

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
DEPARTMENT OF BUSINESS REGULATION
233 RICHMOND STREET
PROVIDENCE, RHODE ISLAND 02903**

_____))
))
IN THE MATTER OF A CHANGE OF))
CONTROL OF))
))
STONEWALL INSURANCE COMPANY) **DBR No. 07-I-0011**
AND SEATON INSURANCE COMPANY))
))
By))
))
VIRGINIA HOLDINGS LIMITED))
_____))

DECISION

Hearing Officers: Elizabeth Kelleher Dwyer
Jack Broccoli

Hearing Held: April 24, 2008

Appearances: Mary E. Kohart, Esq.
Daniel W. Krane, Esq.
Shawn L. Kelly, Esq.
Steven D. Zubiago, Esq. on behalf of the Virginia Holdings

John Nonna, Esq.
Ellen M. Dunn, Esq.
Michael A. Knoerzer, Esq.
Roger Ross, Esq. on behalf of National Indemnity Company

I. INTRODUCTION

The above-entitled matter came before the Department of Business Regulation ("Department") as the result of a filing made pursuant to R.I. Gen. Laws § 27-35-2 for approval of stock purchase agreement dated June 16, 2006, between Dukes Place Holdings, L.P., a Bermuda limited partnership ("Dukes Place") and Virginia Holdings Limited, a Bermuda corporation ("Applicant") which provides that the Applicant will purchase 44.4%

of the issued and outstanding voting securities of Stonewall Acquisition Corporation, a wholly owned subsidiary of Dukes Place. Stonewall Acquisition Corporation, in turn owns 100% of the voting securities of both Seaton Insurance Company (“Seaton”) and Stonewall Insurance Company (“Stonewall”) (collectively the “Insurers”), both of which are Rhode Island domestic insurers. (“Form A Filing”). The Applicant is a subsidiary of Enstar Group Limited, a Bermuda corporation, that also owns Enstar US, Inc. (“Enstar”) (formerly Castlewood (US) Inc., which currently manages the operations of the Insurers under an “Agreement Relating to Administration of Run-off Business” dated January 18, 2006. The Department concluded that this transaction constituted a “change in control” as that term is defined in R.I. Gen. Laws § 27-35-2.

The Department was made aware that National Indemnity Company (“NICO”), a reinsurer of Seaton and Stonewall, wished to be heard with regard to the acquisition and, therefore, the Department exercised its discretion, pursuant to R.I. Gen. Laws § 27-35-2(d), to hold a hearing on the Form A Filing. During the pendency of this Form A, arbitration proceedings between the Insurers and NICO concerning the reinsurance agreements between those parties took place. It is the Department’s understanding that a result of those arbitrations was a transfer of claims handling authority for the Insurers from Enstar to NICO.

A prehearing conference was held on February 7, 2007. NICO requested access to certain documents to which the Applicant claimed confidentiality. Briefs were filed and a hearing held on that issue with an order issued by the Department on April 3, 2007. NICO filed a motion to intervene, which was granted over the Applicant’s objection, on June 14, 2007 after hearing and briefing by the parties. A series of requests for continuance, made by both the parties and the Department, were made and granted. During the intervening period

the Applicant filed amended versions of the Form A and supporting documentation. On February 14, 2008 the Applicant filed a motion to dismiss NICO as an intervener in this matter on the basis of changed circumstances due to the amended Form A. The parties briefed the matter and oral argument was held. On April 16, 2008 the Department issued a Decision denying the motion to dismiss.

A hearing in this matter was held on April 24, 2008. In addition to the testimony offered at the hearing, NICO relied upon its brief and supporting documentation submitted to the Department on January 17, 2008. On April 23, 2008 the Applicant filed an opposition to the brief of NICO. The hearing was held open until May 1, 2008 to allow NICO to file a response to the Applicant's brief. That response was filed on May 1, 2008.

II. JURISDICTION

The Department has jurisdiction over this matter pursuant R.I. Gen. Laws § 27-35-2 and 42-35-1 *et seq.*

III. ISSUES

- 1) Do any of the conditions in R.I. Gen. Laws § 27-35-2(d) exist which would support the denial of the acquisition of control of Seaton and Stonewall by the Applicant?
- 2) Should any conditions be imposed on an approval of the acquisition of control of Seaton and Stonewall by the Applicant to guard against any of the conditions in R.I. Gen. Laws § 27-35-2(d)?

