BILL LOCKYER
Attorney General
W. DEAN FREEMAN
Lead Supervising Deputy Attorney General
MARK P. RICHELSON
Supervising Deputy Attorney General
RAYMOND B. JUE (State Bar No. 061656)
Deputy Attorney General
LISA W. CHAO (State Bar No. 198536)
Deputy Attorney General
300 South Spring Street, Room 1702
Los Angeles, California 90013
Telephone: (213) 897-2480
Facsimile: (213) 897-5775

THOMAS J. WELSH (State Bar No. 142890)
JAMES E. HOUPT (State Bar No. 187878)
STACY E. DON (State Bar No. 226737)
ORRICK, HERRINGTON & SUTCLIFFE LLP
400 Capitol Mall, Suite 3000
Sacramento, CA 95814-4497
Telephone: 916-447-9200
Facsimile: 916-329-4900

Attorneys for Plaintiff
Fremont Indemnity Company

SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF LOS ANGELES

FREMONT INDEMNITY COMPANY, Plaintiff, v. FREMONT GENERAL CORPORATION, FREMONT COMPENSATION INSURANCE GROUP, INC., DOES 1-30, Defendant.	CASE NO. BC316472 THIRD AMENDED COMPLAINT FOR: 1. INTENTIONAL MISREPRESENTATION 2. CONCEALMENT 3. PROMISSORY FRAUD

Fremont Indemnity Company ("Fremont Indemnity"), a California corporation, by and through John Garamendi, Insurance Commissioner of the State of California ("the Commissioner"), acting solely as statutory liquidator of Fremont Indemnity, alleges as follows:

///

INTRODUCTION

1. Fremont General Corporation and its alter ego, Fremont Compensation Insurance Group (collectively, "Fremont General"), engaged in a scheme to strip and convert valuable assets from one of their subsidiaries, Fremont Indemnity, for Fremont General's own use without adequate compensation to Fremont Indemnity. Those assets were more than $900 million in "net operating losses" or "NOLs" that were owned by Fremont Indemnity.

2. NOLs belong to a subsidiary corporation, even if the subsidiary becomes insolvent or impaired, and remain property of the estate even if the ability to use the NOLs is "speculative." *Official Committee of Unsecured Creditors v. PSS Steamship Co. (In re Prudential Lines, Inc.)*, 928 F.2d 565, 571 (2d Cir. 1991). In the absence of an agreement, NOLs remain the subsidiary's property, even when affiliated corporations file a consolidated tax return. Absent an agreement, therefore, Fremont General could not appropriate Fremont Indemnity's NOLs.

3. Fremont General accomplished its scheme by entering into such an agreement with Fremont Indemnity and obtained the consent of then-Commissioner Harry Low on July 2, 2002 (the "July 2002 Agreement").

4. Thereafter, Fremont General converted those NOL assets into more than $300 million in net income by utilizing the NOLs in Fremont General's consolidated tax returns to avoid paying taxes on other operating income.

5. Fremont General fraudulently induced the Commissioner and Fremont Indemnity to enter into the July 2002 Agreement by misrepresenting and concealing material facts and by making false promises. But for these fraudulent acts, the Commissioner and Fremont Indemnity would not have entered into the July 2002 Agreement, and the Commissioner would have placed Fremont Indemnity under the statutory protection of conservation and liquidation earlier than he did. Earlier conservation and liquidation would have allowed the Commissioner to avoid developments that further drained Fremont Indemnity's assets during Fremont General's control. But for Fremont General's fraud, Fremont Indemnity's liabilities would not now exceed its assets by more than $1.1 billion, and Fremont Indemnity's insolvency – and the detriment to its policyholders, creditors, and the public – would be far less severe.

6. By this lawsuit, Fremont Indemnity seeks to: (1) rescind the July 2002 Agreement; (2) disgorge from Fremont General the more than $300 million in ill gotten gains it obtained through this fraudulent transaction; (3) recover damages for the delay of conservation and liquidation that deepened Fremont Indemnity's insolvency; and (4) recover other compensatory and punitive damages from Fremont General and the other defendants arising from their fraudulent conduct.

THE PARTIES

7. Fremont Indemnity was licensed to transact insurance business in California, 45 other states and the District of Columbia and was engaged in the underwriting and sale of workers' compensation insurance. As a California domiciled insurer, Fremont Indemnity was subject to the regulatory authority of the Commissioner. The Commissioner was appointed as the liquidator of Fremont Indemnity by this Court in a proceeding captioned *Insurance Commissioner v. Fremont Indemnity Company*, Los Angeles County Superior Court Case No. BS083582 ("the Liquidation Proceeding"). The Court's Order Appointing Insurance Commissioner As Liquidator and Restraining Orders was issued on July 2, 2003 in the Liquidation Proceeding after finding Fremont Indemnity insolvent.

8. Fremont General Corporation is a publicly traded corporation organized under the laws of the State of Nevada. Fremont Compensation Insurance Group ("Fremont Insurance Group") is a Delaware corporation and is and has been at all relevant times a wholly owned subsidiary of Fremont General. Fremont Indemnity has been at relevant times a wholly owned subsidiary of Fremont Insurance Group.

9. Fremont General Corporation, Fremont Insurance Group and Fremont Indemnity were part of a holding company system that was subject to regulation under the Insurance Holding Company System Regulatory Act, Ins. Code §§ 1215, *et. seq.* (the "Holding Company Act"). Under that Act, Fremont General could not lawfully acquire or remove assets from Fremont Indemnity without the prior approval of the Commissioner.

10. At all relevant times prior to the commencement of the Liquidation Proceeding, Fremont Indemnity was owned, dominated, and controlled by Fremont General Corporation

through its subsidiary, Fremont Insurance Group, which was under the ownership, domination, and control of Fremont General Corporation such that Fremont Insurance Group operated as the alter ego of Fremont General Corporation. Many, but not all, senior officers and directors of Fremont Indemnity were also senior officers and directors of Fremont General. Fremont General operated all its business and the business of all of its affiliates as a common enterprise.

11. Fremont Indemnity is informed and believes and thereon alleges that Does 1 through 30 are persons, corporations, partnerships, or other entities who have directed, approved, committed, participated in, or aided and abetted the acts and transactions alleged in this complaint. Each is therefore liable for the acts alleged in this complaint. The true names and capacities of Does 1-30 are unknown to Fremont Indemnity, and Fremont Indemnity will seek leave of court to amend this complaint when their true names and capacities are known.

