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13 in his Capacity as Conservator of CastlePoint
National Insurance Company
14

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Code § 6103**

15
16 SUPERIOR COURT OF THE STATE OF CALIFORNIA
17 CITY AND COUNTY OF SAN FRANCISCO

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

21 Applicant,

22 v.

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

24 Respondents.
25
26
27
28

Case No.CPF-16-515183

**CONSERVATOR'S REPORT TO THE
COURT CONCERNING THE
CONSERVATION OF CASTLEPOINT
NATIONAL INSURANCE COMPANY**

**Date: January 26, 2017
Time: 2:00 p.m.
Dept: 302
Judge: Hon. Harold E. Kahn**

**ELECTRONICALLY
FILED**
*Superior Court of California,
County of San Francisco*
01/12/2017
Clerk of the Court
BY:ERNALYN BURA
Deputy Clerk

1 **I. INTRODUCTION**

2 On July 28, 2016 (the “Conservation Date”), California Insurance Commissioner Dave
3 Jones was appointed by this Court as the statutory conservator (the “Conservator”) of CastlePoint
4 National Insurance Company (“CastlePoint”), based on a finding that CastlePoint was operating
5 in a hazardous condition. The Conservator, acting through his duly appointed deputies and
6 assistants, immediately took possession of CastlePoint and all of its assets and has been operating
7 CastlePoint’s business, including exercising oversight over the administration of pending claims
8 and liabilities totaling over one billion dollars, since the Conservation Date. The Conservator will
9 seek an order placing CastlePoint into formal liquidation around the end of March 2017, and
10 between the Conservation Date and that time (the “Conservation Period”), the Conservator will
11 continue to operate the company pursuant to his authority under the Order Appointing
12 Commissioner As Conservator And Restraining Orders (“Conservation Order”) and the Insurance
13 Code.

14 The purpose of this Conservator’s Report is to advise the Court and interested parties of
15 material activities undertaken by the Conservator during the Conservation Period and to lay out,
16 at a high level, the Conservator’s expectations for the eventual liquidation of CastlePoint. In sum,
17 the conservation process is proceeding precisely as planned by the Conservator and the other
18 regulators who assisted in developing a plan for the orderly wind-up of the insurance companies
19 that were members of the Tower Group International, Ltd. insurance companies. This orderly
20 process is continuing and there has been no change in the Conservator’s plan to transition the
21 company into liquidation at the end of March 2017. The next major event in this case will be a
22 hearing on the Conservator’s liquidation application, which he expects to file in February for a
23 hearing on or around March 31, 2017.

24 **II. CONSERVATOR’S REPORT OF OPERATIONS ACTIVITIES**

25 **A. Pre-Conservation Regulatory Activities**

26 As described more fully in the Conservator’s Verified Application for Ex Parte Order
27 Appointing Insurance Commissioner as Conservator (“Conservation Application,” at ¶¶ 2-12) and
28 Memorandum of Points And Authorities In Support Of Motion For Order Approving

1 Conservation And Liquidation Plan For CastlePoint National Insurance Company (“Plan MPA,”
2 at pp. 5-7), CastlePoint is the survivor of the merger of ten insurance companies, domiciled in six
3 states and owned by Tower Group International, Ltd (collectively, the “Tower Insurance
4 Companies”).¹ The Tower Insurance Companies, collectively, were admitted in all 50 states and
5 wrote a variety of multi-line property and casualty insurance, with an emphasis on workers’
6 compensation and commercial multi-peril, as well as a significant personal lines business. (Plan
7 MPA, at p. 5).

8 In light of the Tower Insurance Companies’ ongoing financial struggles over the past
9 several years, the Commissioner, prior to his formal appointment as Conservator, began
10 discussions with regulators in each of the Tower Insurance Companies’ domiciliary states
11 (together with the Commissioner, the “Regulator Group”)² to develop a plan that would address
12 the deteriorating financial condition of the Tower Insurance Companies while protecting
13 policyholders and creditors. As part of the multi-state examination into the Tower Insurance
14 Companies, the Regulator Group retained outside counsel, actuaries, and other professionals, for
15 which the Tower Insurance Companies agreed to pay a portion of the costs.³ Ultimately, the
16 Regulator Group determined that the best course of action was to merge the Tower Insurance
17 Companies with and into CastlePoint, and to place CastlePoint into conservation in California.

