)(3)(A)."].) State insurance insolvency proceedings are the state  
8 court corollary to federal bankruptcy court for insurance companies, which are not entitled to file  
9 for protection under the Bankruptcy Code. (See 11 U.S.C. § 109, subd. (b)(2) [expressly  
10 excluding insurers from bankruptcy protection].) As an alternative to bankruptcy protection,  
11 Article 14 of the California Insurance Code (commencing with section 1010) establishes a  
12 receivership proceeding for troubled or failed insurers, pursuant to which the Insurance  
13 Commissioner acts as a statutory receiver and trustee for the benefit of the failed insurer's  
14 creditors. (See § 1011 [title to failed insurer's assets vested in the Commissioner as receiver] and  
15 § 1057 [Commissioner acts as trustee for the benefit of all creditors].)

16 Second, the transfer will result in the historical shareholders and creditors of CastlePoint  
17 having a 100% ownership of CastlePoint after the ownership change, satisfying the second  
18 requirement of Internal Revenue Code section 382(l)(5). With respect to CastlePoint's creditors,  
19 the IRS has opined that if a company transfers its stock to a trust owned by the various creditors,  
20 the stock will be treated for purposes of Internal Revenue Code section 382(l)(5) as owned by the  
21 beneficiaries of the trust in proportion to their respective interests in the trust. (Internal Revenue  
22 Service Private Letter Ruling No. 9619051 (May 10, 1996) 1996 WL 241508.) In other words,  
23 the beneficiaries of the trust are treated as the owners of the company in proportion to their  
24 interests in the trust assets.

25 As applied here, CastlePoint's historical creditors will assume de facto ownership of  
26 CastlePoint in satisfaction of their claims. Under the Plan, all of CastlePoint's assets and  
27 liabilities not previously distributed with the permission of this Court will be transferred to the  
28 Trust by way of the ownership of the CastlePoint stock. Thus, the same pool of assets will be

1 available to creditors as was available prior to the transfer. The Conservator will distribute those  
2 assets to the historical creditors and the shareholders in accordance with the priority scheme set  
3 forth in section 1033(a). As a result, the creditors' pro rata share of CastlePoint's assets will  
4 remain the same before and after the transfer: each will receive the share to which he is entitled  
5 under statute. The only difference will be that the surrender of the CastlePoint stock by SUAI  
6 will conclusively sever CastlePoint from the Tower Tax Group.

7 Because the Conservator's Plan was intended to and should meet all of the requirements  
8 of Internal Revenue Code section 382(l)(5), the Court may appropriately find and determine that,  
9 for purposes of this proceeding, CastlePoint's NOLs accrued since September 2014 have been  
10 preserved and are available to carry forward to offset any operating income that may be generated  
11 by CastlePoint during its liquidation.<sup>6</sup>

12 **2. The Plan and Establishment Of A Trust Is The Best Alternative To Achieve**  
13 **Deconsolidation While Preserving CastlePoint's NOLs**

14 Structuring the transfer of CastlePoint stock to satisfy the requirements of Internal  
15 Revenue Code section 382(l)(5) is the best alternative to preserve the value of CastlePoint's  
16

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17 <sup>6</sup> The IRS will be given special notice of this Motion and the Commissioner's Plan. However, since it appears  
18 unlikely that the IRS will appear in the proceeding to participate in the Court's consideration of the Motion, the  
19 Commissioner wishes to advise the Court of certain authorities that could be relied upon by the IRS to assert that a  
20 finding by this Court that the Plan satisfies Internal Revenue Code section 382(l)(5) will not be conclusively binding  
21 on the IRS. Specifically, in the unlikely event that the IRS later seeks to contest the Plan's conformity to the  
22 requirements of Internal Revenue Code section 382(l)(5), the IRS will likely rely on *Commissioner v. Tower*  
23 ("Tower") (1946) 327 U.S. 280, 287-88, in which the Supreme Court stated that a state "cannot by its decisions and  
24 laws governing questions over which it has final say, also decide issues of federal tax law and thus hamper the  
25 effective enforcement of a valid federal tax levied against earned income." In reliance on *Tower* the U.S. Tax Court  
26 has simply stated: "Finally, it is well settled that State courts by their decisions cannot determine issues of Federal tax  
27 law." (*Picou v. C.I.R.* (May 22, 2006) T.C. Summ.Op. 2006-82, 2006 WL 1391391, U.S. Tax Ct., (No. 10879-05S).)