JURISDICTION

12. This Court has jurisdiction to hear and determine this action pursuant to Insurance Code Section 1058, since it affects the interests of Fremont Indemnity and the Commissioner as statutory liquidator of Fremont Indemnity.

THE NOLs AND THE JULY 2002 AGREEMENT

13. Prior to the July 2002 Agreement, Fremont Indemnity owned the NOLs. Fremont General knew and understood that fact and knew that absent an agreement approved by the Commissioner, it could not appropriate the NOLs from Fremont Indemnity.

14. Prior to the July 2002 Agreement, Fremont General had acknowledged and agreed that if it acquired the NOLs from Fremont Indemnity, to which it owed a fiduciary duty, it would compensate Fremont Indemnity for the value that Fremont General would realize from its own use of the NOLs. That agreement and acknowledgment was reflected, among other ways, in a course of dealing between Fremont General and Fremont Indemnity, a 1998 tax sharing agreement between Fremont General and Fremont Indemnity, and in a letter dated December 3, 2001, from John Donaldson, purporting to act as Executive Vice President and Chief Financial Officer of Fremont Insurance Group, to Ramon Calderon, then Chief Insurance Examiner of the Field Examination Division of the California Department of Insurance.

15. In addition to its agreement and acknowledgement that it would pay Fremont Indemnity for the NOLs, Fremont General also knew and understood that California law requires that transactions between an insurer and any affiliated company must be on terms that are "fair and reasonable." Ins. Code § 1215.5(a)(1). Fremont General also knew and understood that under the law, it could not acquire the NOLs from Fremont Indemnity without the Commissioner's approval.

16. Fremont General Corporation proposed that Fremont General, Fremont Indemnity, and the Commissioner enter into the July 2002 Agreement. By the terms of that agreement, Fremont Indemnity transferred to Fremont General all of its right, title and interest in, and the right to benefit from, the NOLs.

17. In exchange, Fremont General promised to infuse up to $92.75 million into Fremont Indemnity over a period of time. More specifically, Fremont General agreed that it would contribute $13.25 million in cash to Fremont during each of the calendar years 2002 through 2004, and would continue to pay amounts up to $13.25 million during any year from calendar year 2005 going forward if Fremont's reserves plus surplus became insufficient to pay claims.

18. Fremont General, however, conditioned its obligation to make future payments to Fremont Indemnity. Under the July 2002 Agreement, Fremont General's obligation would cease if the Commissioner sought conservation or liquidation of Fremont Indemnity prior to March 1, 2004.

19. Proceedings for the conservation and liquidation of Fremont Indemnity began on June 4, 2003, less than a year after the July 2002 Agreement. Because those proceedings commenced prior to the March 1, 2004 date referred to in the July 2002 Agreement, Fremont General ceased making cash infusions to Fremont Indemnity.

20. Shortly after the conservation and liquidation of Fremont Indemnity began, and after the Commissioner had advised Fremont General of his position that the July 2002 Agreement was invalid, Fremont General filed a consolidated tax return in which it utilized the vast majority of the NOLs. Fremont Indemnity is informed and believes and thereon alleges that

the actual value realized by Fremont General on account of Fremont Indemnity's NOLs was in excess of $300 million.

21. Prior to and in connection with the July 2002 Agreement, Fremont General represented to the Commissioner that Fremont Indemnity's assets were sufficient to allow Fremont Indemnity to avoid insolvency well past March 2004. In fact, however, Fremont General knew, but concealed from the Commissioner and Fremont Indemnity, that Fremont Indemnity's assets would not permit a delay of conservation and liquidation until March 2004. Among other things, Fremont General knew, but misrepresented and concealed from the Commissioner and Fremont Indemnity, that there had been and were serious abuses of reinsurance treaties by Fremont General and that the largest single source of cash for Fremont Indemnity, a reinsurer, would soon cease its payments to Fremont Indemnity, making conservation and liquidation well before March 2004 inevitable.

22. Prior to and in connection with the July 2002 Agreement, Fremont General also falsely represented that conservation or liquidation of Fremont Indemnity before March 2004 would so threaten Fremont General's financial condition that it would be unable to make further cash contributions to Fremont Indemnity. Fremont General made those misrepresentations to justify its need for the NOLs, to justify its need to schedule its payments over seven years, and to explain the need to delay conservation or liquidation until at least March 2004.

23. Because of Fremont General's misrepresentations and concealment of material information, the Commissioner did not know when he agreed to the July 2002 Agreement the severity of the financial condition of Fremont Indemnity and that pending adverse developments would make it impossible for him to forestall conservation or liquidation until March 1, 2004.

24. But for Fremont General's misrepresentations and concealments, the Commissioner would have conserved Fremont Indemnity with its NOLs intact. As a taxpayer even in liquidation, Fremont Indemnity has more than a "speculative" risk of earning income, or even phantom income through such taxable developments as the write-off of bad debt, among other things. Because of Fremont General's fraud, however, Fremont Indemnity is now left

///

without NOLs to reduce that income, and Fremont Indemnity is now left without the means to negotiate with its affiliates for a fair exchange of value for the NOLs.

FREMONT GENERAL'S CONCEALMENT OF ITS ABUSE OF REINSURANCE TREATIES AND THE THREATS TO FREMONT INDEMNITY'S CONTINUED RECEIPT OF REINSURANCE PAYMENTS

25. As a holding company, Fremont General owed a variety of duties under the Holding Company Act and other provisions of the California Insurance Code. Among those was the duty to ensure that its insurance subsidiaries made regular, accurate, and complete reports to the Commissioner of the subsidiaries' financial condition and risks to its financial condition. Fremont General also had a duty, apart from the Holding Company Act, to be truthful when it communicated with the Commissioner, and to not conceal information. Despite these duties, Fremont General misrepresented and concealed from the Commissioner material facts regarding the threat to Fremont Indemnity's continued receipt of reinsurance payments from its reinsurers, which was the primary source of funds used to fund the operations.

26. Reinsurance is commonly described as "insurance for insurance companies." An insurer can enter into an agreement, frequently referred to as a "treaty," with a "reinsurer" under which the reinsurer assumes some defined portion of the insurance risk of loss incurred by an insurer when it issues insurance policies to its customers. In return, the reinsurer agrees to receive a negotiated percentage, commensurate with the risk that the reinsurer assumes, of premiums paid by policyholders under the underlying insurance policies. An insurer owes a contractual and common law duty to its reinsurers to underwrite the policy for the mutual benefit of the insurer and its reinsurers.