18 **B. CastlePoint Is Placed Into Conservation**

19 The Insurance Commissioner filed his Conservation Application with the Court on
20 July 27, 2016, outlining the Tower Insurance Companies’ financial struggles and the pre-
21 conservation merger of the companies into CastlePoint. On July 28, 2016, the Court issued its
22 Conservation Order. The Conservation Order granted the Conservator numerous powers,
23 including, among others, the authority to take possession of and manage CastlePoint’s assets and

24 ¹ The nine other insurers that merged with and into CastlePoint are: Tower Insurance Company of New York, Tower
25 National Insurance Company, Hermitage Insurance Company, CastlePoint Florida Insurance Company, North East
26 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. (Plan MPA, p. 1 n. 3.)

27 ² In addition to California, the Regulator Group involved in these discussions included regulators from Florida,
Maine, Massachusetts, New Jersey, and New York.

28 ³ The fees and costs incurred during the pre-conservation period and Conservation Period will be outlined in the
Conservator’s Application For Approval Of Administrative Expenses, which will be filed following the close of the
Conservation Period.

1 records; to assume, reject, or modify executory contracts; to initiate necessary legal proceedings;
2 to terminate and enter into compensation and benefits arrangements with CastlePoint employees;
3 and to pay all reasonable costs of conserving CastlePoint out of CastlePoint assets.

4 **C. Notice of Conservation to Interested Parties**

5 Upon taking control of CastlePoint, the Conservator promptly notified all interested
6 parties that CastlePoint had been placed into statutory conservation ("Notice of Conservation").
7 This notice was given to, among others, all claimants and their attorneys, policyholders, payees,
8 managing general agents, state and federal agencies, vendors, third-party administrators ("TPA"),
9 reinsurers, agents, brokers, insurance defense counsel, holders of trust-preferred securities, and
10 other parties and individuals that the Conservator could reasonably determine had any interest in
11 or relationship with CastlePoint. The Conservator also posted a copy of the Notice of
12 Conservation and Conservation Order on the Conservation and Liquidation Office's website and
13 published legal notice of the Conservation Order in USA Today on August 3, 2016, and in the
14 San Francisco Chronicle and Los Angeles Times on August 6, 2016.

15 The Conservator also began mailing out his Notice of Conservation on August 1, 2016,
16 and largely completed that mailing by August 10, 2016. A total of 21,414 mailings with the
17 Notice of Conservation were sent out, broken down as follows:⁴

18 Claimants and Claim	
19 Services	17,330
20 Claimant Attorneys	2,415
21 Managing General Agents	15
22 State and Federal Agencies	148
23 Vendors and States	466
24 TPAs	24
25 Reinsurers and Brokers	42
26 Agents	180
27 Claim Defense Attorneys	794
28 Total	21,414

27 ⁴ The number of mailings listed in this Conservator's Report is higher than that stated in the Declaration of David E.
28 Wilson Confirming Service And Publication Of Notices Required By September 13, 2016 Order, dated August 31,
2016. This is because while most of the notice mailings occurred on or before August 10, the Conservator has
continued to send out notices as he has been made aware of additional interested parties.

1 **D. The Conservation and Liquidation Plan**

2 The Conservator filed his Motion For Order Approving Conservation And Liquidation
3 Plan For CastlePoint National Insurance Company (the “Motion” for approval of the “Plan”) on
4 July 29, 2016, and submitted additional materials in support of the Plan on August 5, 2016. The
5 Plan, which was the product of extensive cooperation between the Conservator, CastlePoint’s
6 management, the Regulator Group, and other interested parties, laid out a four-step process to
7 prepare for and implement the conservation, and eventual liquidation, of CastlePoint: (1) First,
8 the various Tower Insurance Companies were merged with and into CastlePoint, with Castlepoint
9 then being placed into conservation; (2) Second, CastlePoint’s equity ownership would be
10 restructured in order to preserve hundreds of millions of dollars in tax attributes and to protect
11 CastlePoint from exposure to future tax liabilities; (3) Third, the Conservator would enter into a
12 series of Conservation Agreement Transactions on behalf of CastlePoint that would bring \$200
13 million in additional liquidity into the estate and provide free policy and claims administration
14 services for up to two years; and (4) Finally, the Plan anticipates that the Conservator will, at an
15 appropriate time, seek to place CastlePoint into liquidation and transfer claims administration
16 processes to the appropriate state guaranty associations.