28 While these and similar authorities establish that the federal courts are generally entitled to the final word on  
the interpretation and application of federal tax law, none of these cases arose in the context of an insurance company  
liquidation and thus were not required to examine the complex jurisdictional issues that arise from the Congressional  
delegation to states insurance commissioners and state courts of responsibility over the liquidation of failed domestic  
insurers (See 15 U.S.C. §§ 1011-1015 [the McCarran-Ferguson Act delegates to the states the duty to regulate and  
liquidate domestic insurance companies].) The Commissioner has been unable to locate any federal authorities that  
expressly address the issue of whether an insurance insolvency court's exclusive jurisdiction over the assets of a  
failed insurer – including tax assets like NOLs – authorize the state court to conclusively determine whether tax  
assets are protected by application of federal law. However, the U.S. Supreme Court has conclusively established  
that the states are authorized to subordinate the payment of IRS claims to the claims of insurance policyholders.  
(*United States Dept. of the Treasury v. Fabe*, (1993) 508 U.S. 491, 113 S.Ct. 2202, 124 L.Ed. 2d 449.) The State of  
California has done just that by relegating IRS claims to "Class 3" priority under Insurance Code section 1033(a).  
(*See* § 1033, subd. (a)(3).)

1 NOLs for use to offset future taxable operating income. No other alternatives would accomplish  
2 this objective. First, a direct transfer of CastlePoint's stock to the Conservator, without  
3 establishing a Trust, might meet the requirements of Internal Revenue Code section 382(l)(5).  
4 (*See* Ins. Code, § 1057 [Commissioner as liquidator acts as a trustee for the benefit of all creditors  
5 and other persons interested in the estate].) However, the Internal Revenue Service has not  
6 directly addressed whether such a transfer satisfies Internal Revenue Code section 382(l)(5),  
7 creating the additional and unnecessary risk that the IRS might later conclude that such a transfer  
8 did not satisfy that section and thus resulted in an extinguishment of CastlePoint's NOLs. By  
9 contrast, the IRS already has issued a letter ruling to the effect that a transfer to a trust for the  
10 benefit of creditors will satisfy this section of the Internal Revenue Code. (IRS Private Letter  
11 Ruling No. 9619051.) As a result, the Conservator believes that creating a Trust for the benefit of  
12 policyholders and creditors is the best alternative to preserve the value of CastlePoint's NOLs.

13 The only remaining alternative is to do nothing. During negotiation of the Conservation  
14 Agreement, ACP Re notified the Conservator of its need to effect the final deconsolidation of  
15 CastlePoint if CastlePoint is unable to secure this Court's approval of the Plan by October 15,  
16 2016. If the Conservator and the Court fail to enjoin such actions, ACP Re could cause the final  
17 and certain deconsolidation in whatever expedient manner it may choose, thereby potentially  
18 triggering an ownership change that extinguishes CastlePoint's NOLs under section 382(a) of the  
19 Internal Revenue Code. This alternative is far worse for CastlePoint's policyholders and  
20 creditors, as it may result in the loss of the protection afforded by CastlePoint's NOLs and may  
21 result in the payment of tens of millions of dollars to the IRS prior to the full payment of all class  
22 2 policyholder claims. While an election under Internal Revenue Code section 831(b) remains  
23 available to mitigate tax exposure from insurance reserve reductions, such an election would  
24 require CastlePoint to pay taxes on all investment income, income that would otherwise have  
25 been offset by carrying forward NOLs.

26 After considering all available alternatives, the Conservator has determined that the  
27 restructuring provisions for CastlePoint as outlined in the Plan are in the best interests of  
28 policyholders and creditors.

1           **3. The Transactions Provided For In The Conservation Agreement Are**  
2           **Beneficial To The CastlePoint Estate, Policyholders and Creditors.**

3           The Conservation Agreement provides for three primary transactions, each of which are  
4           beneficial to and add value to the CastlePoint estate for the benefit of policyholders, claimants,  
5           creditors and the shareholder. The Conservator is expressly authorized to enter into agreements  
6           that involve the assets and business of CastlePoint if he determines that such agreements either  
7           add value to the estate or reduce the estate's liabilities. (§ 1037, subd. (d).) The transactions  
8           provided for in and under the Conservation Agreement do both, and thus should be approved.