27. Reinsurers consider it a breach of that duty if the insurer's underwriting process (which determines that amount of premiums that a policyholder will be charged) focused solely on obtaining sufficient premiums to cover the insurer's retained risk, without regard to whether sufficient premium is collected to cover the portion of the risk assumed by the reinsurer. This practice has been referred to as "net-line underwriting." If an insurer engages in net-line underwriting, the insurer may be liable to the reinsurer for breach of contract. If an insurer enters

into the treaty with the intent to abuse the treaty in this or a similar manner, or if the insurer materially and significantly breaches the treaty by extreme and persistent net-line underwriting, the reinsurer may demand a rescission in which the insurer would be required to reimburse the reinsurer for all reinsurance payments made by the reinsurer.

28. Beginning in approximately 1998, Fremont General caused Fremont Indemnity to enter into a number of reinsurance treaties. Louis Rampino, then holding executive officer titles with both Fremont General and Fremont Indemnity, but acting only in Fremont General's interest, urged and encouraged Fremont Indemnity underwriters to provide price quotes to insureds based on the inappropriate practice of net-line underwriting as a means of increasing Fremont Indemnity's business and market share at the reinsurers' expense. Fremont Indemnity is informed and believes and thereon alleges that some Fremont Indemnity underwriters engaged in such net-line underwriting. The Commissioner did not know about these activities.

29. Reliance Reinsurance ("Reliance") was one of the several reinsurers who entered into reinsurance treaties with Fremont Indemnity in 1998. In or about late 1999, Reliance demanded its contractual right under its reinsurance treaty to audit Fremont Indemnity's underwriting practices. Reliance hired Robert Drag of Altair Associates, Inc. to perform the audit on behalf of Reliance.

30. Fremont Indemnity is informed and believes and thereon alleges that Alan Faigin, Fremont General's General Counsel, attempted to prevent Mr. Drag's discovery of the net-line underwriting practices, insisting that Mr. Drag could meet with no Fremont Indemnity personnel unless Mr. Faigin or an appointed representative was present. Fremont Indemnity is informed and believes and thereon alleges that the purpose for Mr. Faigin's or a representative's presence at the interview was to prevent employees from responding to certain lines of inquiry by Mr. Drag and to prevent Mr. Drag's access to certain records and files. Fremont Indemnity is informed and believes and thereon alleges that despite Mr. Faigin's efforts, Mr. Drag uncovered evidence of net-line underwriting. Reliance provided Mr. Faigin with a summary of Mr. Drag's findings regarding the net-line underwriting.

///

31. Fremont Indemnity is informed and believes and thereon alleges that in early 2000, Reliance demanded either arbitration with Fremont as provided by the reinsurance treaty between the parties, or that Fremont agree to a compromise and settlement, otherwise known as a "commutation." The commutation, announced February 28, 2000, terminated the treaty in return for Reliance's payment of only a portion of amounts then owing and likely to be owing in the future by Reliance to Fremont Indemnity under the treaty causing a pre-tax loss of approximately $100 million.

32. At about the same time, the Commissioner was continuing his review for a Report Of Examination of Fremont Indemnity. Constance Korte, working under contract to the Commissioner to assist with the examination, was informed by Ronald Groden, Fremont Indemnity's Chief Financial Officer, that the treaty was being commuted only because of concerns about Reliance's financial condition. Mr. Groden did not disclose the findings from Reliance's audit to Ms. Korte or the real reason for the commutation. Fremont Indemnity is informed and believes and thereon alleges that Mr. Groden was acting at Fremont General's direction and on its behalf in so communicating with Ms. Korte.

33. After the commutation of the Reliance treaty, Mr. Faigin, Wayne Bailey, then Fremont General's Chief Financial Officer and currently its Executive Vice President and Chief Operating Officer, and others from Fremont General met from time to time with Mr. Calderon and with Norris Clark, then Deputy Commissioner and Chief of the Commissioner's Financial Surveillance Branch, to discuss Fremont Indemnity's financial condition. In one or more of these meetings in 2000, Mr. Faigin stated that Fremont General commuted the Reliance treaty only because of concerns about Reliance's financial condition. Mr. Faigin, Mr. Bailey, and others from Fremont General did not disclose Mr. Drag's findings of the net-line underwriting practices that Mr. Rampino had directed.

34. To the contrary, David Brody, Fremont General's Assistant General Counsel, wrote to Mr. Drag on or about August 25, 2000, to try to convince Mr. Drag that he should return or destroy all documents that Mr. Drag obtained in the audit.

///

35. The facts learned by Mr. Faigin as a result of his negotiations with Reliance were material because Mr. Drag's findings, if known by other reinsurers, would likely cause other reinsurers to suspend payments to Fremont Indemnity or to demand arbitration of their treaties and create the risk of termination and rescission.

36. The continued receipt of reinsurance payments was essential to Fremont Indemnity's ability to continue paying claims and other expenses as they came due. The continued receipt of reinsurance payments was also essential to protect the ability of Fremont Indemnity to continue to include the anticipated future reinsurance receivables as admitted assets on its financial statements. Fremont Indemnity was permitted to include reinsurance on its financial statements only if it believed that the reinsurance was not subject to material dispute by the reinsurer.

37. As discussed in paragraphs 45 through 60 below, Fremont General's cover-up of the improper net-line underwriting and abuse of reinsurers continued and escalated through the execution of the July 2002 Agreement, as it concealed a material risk that Fremont Indemnity's primary reinsurer would cease making payments, resulting in substantial additional impairment to Fremont Indemnity's financial condition.

FREMONT GENERAL'S FALSE PROMISE TO PERMIT THE COMMISSIONER ENHANCED REGULATORY OVERSIGHT OF FREMONT INDEMNITY

38. The investigation for the Report Of Examination referred to in paragraph 32 above caused the Commissioner to be concerned about the solvency of Fremont Indemnity. Therefore, the Commissioner considered the need to seize and conserve Fremont Indemnity to protect Fremont Indemnity's policyholders and the public. The possibility of Fremont Indemnity's conservation had to cause deep concern at Fremont General, since conservation would cause Fremont General to lose control of Fremont Indemnity and its NOLs, would increase the likelihood that the Commissioner would learn about Mr. Drag's findings in the Reliance audit, Fremont General's concealment of those findings, and the threat those findings posed to all other reinsurance transactions of Fremont Indemnity.