IV. MATERIAL FACTS AND TESTIMONY AND DISCUSSION

R.I. Gen. Laws § 27-35-2(d) provides:

(1) The commissioner shall approve any merger or other acquisition of control referred to in subsection (a) of this section unless, after a public hearing held on the merger or acquisition, at the discretion of the commissioner or upon the request of the acquiring party, the insurer or any other interested party, he or she finds that any of the following conditions exist:

Following this language are the six bases upon which the Department may reject the filing for an approval of a change in control. Of these six, NICO advocated that four were implicated in this filing.¹ Those sections are:

(i) After the change of control the domestic insurer referred to in subsection (a) of this section would not be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently authorized;

(iii) The financial condition of any acquiring party is such as might jeopardize the financial stability of the insurer, or prejudice the interest of its policyholders or the interests of any remaining securityholders who are unaffiliated with the acquiring party;

(v) The plans or proposals which the acquiring party has to liquidate the insurer, sell its assets or consolidate or merge it with any person, or to make any other material change in its business or corporate structure or management, are unfair and unreasonable to policyholders of the insurer and not in the public interest; or

(vi) The competence, experience, and integrity of those persons who would control the operation of the insurer are such that it would not be in the interest of policyholders of the insurer and of the public to permit the merger or other acquisition of control

¹ The Department has evaluated the other two bases (effect on competition and unfairness to security holders) and has found that none of these bases are applicable to this filing.

The Department will address the factual arguments for each of these basis below:

**Unable to Satisfy Conditions for Licensure and Changes Unfair to
Policyholders or Public Interest**

NICO argues that these bases, as set forth in subsections (i) and (v) are implicated by the manner in which the Applicant² is running the business. Specifically, NICO argues that the management of the Insurers could imperil the reinsurance agreement and that without that agreement Seaton and Stonewall would be unable to satisfy the conditions for licensure. The areas of which NICO is critical are: (1) the projected income statement for Stonewall for calendar year 2007 states that there were \$0 Losses and ALAE; (2) the income statement state that there will be no adverse development of losses or ALAE in 2008 and beyond other than current reserves and that at least one claim is significantly under reserved; (3) the business plan does not provide for the payment of the claim servicing fees to NICO and (4) the prior business plan advocated acceleration of the Insurers obligations and the revised business plan simply removes any discussion of strategy so there is no evidence that the strategy has actually changed.

The Applicant counters that NICO is misreading the projections. According to the Applicant the projections are set off by the Retroactive Reinsurance and, therefore do not, as claimed by NICO represent a statement by the acquirer that there will be no further development. With regard to the development of Losses and ALAE on the projected income statements, the Applicant counters that this statement is based upon the reserve adequacy analysis of its retained actuary. Finally, the Applicant indicates that the claim servicing fee is included in the “Enstar US fixed fee” in the Business Plan. Although there is a dispute

² References to Applicant when discussing the Insurer’s management is actually reference to Enstar, however, due to Enstar’s affiliation with the Applicant, the management philosophy, competency and

between the parties as to the amount of service fees due, the Applicant indicates that the Business Plan provides for "...any conceivable claim servicing fees possibly due NICO..."

The Department rejects the claim made by NICO that the income statement projections and business plan submitted as part of the Form A filing provide a basis for determination that concerns relating to subsections (i) and (v) exist and therefore a change in control be denied. Since Seaton and Stonewall are in runoff and do not write new or renewal business, subsection (i) is not applicable in this case. With regard to subsection (v), the Department basis this statement on the fact that the day-to-day operations and management of the Insurers would not change as a result of a change in control since NICO would continue to have claims handling authority (as a result of its successful arbitration ruling) and Enstar would continue to manage the Insurers' financial reporting and overall operations. In addition, Dukes Place would continue to own a majority of the outstanding shares of Stonewall Acquisition Corporation and therefore continue to control the affairs of the Insurers. As such, the Department finds that the proposed change in control would not be unfair to the policyholders of the Insurers or against the public interest.

Competence and Integrity

NICO argues that three persons associated with the applicant "...have demonstrated such a lack of competence, experience and integrity as to threaten the interest of the Insurers' policyholders and the public" and that this forms a basis for the Department to deny the Form A pursuant to subsection (vi). Specifically, NICO argues that Mr. Joseph Follis, who is currently serving a Chief Claims officer for Seaton, has refused to authorize payments that are admittedly due to a policyholder under a coverage-in-place agreement entered into by

integrity relate to the entire organization of the Applicant and therefore Enstar and Applicant are used

Seaton in 1997 and further has failed to establish an indemnity reserve for that agreement. In addition, NICO produced an email, which was sent by Mr. Follis, which encouraged a claim settlement by stating that it was “inevitable” that Seaton would be placed in receivership. NICO further argued that Robert Carlson, Treasurer of Seaton and Stonewall, testified in the reinsurance arbitration between the parties that the reinsurance agreements were not risk bearing, however, in previous correspondence he had represented exactly the opposite. Finally, NICO argued that Karl Wall, President of Seaton and Stonewall has permitted the argument to be made that the reinsurance agreements are not risk bearing and has supervised Mr. Follis in his improper claims handling.