17 The Conservator received a handful of formal comments and complaints to the Plan,
18 which counsel addressed in the Conservator’s September 6, 2013, Reply Brief In Support Of
19 Motion For Order Approving Conservation And Liquidation Plan For CastlePoint National
20 Insurance Company (“Plan Reply”). These formal comments and complaints included parties
21 seeking clarification as to their treatment under the Plan,⁵ parties seeking additional financial
22 information demonstrating the Commissioner’s rationale for placing CastlePoint into
23 conservation, and parties with recently settled claims or pending litigation challenging their
24 treatment under the Plan. (*See* Plan Reply, at p. 1 n. 1; *see also* Appendix Of Support, Comment,
25 Or Opposition To Conservation And Liquidation, Ex. A to Declaration of David E. Wilson In
26

27 ⁵ One such comment was filed by Wellington Insurance Company, which requested that policies reinsured by
28 Wellington be assigned to Wellington for payment and administration. The Conservator CastlePoint and Wellington
have been in contact and continue to discuss the treatment of these policies. The Conservator expects Wellington’s
request will be resolved prior to liquidation.

1 Support Of Reply Brief In Support Of Motion For Order Approving Conservation And
2 Liquidation Plan For CastlePoint National Insurance Company.) The Conservator also received
3 numerous informal comments and questions by phone and e-mail. *Id.* The vast majority of these
4 informal comments and questions sought basic information as to the function and consequences
5 of the Plan. *Id.*

6 On September 13, 2016, the Court held a hearing on the Plan during which counsel for the
7 Conservator addressed each of the formal responses to the Plan, as well as additional comment
8 and opposition raised at the hearing. Following the hearing, the Court issued its Order Approving
9 Conservation And Liquidation Plan For CastlePoint National Insurance Company (“Plan Order”),
10 which authorized the Conservator to take all actions, and complete all transactions, laid out in the
11 Plan.

12 At the hearing, certain interested parties made requests for additional financial
13 information. As a result, the Conservator and these parties agreed to the inclusion of Paragraph
14 26 in the Plan Order, which provided that interested parties could submit a request to the
15 Conservator for additional “information related to the financial condition of CastlePoint and/or
16 the Constituent Companies.” The Conservator received twelve requests for additional financial
17 information during or shortly after the period set by the Plan Order and provided responsive and
18 available financial documents to each requesting party.⁶

19 **E. Closing of the Conservation Agreement Transactions**

20 The Conservation and Liquidation Plan filed by the Conservator, and approved by the
21 Court, provided for the execution of a number of related Conservation Agreement Transactions,
22 including:

- 23 • The payment of \$200 million into the CastlePoint estate, net of certain pre-closing
24 advances and the reconciliation of intercompany balances between CastlePoint and the
25 counterparties to these transactions;⁷

26
27 ⁶ One party (Northern Star Management, Inc.) recently sent a follow-up letter requesting clarification and additional
documents and the Conservator is preparing a response to that letter.

28 ⁷ This reconciliation process continues on a post-closing basis as described in the next Section of this Conservator’s
Report.

- The execution of two Administrative Services Agreements by CastlePoint with AmTrust Financial Services Inc. and with National General Holdings Company for the continuity of claims servicing and payment processing at no cost to the CastlePoint estate;
- The cancellation of existing CastlePoint stock and execution of a Trust Agreement to create a trust to hold new CastlePoint stock; and
- The commutation of a series of reinsurance, retrocessional and stop loss agreements between or among CastlePoint, CastlePoint Reinsurance Company (“CPRé”) (a Bermuda reinsurance company that was an affiliate of CastlePoint), ACP Re, Ltd. (“ACP Re”) and other companies, for the collective purpose of restoring CastlePoint’s direct control of its policy liabilities and the recovery of related assets and reinsurance receivables to streamline and simplify the eventual liquidation process.