///

39. To avoid conservation, Fremont General proposed that the Commissioner permit Fremont General to maintain its control of Fremont Indemnity. In return, Fremont General promised to infuse at least $6 million cash yearly into Fremont Indemnity. By concealing the threat to Fremont Indemnity's continued receipt of reinsurance payments, Fremont General convinced the Commissioner that Fremont Indemnity retained sufficient admitted assets to continue paying claims and funding operational expenses as they came due. In return, the Commissioner required that Fremont Indemnity limit the writing of new business, and that Fremont General agree to accept enhanced regulatory oversight of Fremont Indemnity by the Commissioner. Unaware of the facts that Fremont General concealed, the Commissioner permitted Fremont General to retain its control and management of Fremont Indemnity.

40. On November 27, 2000, the Commissioner, acting solely in his capacity as the statutory regulator of Fremont Indemnity, entered into a Letter of Regulatory Oversight (the "November 27, 2000 Letter") with Fremont General Corporation, Fremont Insurance Group, and Fremont Indemnity. The November 27, 2000 Letter included the appointment of a Special Deputy Examiner to provide day-to-day supervision and regulatory oversight of Fremont General's insurance subsidiaries by the Commissioner. The Commissioner appointed Ms. Korte to act as Special Deputy Examiner.

41. Fremont Indemnity is informed and believes and thereon alleges that Fremont General had no intention of permitting enhanced regulatory oversight, and instead intended to continue to dominate and control Fremont Indemnity to prevent Ms. Korte, the Commissioner, or even Fremont Indemnity itself from learning the extent of Fremont Indemnity's deteriorating financial condition. Fremont General retained much and, in some cases, all of the accounting, investment, and financial oversight of Fremont Indemnity.

42. While Ms. Korte had reasonably free access to Fremont Indemnity's operations in Glendale, California, Fremont General prevented her from having the same level of access to Fremont General's operations in Santa Monica, the office in which Fremont Indemnity's assets were managed and reinsurance was collected. Therefore, Fremont General was able to control the amount of information that Ms. Korte received, to deny her any access to information that

might reveal Fremont General's schemes, and to continue its domination and control of Fremont Indemnity.

43. For example, in or about April 2001, Allyson Simpson, the General Counsel of Fremont Indemnity, was reprimanded by officers of Fremont General, for meeting with Ms. Korte in Ms. Simpson's office in Glendale. Fremont General instructed Ms. Simpson that she was not permitted to meet with Ms. Korte or to provide her or the Department of Insurance with any information about Fremont Indemnity without the prior approval of Fremont General. Fremont General also systematically excluded Ms. Simpson from any material involvement in important aspects of the operations and legal affairs of Fremont Indemnity, including the management of disputes with reinsurers. Thereafter, when Ms. Simpson refused to participate in the dissemination to state insurance regulators of information that she believed to be false, materially misleading or incomplete, Fremont General caused her position as General Counsel to "be eliminated" and terminated her employment.

44. In addition, though industry standards and sound commercial practices would have required Fremont General to prepare or cause to be prepared projections of Fremont Indemnity's cash flows into the future, Fremont General did not disclose or did not fully disclose these cash flow projections to Ms. Korte, and continued to deny that any such reports even existed.

THE THREAT FROM FREMONT INDEMNITY'S PRIMARY REINSURER, AND FREMONT GENERAL'S CONCEALMENT OF THAT THREAT

45. By March 2002, Fremont General had approached the Commissioner about entering into a modification of the November 27, 2000 Letter. That modification would result in the July 2002 Agreement.

46. On or about May 22, 2002, as Fremont General actively sought an amendment of the November 27, 2000 Letter, Fremont General learned that the threat to Fremont Indemnity's continuing receipt of reinsurance payments was materializing. Gerling Global Reinsurance Corporation of America ("Gerling"), Fremont Indemnity's largest source of reinsurance payments at approximately $10 million per month, demanded an audit of Fremont Indemnity pursuant to its

///

reinsurance treaty. Gerling further advised that it had hired Mr. Drag and Altair Associates, Inc. to conduct the audit – the same auditors who found evidence of net-line underwriting for Reliance. Gerling's letter demanded access to a broad range of documents and other information and added that Altair was prepared to begin its work during the week of June 10, 2002.

47. Upon receipt of Gerling's letter, Fremont General, through its General Counsel Mr. Faigin, took complete control over all communications with Gerling and all negotiations over the requested audit. Fremont General did not advise Ms. Korte or the Commissioner of Gerling's audit request or the threat to continued payments from Gerling.

48. Fremont General recognized the risk that the audit would reveal Fremont General's abuse of reinsurance treaties before Fremont General could get the Commissioner to approve Fremont General's proposed acquisition of Fremont Indemnity's NOLs. Fremont General also knew that the Commissioner's discovery would cause the Commissioner to realize the impossibility of delaying an order of conservation until at least March 1, 2004. Therefore, Fremont General had to stall the audit, and did so by sending an evasive letter dated June 4, 2002 to Gerling.

49. Though knowing that Mr. Drag had already found evidence of net-line underwriting, Mr. Faigin needed to determine the extent of the risk that Fremont Indemnity's underwriting employees would be forthcoming with Mr. Drag during the audit. Mr. Faigin needed to know this information both for purposes of concealing the brewing Gerling dispute from the Commissioner long enough that the Commissioner would approve the NOL transfer, and to delay Mr. Drag's confirmation of his prior findings.

50. On June 18, 2002, Mr. Faigin met with Steven Blew, a senior underwriter for Fremont Indemnity, at Mr. Blew's office in Glendale. Mr. Blew confirmed that certain other Fremont Indemnity underwriters had engaged in net-line underwriting, and that Mr. Blew would feel compelled to answer truthfully about those facts if asked by Mr. Drag. Mr. Faigin did not reveal these facts to Ms. Korte or to the Commissioner, in spite of the fact that the interview must have convinced Mr. Faigin that there was a high risk that Gerling would find evidence of net-line underwriting and would use that as a basis to terminate its $10 million monthly reinsurance

payments to Fremont Indemnity and to seek to rescind its reinsurance treaty with Fremont Indemnity.