The Applicant characterizes the arguments made by NICO as “slanderous” and notes that Mr. Follis has achieved three full policy buy-back settlements and, as a result significantly reduced Seaton’s liabilities under these policies. Additionally, Mr. Follis has commuted assumed reinsurance with at least five ceding companies within the amounts authorized by NICO, which were less than the reserves. In addition, Tom Ryan, NICO’s only witness in the Form A has testified to Mr. Follis’ competence. At the hearing Mr. Ryan admitted this but elaborated on some claims decisions with which he disagreed. As to the specific refusal to authorize payment on the coverage in place agreement, the Applicant indicated that an audit was conducted at the suggestion of Mr. Ryan and that there were questions as to whether the policyholder has billed losses not covered by the contract. As to the “threats” to policyholder in settlement negotiations the Applicant pointed to the financial condition of Seaton and characterized Mr. Follis’ statements as “prudent and truthful statements regarding Seaton’s financial condition which the policyholder presumably will

interchangeably.

want to consider...” With regard to Mr. Carlson and Mr. Wall, the Applicant indicated that both had testified that the reinsurance agreements as written were risk transferring but that NICO had “...perverted the Treaties to operate in a manner that did not transfer risk...”

At the hearing, NICO added another argument concerning the attorney fees, expended by the Insurers in litigation with NICO. NICO indicated that Seaton and Stonewall have expended more than \$5 million dollars in attorneys fees in 2007 alone. However, the stock purchase agreement provides that if any funds are recovered from NICO, the Insurers would use their “best efforts” to have those funds paid to the Applicant and Dukes Place .

NICO also argued at the hearing and in their brief that the deteriorating financial condition of Seaton mandated that any approval of the Form A be conditioned on an influx of capital from the Acquirer into the Insurers.

The Department rejects the claim by NICO that the Applicant has demonstrated such a lack of competence, experience and integrity as to threaten the interest of the Insurers’ policyholders and the public. The evidence produced by NICO merely demonstrates that there are disagreements between NICO and Enstar regarding the handling of claims and settlement opportunities. There is clearly a difference in the claims management and settlement philosophy of Enstar and NICO, however, there was no conclusive evidence presented that would indicate that Enstar’s philosophy would be detrimental to the Insurers or to their policyholders. In fact, recent settlement opportunities negotiated by Enstar have proven to be beneficial to Seaton and even received praise from NICO. The Department, therefore, finds that a basis for denial of the change in control pursuant to R.I. Gen. Laws § 27-35-2(d)(vi) does not exist in this application.

Financial Condition of the Acquirer

In its reply brief, NICO adds an argument for denial under R.I. Gen. Laws § 27-35-2(d)(iii). Citing the evidence at the hearing that the statutory surplus of Seaton had decreased to within Mandatory Control Level, NICO argued that the financial condition of Seaton implicates this section and suggests that DBR should only approve the Form A if the Acquirer agrees to a capital infusion into Seaton. While DBR is, of course, concerned with the financial condition of Seaton in its regulatory role, those facts do not implicate R.I. Gen. Laws § 27-35-2(d)(iii) in a Form A approval. The clear statutory language of R.I. Gen. Laws § 27-35-2(d)(iii) requires that the Department review the financial condition of the Acquirer. In this case it is the financial condition of one of the insurers which is at issue. Therefore, R.I. Gen. Laws § 27-35-2(d)(iii) does not provide a basis for denial of the change in control under the facts in this application.

V. FINDINGS OF FACT

1. On or about October 3, 2006, a Form A filed by Seaton and Stonewall seeking approval of a stock purchase agreement which provides that the Applicant will purchase of 44.4% of the issued and outstanding voting securities of Stonewall Acquisition Corporation.

2. The approval of the Form A was opposed by NICO, the major reinsurer of Seaton and Stonewall, which was granted intervener status in the proceeding before the Department.

3. A hearing in this matter was held on April 24, 2008. In addition to the testimony and argument at the hearing, the Department considered the brief filed by the Applicant and NICO and the responsive brief filed by NICO.

4. The Department finds that none of the conditions in R.I. Gen. Laws § 27-35-2(d) exist in this acquisition of control.

5. As to the conditions in R.I. Gen. Laws § 27-35-2(d)(i), the Insurers are in runoff and are not issuing policies. As such, this provision is not applicable to the facts presented in this application.