Upon the approval of the Plan, the Conservator and other parties completed their preparations to close these transactions, and such transactions were officially closed on September 20, 2016. On that date, CPRé commuted all of its reinsurance agreements with CastlePoint and the pre-merged companies, with CastlePoint receiving rights to all of the net tangible assets of CPRé as consideration such that, after the commutation, CPRé will have no further obligation to CastlePoint other than the transfer of all of its net tangible assets to CastlePoint as they became available. CastlePoint also received the aforementioned cash payment of \$200 million from the owners of ACP Re in exchange for their agreement to the Plan and Conservation Plan Transactions. ACP Re surrendered its CastlePoint stock to the Conservator for cancellation, such that after the closing, ACP Re no longer owned or had any control over CastlePoint, and CastlePoint was deconsolidated from the ACP Re tax group.

F. Post-Closing True-Up of Closing Amounts

The complicated process of quickly closing the many transactions described above required that the parties complete the deals based on preliminary accounting and reconciliation of intercompany balances between and among them, subject to an agreement to “true-up” and finalize the accounting within a reasonable period after closing. More specifically, the above-described \$200 million payment due to CastlePoint under the Conservation Agreement

1 Transactions was subject to offsets to reimburse other parties for certain claims-related advances
2 made in the months prior to conservation, as well as debits and credits from reinsurance
3 collections and administrative expense allocations. [The statement of these used to close the
4 transaction (the “Closing Statement”) is attached hereto as **Exhibit A.**] The post-closing true-up
5 process is materially completed and the parties anticipate that a short agreement memorializing
6 the completion of the true-up will be signed within the next 2 to 3 weeks.

7 **G. Claims Administration**

8 As of the Conservation Date, CastlePoint had a backlog in claims payments of roughly
9 \$44 million. Over the period beginning on the Conservation Date through December 31, 2016,
10 CastlePoint, under the management of the Conservator, has made claims payments totaling
11 approximately \$210,107,170, including the \$44 million in backlogged payments. CastlePoint is
12 now up-to-date on its claims payments and continues to timely administer and pay claims as they
13 are received.

14 The Conservator has broad discretion in the administration of the CastlePoint estate,
15 which extends to the handling of claims. (See Cal. Ins. Code §§ 1011, 1037; Plan Order, at ¶¶ 17,
16 21.) Upon assuming the management of CastlePoint, the Conservator also assumed responsibility
17 for the oversight of all claims administration and the processing of claims on policies issued by
18 CastlePoint and its predecessors. The Conservator developed and implemented “Procedures For
19 Claims Administration and Payments During Conservation” (the “Conservation Procedures”) that
20 were posted to the Conservation & Liquidation Office’s website along with answers to frequently
21 asked questions (“FAQs”) relating to the claims administration procedure during the conservation
22 phase. [Copies of the Conservation Procedures and FAQs are attached hereto as **Exhibits B and**
23 **C** and are available on the website for the California Conservation & Liquidation Office,
24 www.caclo.org] Pursuant to the Conservation Procedures, claims received by CastlePoint during
25 the Conservation Period have been satisfied in two parts. First, the CastlePoint estate pays
26 accepted claims up to the amount allowed by statute for the insurance guaranty association
27 (“IGA”) in the state of the policy (that is, the state IGA that would administer the claim if
28 CastlePoint were in liquidation). The resolved claims that exceed the relevant IGA maximum

1 amount⁸ will automatically receive, in addition to the cash payment, a pre-approved Class 2
2 priority proof of claim against the CastlePoint estate for the remaining amount of the claim up to
3 the applicable policy limits. That proof of claim will be administered through the liquidation
4 proceedings.

5 The rationale for this two-part process is straightforward. California law requires that all
6 similarly-situated policyholder claimants be treated equally and expressly prohibits the payment
7 of preferences. (Cal. Ins. Code §§ 1020, 1033, 1034). The Conservation Order and Plan Order
8 also require that claim payments be made in the order of priority established by California law
9 and prohibit preferences. (Conservation Order, at ¶ 21; Plan Order, at ¶¶ 16, 21.) The
10 Conservator therefore cannot provide different treatment to policyholder claimants whose claims
11 are finalized and submitted during the Conservation Period than he does to policyholder claimants
12 whose claims are not received until after CastlePoint is placed into liquidation. Because post-
13 liquidation claims will receive cash payments from the IGAs up to the applicable cap amount,
14 plus a proof of claim in the liquidation proceeding for any excess, pre-liquidation claimants must
15 receive the same treatment.