51. After receiving Fremont General's evasive letter, Gerling threatened to terminate reinsurance payments to Fremont Indemnity unless Fremont General agreed to cooperate fully in an audit and submit to the audit within a reasonable period of time. Fremont General was well aware that Ms. Korte had previously insisted that Fremont General and Fremont Indemnity keep her advised about the receipt of all reinsurance payments. Termination of the payments would have to be disclosed to the Commissioner.

52. In response to these threats from Gerling's legal counsel, Mr. Faigin claimed in a June 26, 2002 letter that "there was an error" in the earlier letter about Fremont Indemnity's readiness for an audit, and that Fremont Indemnity could be ready to start the audit on July 22, 2002. Mr. Faigin added: "The above scheduling is contingent upon your clients' agreement to continue to make payments in a timely manner and to bring all delinquent payments current."

53. By delaying the audit until at least July 22, Mr. Faigin was able to stall the audit until after the Commissioner approved the NOL transfer, and ensured that Fremont Indemnity would receive a reinsurance payment from Gerling by the end of June, leaving the Commissioner with no reason to question Fremont Indemnity's continued receipt of reinsurance payments. Mr. Faigin concealed his June 26, 2002 letter from Ms. Korte and the Commissioner.

54. The November 27, 2000 letter, and the proposed amendment to it both provided that "Fremont shall not enter into any new material reinsurance agreement nor amend in any material respect any existing material reinsurance agreement without prior approval by the Department" (November 27, 2000 Letter) or "without the prior written approval of the Department" (proposed amendment). Without advising Ms. Korte or the Commissioner, and without providing copies to them of his letter, Mr. Faigin's June 26, 2002 letter offered: "[A]t your request, Fremont is willing to discuss early termination of the Reinsurance Agreement sometime during the week of July 29th." Fremont Indemnity is informed and believes and thereon alleges that Mr. Faigin was offering the prospect of commuting the treaty to prevent Gerling's discovery of net-line underwriting, to allow Fremont General to conceal its own

wrongdoing, and to prevent or hinder Ms. Korte and the Commissioner from learning of the threat to Fremont Indemnity's continuing receipt of reinsurance recoveries.

55. Fremont General did not notify either Ms. Korte or the Commissioner of the unusual scope and breadth of Gerling's audit requests. Even while promising full cooperation in the audit, Fremont Indemnity is informed and believes and thereon alleges that Mr. Faigin and Mr. Brody planned to deny access to a large number of documents requested by Gerling or Mr. Drag. As they reviewed the list of requests for files or documents, one or more individuals acting at Fremont General's behest made notations that they would not permit inspection of numerous requested documents. Neither Mr. Faigin nor Mr. Brody advised Gerling, Mr. Drag or the Commissioner that Fremont General intended to withhold requested documents.

56. Mr. Faigin and Mr. Brody knew that by withholding documents, Fremont General could further delay Gerling from ultimately withholding a reinsurance payment, and therefore the date the Commissioner would learn of the Gerling dispute and the threat to this vital $120 million annual source of cash for Fremont Indemnity.

57. Gerling paid the June reinsurance payment and Fremont General thereby avoided alerting the Commissioner to the dispute. Mr. Brody sent an e-mail to Ms. Korte and others on June 27, 2002, stating that Gerling's payment "should be wired and in Fremont's account by the end of business tomorrow." Mr. Brody's e-mail to Ms. Korte did not disclose the audit request from Gerling, the fact that Mr. Drag had found evidence of net-line underwriting in the prior audit for Reliance, Mr. Blew's confirmation of net-line underwriting, or the offer of full cooperation with Gerling even while Fremont General planned to withhold requested documents in spite of the offer.

58. The Commissioner, acting in reliance on Fremont General's representations about Fremont's allegedly significant assets and adequate cash flow, would not have signed the July 2002 Agreement had he known the truth about Fremont Indemnity's financial condition and the imminent loss of Gerling's reinsurance payments. Mr. Rampino, Mr. Bailey, Mr. Faigin, Mr. Brody, and others at Fremont General knew that the dispute with Gerling, and Fremont General's plans to withhold documents requested by Gerling and Mr. Drag, would soon result in a

termination of more than $120 million in annual reinsurance payments to Fremont Indemnity, and that the loss of this reinsurance revenue would ensure that the Commissioner would be unable to delay conservation or liquidation proceedings until March 1, 2004.

59. Gerling had paid $189 million to Fremont Indemnity at the time of the audit. Gerling made its last scheduled payment to Fremont Indemnity on July 31, 2002. Fremont Indemnity is informed and believes and thereon alleges that Fremont General unilaterally terminated Gerling's audit on or about September 6, 2002. Fremont General did not advise the Commissioner of the development. On or about September 11, 2002, the Commissioner learned of the dispute only when Gerling's legal counsel, Lord, Bissell & Brook, sent a demand to Mr. Faigin for arbitration with Fremont, and forwarded a copy of the letter to Deputy Commissioner Clark. In a meeting with Mr. Clark and Mr. Calderon shortly after Mr. Clark's receipt of the letter, Mr. Faigin downplayed the arbitration demand, claiming it had come "out of the blue," and that Gerling was just using arbitration to delay payments. Mr. Faigin assured Mr. Clark and Mr. Calderon that Gerling's claims were meritless.

60. In truth, Mr. Faigin had long been aware of the findings that Mr. Drag had made in the Reliance audit, about the information that Mr. Blew provided about Fremont's underwriting practices, and about Fremont General's attempts to prevent Mr. Drag's access to potentially damaging documents in the Gerling audit. Mr. Faigin disclosed none of these facts to Mr. Clark or Mr. Calderon.

61. On July 27, 2005, Gerling filed a complaint against Fremont General and Mr. Rampino alleging that Gerling had sustained at least $128.5 million in damages arising from fraud in connection with the reinsurance treaty between Gerling and Fremont Indemnity. That lawsuit was filed in the United States District Court for the Central District of California, CV05-5454 DDP.