9           First, the Conservation Agreement provides for the commutation (termination) of existing  
10          reinsurance agreements, including the LPT with CP Re and the \$250 million aggregate stop loss.  
11          In addition to obtaining the immediate \$200 million infusion and the return of assets transferred  
12          and rights assigned to CP Re under the LPT, CastlePoint is significantly benefitted by the  
13          elimination of the \$56 million reinsurance premium payment obligation due September 2019  
14          under the stop loss agreement and by elimination of any credit risk associated with collection on  
15          the LPT with CP Re, a Bermuda based reinsurer. (Supp. Wilson Decl., ¶ 23(d).) Absent the  
16          commutation of the LPT, if CP Re was determined to be insolvent and was placed into  
17          receivership in Bermuda by its regulator, the Bermuda Monetary Authority, the Conservator and  
18          CastlePoint would suffer extensive delays and expense from becoming involved in an  
19          international receivership process. This scenario is avoided if the Conservation Agreement is  
20          approved and the reinsurance commutations are concluded.

21          Second, the Conservation Agreement provides for the formal assignment and assumption  
22          of CastlePoint policies issued after September 15, 2014 by insurance company affiliates of  
23          AmTrust and National General. (Supp. Wilson Decl., ¶ 9(c).) Those insurers are issuing "cut-  
24          through" endorsements to all of those Fronted Policies. The cut-through endorsement provides  
25          that those policyholders may submit claims under the Fronted Policies directly to those solvent  
26          insurance companies, rather than having the claims swept into the CastlePoint conservation and  
27          liquidation proceedings and into the IGAs. In addition to being a clearly better option for the  
28          affected policyholders, this transaction also benefits CastlePoint and the IGAs by relieving the

1 estate and IGAs from responsibility for administering and paying claims under the Fronted  
2 Policies. (*Ibid.*)

3 Third, the Conservation Agreement provides for affiliates of AmTrust and National  
4 General to provide runoff administration services for CastlePoint without charge. This benefit of  
5 the Conservation Agreement avoids up to \$40 million in administration fee liability that  
6 CastlePoint would otherwise be required to pay while running off and administering CastlePoint's  
7 policies and claims. (*Ibid.*)

8 The value of the Conservation Agreement transactions are significant and inure to the  
9 benefit of all parties interested in CastlePoint. Given the obvious importance of the Conservation  
10 Agreement to the overall Plan for CastlePoint, the Conservation Agreement should be approved.

11 **C. The Conservator's Goals Are Met By The Conservation and Liquidation Plan**

12 The Plan satisfies the Conservator's goals for the conservation and liquidation of the  
13 CastlePoint estate as follows:

14 **a. Protection of CastlePoint Policyholders**—The Plan provides for continued  
15 administration and payment of policyholder claims by AmTrust and National General as well as  
16 the smooth, uninterrupted transition of payment and administrative obligations to the IGAs upon  
17 the liquidation of CastlePoint. Further, under the Plan, the CastlePoint Estate will receive \$200  
18 million, net advances already made, that will be available immediately for the payment of  
19 policyholder claims. The Plan also minimizes expenses to the estate, thereby maximizing the  
20 assets available to pay policyholder claims. Based on the analysis and evaluation described above,  
21 the Conservator has concluded that the Plan, the Conservation Agreement, and the Conservation  
22 Transaction Agreements are fair and reasonable and provide significantly greater benefits to  
23 policyholders than they would obtain under a statutory liquidation of CastlePoint.

24 **b. Preservation of the Guaranty Association Safety Net**—The Plan recognizes the  
25 statutory role and responsibilities of the IGAs, and does nothing to alter or limit the safety net  
26 provided by the IGAs to policyholders. To the contrary, the Conservation and Liquidation Plan is  
27 designed to allow for the seamless transition of claims administration and payment to the IGAs  
28 upon the ultimate liquidation of CastlePoint.

1           **c. Mitigation of Exposure to Federal Income Tax Liabilities**—As set forth in  
2 detail above, the Plan also provides for the restructuring of CastlePoint’s equity ownership,  
3 pursuant to Internal Revenue Code Section 382(l)(5), to mitigate CastlePoint’s exposure to  
4 potentially significant federal income tax liabilities during the conservation and liquidation. By  
5 restructuring the equity ownership, the Plan ensures that CastlePoint’s tax attributes, including its  
6 sizeable NOLs, will be preserved so that the CastlePoint estate is not inappropriately subjected to  
7 federal income tax liabilities, which will ensure that the recoveries available for policyholders and  
8 other creditors are maximized to every extent possible. The tax deconsolidation procedure in the  
9 Plan also eliminates the risk of future joint and several tax liability from members of  
10 CastlePoint’s tax group thereby further providing protection to CastlePoint’s policyholders and  
11 creditors.