16 **H. Employment Matters**

17 Pursuant to the Conservation Order, the Conservator was authorized to terminate
18 compensation and benefit arrangements with CastlePoint employees as well as to assume, reject,
19 or modify any executory contracts. Upon the commencement of the Conservation Period, the
20 Conservator identified that the services of twenty-six (26) existing CastlePoint employees were
21 important to the Conservator's ability to conduct the operations of the company through the filing
22 of its first financial statements in conservation, and so he retained the 26 employees through
23 November 15, 2016. In order to retain these key employees, the Conservator determined that it
24 was necessary and reasonable to offer them a retention agreement that provided for reasonable
25 compensation enhancements if they stayed on to assist the Conservator in the conservation
26 process. This is a common practice in insurance conservatorships that is authorized by section

27 _____
28 ⁸ As of the date of this Conservator's Report, there are four resolved claims in excess of the applicable statutory cap. While this number will likely increase between now and the date of liquidation, the Conservator expects that such claims will represent a small minority of all policy claims.

1 1037 of the Insurance Code. Accordingly, the Conservator prepared retention agreements for
2 these employees, which offered a retention incentive equal to an additional 10% of annual
3 compensation to the employees. The Conservator then identified seventeen (17) key CastlePoint
4 employees whose continued service from November 15, 2016, to March 31, 2017, is important to
5 the Conservator's ability to conduct the operations of the company in an efficient and effective
6 manner, to continue to provide service to the policyholders, and to facilitate a smooth transition of
7 the company into liquidation. Accordingly, the Conservator prepared new retention agreements
8 for these 17 employees with the same terms as the previous retention agreements. Retention
9 incentive payments of \$391,515 were paid on November 15, 2016, and retention incentive
10 payments of \$296,877 are expected to be paid on March 31, 2017, if all retained employees stay
11 with the company to assist the Conservator until that date. As of the date of liquidation, the
12 Conservator expects a further reduction in the employment of the CastlePoint employees (the
13 Conservator is currently in the planning stages of determining the number of employees to retain),
14 and believes that by the end of 2017 CastlePoint will have few if any employees. The
15 Conservator will develop a final retention agreement for any employees retained from April 1,
16 2017 forward.

17 **I. Preparing for Liquidation and Coordination with Guaranty Associations**

18 Based on CastlePoint's current reserves, claims run-off rate, and cash forecast, the
19 Conservator expects that it will be necessary to transition CastlePoint from conservation into
20 liquidation sometime around the end of the first quarter of 2017. The entry of a liquidation order,
21 with an accompanying judicial finding of insolvency, will trigger affected state IGAs to take over
22 the administration of claims on CastlePoint policies. Therefore, in anticipation of liquidation
23 proceedings, the Conservator's staff has been communicating and working with the affected IGAs
24 to prepare for the eventual transfer of files and claims administration duties to the IGAs.

25 This process has focused largely on consolidating electronic claims files and data from the
26 company's third party claims administrators, and converting the data to the uniform data
27 standards ("UDS") utilized by the IGAs around the country. The data consolidation and UDS
28 conversion process is essential to ensure that the IGAs can assume their claims administration and

1 payment responsibilities promptly and efficiently upon the entry of a liquidation order. A smooth
2 transition of claims administration to the IGAs is critical to protecting the interests of
3 CastlePoint's policyholders and insurance claimants as the company transitions into liquidation.

4 While the exact liquidation date depends on a number of factors, the Conservator
5 anticipates filing a motion seeking a liquidation order in mid-February 2017, with a liquidation
6 hearing set for late-March 2017 (preferably on March 31, 2017). In addition to seeking the entry
7 of a liquidation order, the Conservator's liquidation application will also ask for the establishment
8 of a claims bar date and a standard proof of claim process. The liquidation claim process will
9 address policy claims for amounts above the applicable IGA cap payment (whether the initial
10 claim arose pre-conservation, during conservation, or during liquidation), for general creditor and
11 other non-insurance claims, and will establish a fair and efficient process for the adjustment of
12 such claims.

13
14 Dated: January 12, 2017

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17 By: 

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20 State of California

21 Dated: January 12, 2017

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