FREMONT GENERAL'S OTHER MISREPRESENTATIONS AND OMISSIONS REGARDING FREMONT INDEMNITY'S FINANCIAL CONDITION

62. Between March and July 2002, Fremont General negotiated with the Commissioner what would become the July 2002 Agreement. During those negotiations,

Fremont General continued to represent to the Commissioner's deputies, Mr. Clark and Mr. Calderon, that Fremont Indemnity had significant assets and sufficient cash flow to pay Fremont Indemnity's claims as they came due. However, Fremont General refused to permit any Fremont Indemnity officers from participating in these negotiations with the Commissioner's deputies, and prohibited Fremont Indemnity's President, Mary-Lou Misrahy, and its then Chief Financial Officer, Mr. Donaldson, as well as Ms. Korte, from participating in a key negotiating session with the Commissioner concerning the planned transfer of Fremont Indemnity's NOLs to Fremont General. In this manner, Fremont General was able to conceal critical information from the Commissioner's deputies about the financial condition of Fremont Indemnity and about the potential fair value of the NOLs.

63. Fremont General reiterated in public documents filed with the Securities & Exchange Commission ("SEC") that Fremont Indemnity's financial situation would permit Fremont General to continue the self-administered runoff of Fremont Indemnity's liabilities. In its Form 10-K for 2001, filed on or about April 1, 2002, even as Fremont General urged the Commissioner to amend the November 27, 2000 letter, Fremont General announced publicly:

> [Fremont General] intends to allow the liabilities (primarily loss and loss adjustment expense ("LAE") reserves) related to its discontinued insurance business to run-off and estimates that the dedicated assets (primarily cash, investment securities, ***and reinsurance recoverables***) supporting these operations, and all related future cash inflows, will be adequate to fund future obligations.

(Emphasis added.) Fremont General also conceded the significance of Gerling to Fremont Indemnity's continued viability:

> As of December 31, 2001, Gerling Global Reinsurance Corporation of America ("Gerling") was the only reinsurer that accounted for more than 10% of Fremont Comp's total reinsurance recoverables on paid and unpaid losses. Gerling represented approximately 30% of the total workers' compensation insurance related reinsurance recoverables as of December 31, 2001. Gerling was rated "A" (Excellent) by A.M. Best at December 31, 2001.

The 10-K was incomplete and misleading in its statement that Fremont General "estimates that . . . all related cash inflows, will be adequate to fund future policy obligations," since Fremont General was then aware of material risks to its continuing receipt of reinsurance recoveries. The

10-K did not disclose any potential risk to recoveries from reinsurance contracts, and that failure made the statement incomplete and misleading that "reinsurance recoverables" were an unqualified source of funds for continued operations.

64. On or about May 14, 2002, as Fremont General continued to negotiate with the Commissioner for the July 2002 Agreement, Fremont General filed its Form 10-Q for the first quarter of 2002. Among other things, the 10-Q touted Fremont General's ability to satisfy Fremont Indemnity's policyholders and creditors:

> As of March 31, 2002, the Company believes that Fremont [Insurance Group's] workers' compensation insurance loss and loss adjustment expenses reserves are adequate. The Company intends to allow the liabilities related to this business to run-off and estimates that the dedicated assets supporting these operations, and all related future cash inflows, will be adequate to fund future policy obligations.
>
> * * * *
>
> The discontinued insurance operations have several sources of funds to meet its obligations, primarily its investment securities portfolio ***and recoveries from reinsurance contracts***. The Company invests in fixed income and preferred equity securities with an objective of providing a reasonable return while limiting credit and liquidity risk. The Company believes it has adequate levels of liquidity and invested assets to meet ongoing obligations to policyholders and claimants, and to cover ordinary operating expenses.

(Emphasis added.) The 10-Q was incomplete and misleading in its statement that Fremont General "estimates that . . . all related cash inflows, will be adequate to fund future policy obligations," since Fremont General was then aware of material risks to its continuing receipt of reinsurance recoveries. The 10-Q did not disclose any potential risk to recoveries from reinsurance contracts, and that failure made the statement incomplete and misleading that "recoveries from reinsurance contacts" were an unqualified source of funds for continued operations.

65. After making, and while continuing to make these representations that Fremont Indemnity's finances were sufficiently secure to permit a continued self-administered runoff, but knowing that representations were untrue, Fremont General proposed that the Commissioner permit Fremont Indemnity to continue the self-administered run-off of its policy claims. Fremont General also promised to increase yearly cash contributions to Fremont Indemnity from

///

$6 million to $13.25 million, provided that the Commissioner approve the transfer of Fremont Indemnity's NOLs to Fremont General.

FREMONT GENERAL'S MISREPRESENTATIONS CONCERNING THE CONSEQUENCES TO IT OF A PRE-MARCH 2004 CONSERVATION OF FREMONT INDEMNITY

66. Fremont General claimed both in meetings with Mr. Clark and Mr. Calderon and in publicly filed documents with the SEC that conservation of Fremont Indemnity before March 2004 would cause dire consequences for Fremont General that would end its ability to make any payments or contributions to Fremont Indemnity. In its Form 10-K for 2001, filed on or about April 2, 2002, even as Fremont General urged the Commissioner to amend the November 27, 2000 Letter, Fremont General announced publicly:

> Should the Company's significant workers' compensation insurance subsidiaries come under regulatory conservation, or similar arrangement, this may cause an event of default under the Company's Series B senior notes (the "Senior Notes") outstanding. If an event of default is declared under the Senior Notes, the outstanding principal may become immediately due and payable. The Company's current financial position would not enable it to meet such an obligation and, as a result, the Company and the holders of its Senior Notes may pursue various alternatives. Such actions could have a significant adverse impact upon the Company and the holders of its various securities.

However, Fremont General did not believe that conservation or liquidation either would or might be an "event of default."

67. Fremont General was actually using the threatened event of default as a ruse to justify Fremont General's need for Fremont Indemnity's NOLs, and to explain the need to delay conservation or liquidation until at least March 2004. In truth, as Fremont General explained in an "Earnings Conference Call" in February 2003 with investors and investment advisers, Fremont General did not believe that conservation or liquidation would or might be an event of default, or that bondholders would attempt to accelerate payment:

> [I]f an action such as this was determined to be an event of default, ***which we think is unlikely based upon the advice of bond counsel***, the likelihood of a bond trustee seeking to accelerate the repayment of a debt as remedy for a default under this fact pattern would be very remote and unusual; however, if anyone knows of any bond holders who would like to sell their bonds please call us, we would like to buy them. Next question, please.

Mr. Bailey, introduced on the conference call as Fremont General's Chief Financial Officer, gave the answer above. If Fremont General had disclosed its belief that conservation of Fremont Indemnity was neither an event of default, nor a likely cause for bondholders to seek acceleration of payments, the Commissioner would not have agreed to let Fremont General cease payments to Fremont Indemnity if conservation or liquidation occurred before March 1, 2004.