12           **d. Injection of Liquidity into CastlePoint**—The Plan provides for the immediate  
13 injection of \$200 million (less certain advances) into CastlePoint, which will permit the  
14 uninterrupted payment of policyholder claims. As detailed in the Plan and the analysis above,  
15 CastlePoint will close on a series of integrated transactions set forth in the Conservation  
16 Agreement, pursuant to which \$200 million will be injected into CastlePoint by several parties to  
17 the Conservation Agreement. The Conservator has found that the infusion of this much needed  
18 liquidity, under the terms of the Conservation Agreement and as set forth in the Plan, is fair and  
19 reasonable as it will ensure that policy claims and benefits will continue to be paid during the  
20 conservation period while the Conservator prepares for the eventual liquidation of CastlePoint.

21 **D. Risks Attendant To The Plan**

22           The viability and ultimate value of the Plan depends on number of factors, including the  
23 rate of the runoff of the CastlePoint claims, as well as the continued financial health of AmTrust  
24 and National General as the “Administrators” under the Plan. While the Plan seeks to reduce  
25 policyholder risk, the Plan cannot entirely eliminate the risk of adverse insurance loss  
26 development. The preceding three decades have seen volatility in liabilities on insurance policies  
27 issued by property and casualty insurance companies, and extraordinary volatility in the workers’  
28 compensation markets in particular. There is no way to predict what impact such developments

1 will have on past and current CastlePoint insurance liabilities. Nevertheless, the Conservator  
2 believes that the Plan is based on the best available actuarial assessment of CastlePoint. In sum,  
3 the Conservation and Liquidation Plan has some inherent risk due to the nature of the business  
4 underwritten. The Plan, however, significantly hedges against those risks as described above.

5 **E. Conservator's Recommendation**

6 The Plan provides several advantages over an immediate liquidation. First, under the Plan  
7 CastlePoint will deconsolidate from the Tower Group on terms that maximize and preserve the  
8 value of its tax attributes. Also pursuant to the Plan, CastlePoint will receive between \$90 and  
9 \$150 million in net new value, including an immediate liquidity infusion specifically designated  
10 for the payment of policyholder claims. The Conservator does not believe that, outside of the  
11 Plan, such additional liquidity would be available. Second, the Plan provides for continuity of  
12 claims administration and the efficient, organized runoff of claims, with administration being  
13 provided for up to two years at no cost to CastlePoint. Additionally, the Plan provides for  
14 elimination of risk on the Fronted Policies, and protects those policyholders from engagement  
15 with the conservation and the IGAs. Finally, the Plan provides much needed immediate certainty  
16 for policyholders, as it ensures the provision of administrative services for policyholders and  
17 claimants and provides for the smooth transition of those services to the IGAs upon CastlePoint's  
18 liquidation.

19 Based on the Conservator's analysis and evaluation of the proposed Conservation and  
20 Liquidation Plan, the Conservator has concluded that the Plan, the Conservation Agreement and  
21 the Conservation Transaction Agreements, are fair and reasonable, and provide significantly  
22 greater benefits to policyholders than they would obtain under an immediate statutory liquidation  
23 of CastlePoint. (Supp. Wilson Decl., ¶ 24.) The proposed plan provides several benefits to the  
24 CastlePoint estate, its policyholders, and creditors, including the immediate injection of an  
25 additional \$200 million in liquidity and continuity in the claims and administration process prior  
26 to liquidation. (Supp. Wilson Decl., ¶25.) Based on these benefits, and having considered the  
27 alternatives, the Conservator has determined that the Plan is superior to an immediate liquidation  
28 and provides the best chance of maximizing the assets available to pay creditor claims. (*Ibid.*)

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VI.

CONCLUSION

For all the foregoing reasons, the Conservator requests that the Court approve the Plan and enter the order lodged by the Conservator authorizing the Conservator to implement the transactions set forth in the Plan.

Dated: August 5, 2016

KAMALA D. HARRIS  
Attorney General of the State of California

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MARGUERITE C. STRICKLIN  
Deputy Attorney General

Attorneys for Applicant Dave Jones,  
Insurance Commissioner of the  
State of California

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