68. The Commissioner's agreement to approve the NOL transfer and amend the November 27, 2000 Letter relied on Fremont General's misrepresentation that conservation or liquidation before March 2004 would threaten Fremont General's financial condition such that it would end Fremont General's ability to continue making payments into Fremont Indemnity.

69. Prior to the date of the conference call, Fremont General knew from significant adverse developments confirmed by its actuary that the Commissioner would have no choice but to conserve Fremont Indemnity very soon. Fremont General finally disclosed its belief that conservation or liquidation would not be an event of default, or that bondholders would not accelerate payments, to contradict and distance itself from earlier announcements that conservation might be an event of default, to protect stock prices, and to give investors advance assurance that the Commissioner's expected imminent application for conservation of Fremont Indemnity would have no adverse effects on Fremont General.

INJURIES RESULTING FROM FREMONT GENERAL'S FRAUD

70. Fremont Indemnity seeks recovery of the value of the NOLs misappropriated by Fremont General. In addition, but for Fremont General's misrepresentations and concealments, the Commissioner would have conserved Fremont Indemnity earlier than he did. By fraudulently obtaining the ability to continue its self-administered runoff of Fremont Indemnity when Fremont Indemnity did not have sufficient assets and cash flow to fund the runoff, Fremont General deepened the insolvency of Fremont Indemnity. Earlier conservation would have allowed the Commissioner, through the powers granted to him by the Insurance Code, to staunch the flow of cash from Fremont Indemnity created by Fremont General's mismanagement of its insurance subsidiary. Fremont Indemnity's policyholders and creditors would have received millions more

in distributions on their claims had Fremont General not fraudulently delayed the conservation of Fremont Indemnity and deepened the company's insolvency. Fremont Indemnity is entitled to compensation for damages resulting from this deepened insolvency.

FIRST CAUSE OF ACTION FOR INTENTIONAL MISREPRESENTATION
(Against All Defendants)

71. Fremont Indemnity incorporates by reference the allegations in paragraphs 1 through 70 above.

72. Fremont General and Does 1 through 30, acting under the direction and on behalf of Fremont General, made statements: (a) that were false representations of a material fact to Fremont Indemnity and the Commissioner; (b) that Fremont General and Does 1 through 30 knew were false or were made recklessly and without regard for their truth; (c) that Fremont General and Does 1 through 30 intended Fremont Indemnity and the Commissioner to rely upon; (d) that Fremont Indemnity and the Commissioner reasonably relied upon; (e) that Fremont Indemnity's and the Commissioner's reliance upon was a substantial factor in causing damage to Fremont Indemnity; and (f) that caused damages to Fremont Indemnity as described in paragraphs 6 and 70, above.

73. The intentional misrepresentations by Fremont General and Does 1 through 30 consist of at least the following:

a. Representing that Fremont Indemnity had sufficient assets and sufficient cash flow to pay Fremont Indemnity's claims and fund operational expenses as they came due, when Fremont General knew that assets and cash flow were not sufficient to permit a run-off of Fremont Indemnity's policy obligations;

b. Representing that Fremont Indemnity's assets were sufficient to allow it to avoid insolvency well past March 1, 2004, when Fremont General knew that Fremont Indemnity's conservation and liquidation well before March 2004 was inevitable;

///

c. Representing that Fremont Indemnity's cash inflows would be adequate to fund future policy obligations, when Fremont General knew that there were material risks to Fremont Indemnity's continued receipt of reinsurance recoveries, which were its largest sources of cash;

d. Representing that recoveries from reinsurance contracts were an unqualified source of funds for continued operations, when Fremont General knew that those funds were in serious jeopardy;

e. Representing that Fremont General commuted the Reliance treaty only because of concerns about Reliance's financial condition, when Fremont General commuted the treaty because of Reliance's finding about net-line underwriting;

f. Representing that Fremont General could not afford the increased contributions contemplated by the July 2002 Agreement without the ability to use Fremont Indemnity's NOLs, when Fremont General knew that it had the ability to make the increased contributions and used the representation only as a ruse to justify its acquisition of the NOLs;

g. Representing that conservation of Fremont Indemnity before March 2004, either would or might be an event of default under Fremont General's Senior Notes, ending its ability to make any payments or contributions to Fremont Indemnity, when Fremont General did not believe that conservation either would or might be an event of default;

h. Representing that conservation of Fremont Indemnity before March 2004 either would or might be an event of default under Fremont General's Senior Notes, and that Fremont General would be unable to meet an obligation to pay the outstanding principal, when Fremont General did not believe that conservation either would or might be an event of default or that it would be unable to pay the outstanding principal; and

///

i. Representing that Gerling's demand for arbitration had come "out of the blue" and was meritless when Fremont General knew that Gerling's auditor had found evidence previously of net-line underwriting which could support substantial claims by Gerling relating to its reinsurance treaty.

SECOND CAUSE OF ACTION FOR CONCEALMENT
(Against All Defendants)

74. Fremont Indemnity incorporates by reference the allegations in paragraphs 1 through 73 above.

75. Fremont General and Does 1 through 30, acting under the direction and on behalf of Fremont General, concealed certain facts: (a) that Fremont General had a duty to disclose; (b) that Fremont General intentionally failed to disclose, that were material, and that neither Fremont Indemnity nor the Commissioner could have reasonably discovered; (c) that by concealing these facts, Fremont General intended to deceive Fremont Indemnity and the Commissioner; (d) that Fremont Indemnity and the Commissioner relied upon Fremont General not to conceal, and that such reliance was reasonable under the circumstances; (e) that the concealments were a substantial factor in causing damage to Fremont Indemnity; and (f) that caused damages to Fremont Indemnity as described in paragraphs 6 and 70, above.

76. The facts concealed by Fremont General and Does 1 through 30 consist of at least the following:

a. The fact that Fremont Indemnity's assets were not sufficient to permit a delay of conservation and liquidation until March 2004;

b. The fact that there had been and were serious abuses by Fremont General of Fremont Indemnity's reinsurance treaties;

c. The fact that the auditor for one reinsurer, Reliance, had found evidence of net-line underwriting;

d. The fact that Reliance had demanded arbitration or commutation of its arbitration treaty because of the discovery of net-line underwriting;

e. The fact that Fremont Indemnity's largest reinsurer, Gerling, had made an audit request, and that the audit request was of unusual scope and breadth;

f. The fact that Gerling had threatened to terminate payments unless Fremont General cooperated fully in the audit and submitted to the audit within a reasonable period of time;

g. The fact that Gerling had hired the same auditor who had found evidence of net-line underwriting in his audit of Reliance;

h. The fact that there was a substantial risk that Gerling would find evidence of net-line underwriting and would use that as a basis to terminate payments to Fremont Indemnity under its reinsurance treaty;

i. The fact that Fremont General planned to withhold and deny access to numerous documents requested by Gerling;

j. The fact that Fremont General had offered to discuss with Gerling an early termination of its reinsurance treaty, and had offered to do so to prevent Gerling's discovery of net-line underwriting, to allow Fremont General to conceal its own wrongdoing, and to prevent or hinder the Commissioner's ability to learn of the threat to Fremont Indemnity's continued receipt of reinsurance recoveries;

k. The fact that the loss of payments from Gerling would ensure that Fremont Indemnity would be placed in conservation prior to March 1, 2004;

l. The fact that there were material risks to Fremont Indemnity's continuing receipt of recoveries on its reinsurance contracts;

m. The fact that Fremont General had concluded that Fremont Indemnity's conservation before March 2004 neither would nor might be an event of default under Fremont General's Senior Notes; and

n. The fair value of the NOLs.

///

///

THIRD CAUSE OF ACTION FOR PROMISSORY FRAUD
(Against All Defendants)

77. Fremont Indemnity incorporates by reference the allegations in paragraphs 1 through 76 above.

78. Fremont General and Does 1 through 30 made promises, and through its control and domination of Fremont Indemnity, caused promises to be made: (a) that were material to transactions between Fremont General and Fremont Indemnity; (b) that Fremont General did not intend to perform; (c) that Fremont General intended Fremont Indemnity and the Commissioner to rely upon; (d) that Fremont Indemnity and the Commissioner reasonably relied upon; (e) that Fremont General did not perform; (f) that Fremont Indemnity's and the Commissioner's reliance upon was a substantial factor in causing damage to Fremont Indemnity; and (g) that caused damages to Fremont Indemnity as described in paragraphs 6 and 70, above.

79. The false promises by Fremont General and Does 1 through 30 consist of at least the following:

a. Compelling Fremont Indemnity to enter into the November 27, 2000 Letter with no intention of permitting enhanced regulatory oversight;

b. Entering into and compelling Fremont Indemnity to enter into the July 2002 Agreement, knowing that the Commissioner would be unable to delay conservation or liquidation of Fremont Indemnity until March 2004, and knowing that Fremont General would refuse to pay anything but a fraction of its promised $92.75 million in payments to Fremont Indemnity;

c. Entering into and compelling Fremont Indemnity to agree to enter into the July 2002 Agreement with no intention of permitting enhanced regulatory oversight.

///

///

///

///

WHEREFORE, Fremont Indemnity, by and through the Commissioner as liquidator of Fremont Indemnity, prays that judgment be entered for Fremont Indemnity for the following:

1. An Order rescinding the July 2002 Agreement;

2. Compensatory damages according to proof;

3. Disgorgement of an amount not less than $300 million, constituting the net value realized by Fremont General on the utilization of Fremont Indemnity's NOLs;

4. Punitive damages according to proof;

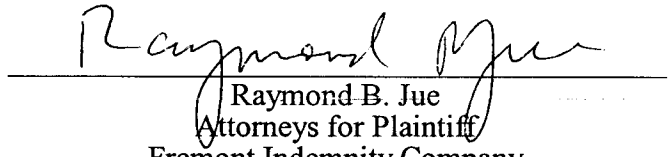
5. Pre-judgment interest at the legal rate on all sums awarded;

6. Costs of suit; and

7. General relief.

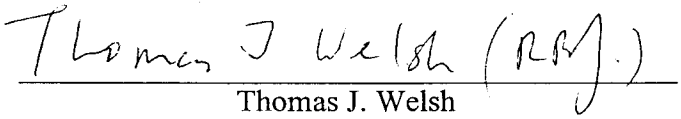
Dated: August 4, 2005.

BILL LOCKYER
Attorney General of the State of California
W. DEAN FREEMAN
Lead Supervising Deputy Attorney General
MARK P. RICHELSON
Supervising Deputy Attorney General
RAYMOND B. JUE
Deputy Attorney General
LISA W. CHAO
Deputy Attorney General



Raymond B. Jue
Attorneys for Plaintiff
Fremont Indemnity Company

THOMAS J. WELSH
JAMES E. HOUPT
STACY E. DON
ORRICK, HERRINGTON & SUTCLIFFE LLP



Thomas J. Welsh
Attorneys for Plaintiff
Fremont Indemnity Company

DECLARATION OF SERVICE BY U.S. MAIL

Case Name: **FREMONT INDEMNITY COMPANY v. FREMONT GENERAL CORPORATION, FREMONT COMPENSATION INSURANCE GROUP, INC., DOES 1-30**

No.: **BC316472**

I declare:

I am employed in the Office of the Attorney General, which is the office of a member of the California State Bar, at which member's direction this service is made. I am 18 years of age or older and not a party to this matter; my business address is 300 South Spring Street, Suite 1702, Los Angeles, CA 90013.

On August 4, 2005, I served the attached

THIRD AMENDED COMPLAINT FOR:
1. INTENTIONAL MISREPRESENTATION
2. CONCEALMENT
3. PROMISSORY FRAUD

by placing a true copy thereof enclosed in a sealed envelope with postage thereon fully prepaid, in the United States Mail at Los Angeles, California, addressed as follows:

Iain A.W. Nasatir, Esq.
James K. T. Hunter, Esq.
PACHULSKI, STANG, ZIEHL, YOUNG, JONES & WEINTRAUB P.C.
10100 Santa Monica Blvd., 11th Floor
Los Angeles, CA 90067-4100

George T. Caplan
Kristopher s. davis
KAYE SCHOLER LLP
1999 Avenue of the Stars, Suite 1700
Los Angeles, CA 90067

I declare under penalty of perjury under the laws of the State of California the foregoing is true and correct and that this declaration was executed on August 4, 2005, at Los Angeles, California.

Linda Richardson
Declarant

Linda Richardson
Signature

60090773.wpd