6. As to the conditions in R.I. Gen. Laws § 27-35-2(d), the Department finds that there is no issue with regard to the financial condition of the Acquirer presented in this application.

7. As to the conditions in R.I. Gen. Laws § 27-35-2(d)(v), the Department finds that plans and proposals submitted by the Acquiring party are not unfair to the policyholders of the Insurers or not in the public interest since current day-to-day operations and management of the Insurers would not change as a result of the change in control.

8. As to the conditions in R.I. Gen. Laws § 27-35-2(d)(vi), the Department finds that while there are disagreements between NICO and Enstar regarding the handling of claims and settlement opportunities, those differences do not lead to the conclusion that Enstar's philosophy would be detrimental to the Insurers or to their policyholders.⁹ The Department further finds that the following conditions should be applied to this approval to assure that the requirements of R.I. Gen. Laws § 27-35-2(d)(vi) are met:

a. Seaton and Stonewall shall not make any dividend distributions without the prior written approval of the Department.

b. Seaton and Stonewall shall not initiate any new litigation that is not in the ordinary course of business without prior or concurrent notification to the Department.

c. Seaton and Stonewall shall immediately report any lawsuit filed against them that is not in the ordinary course of business.

d. All legal expenses associated with this Form A filing shall be incurred by the Applicant and not be charged back to Seaton or Stonewall.

e. No assets of Seaton or Stonewall shall be used to pay for legal expenses that are not in the ordinary course of business without the prior written approval of this Department.

f. Any monetary judgments awarded to Seaton and/or Stonewall as a result of litigation shall become an asset of Seaton and/or Stonewall and shall not be transferred in any manner without the prior written approval of this Department.

VI. CONCLUSIONS OF LAW

Based on the testimony and facts presented we conclude as follows:

1. The Department has jurisdiction over this matter pursuant to R.I. Gen. § 27-35-2 and 42-35-1 *et seq.*

2. The Department finds that none of the conditions in R.I. Gen. Laws § 27-35-2(d) exist in this acquisition of control sufficient to justify denial of the application.

3. All Finding of Fact listed above which are also Conclusions of Law are hereby incorporated.

VII. RECOMMENDATION

Based on the above analysis, the Hearing Officers recommend

1. That the Form A be approved.
2. That the following conditions be imposed upon the granting of this Form A:
 - a. Seaton and Stonewall shall not make any dividend distributions without the prior written approval of the Department.
 - b. Seaton and Stonewall shall not initiate any new litigation that is not in the ordinary course of business without prior or concurrent notification to the Department.
 - c. Seaton and Stonewall shall immediately report any lawsuit filed against them that is not in the ordinary course of business.
 - d. All legal expenses associated with this Form A filing shall be incurred by the Applicant and not be charged back to Seaton or Stonewall.
 - e. No assets of Seaton or Stonewall shall be used to pay for legal expenses that are not in the ordinary course of business without the prior written approval of this Department.
 - f. Any monetary judgments awarded to Seaton and/or Stonewall as a result of litigation shall become an asset of Seaton and/or Stonewall and shall not be transferred in any manner without the prior written approval of this Department.



Dated: May 23, 2008

Elizabeth Kelleher Dwyer, Esq.
Hearing Officer



Dated: May 23, 2008

Jack Broccoli
Hearing Officer

I have read the Hearing Officer's Decision and Recommendation in this matter, and I hereby

ADOPT
 REJECT
 MODIFY

the Decision and Recommendation.



Dated: May 27, 2008

A. Michael Marques
Director

NOTICE OF APPELLATE RIGHTS

THIS DECISION CONSTITUTES A FINAL ORDER OF THE DEPARTMENT OF BUSINESS REGULATION PURSUANT TO R.I.G.L. § 42-35-12. PURSUANT TO R.I.G.L. § 42-35-15, THIS ORDER MAY BE APPEALED TO THE SUPERIOR COURT SITTING IN AND FOR THE COUNTY OF PROVIDENCE WITHIN THIRTY (30) DAYS OF THE MAILING DATE OF THIS DECISION. SUCH APPEAL, IF TAKEN, MUST BE COMPLETED BY FILING A PETITION FOR REVIEW IN SUPERIOR COURT. THE FILING OF THE COMPLAINT DOES NOT ITSELF STAY ENFORCEMENT OF THIS ORDER. THE AGENCY MAY GRANT, OR THE REVIEWING COURT MAY ORDER, A STAY UPON THE APPROPRIATE TERMS.

CERTIFICATION

I hereby certify on this 27th day of May, 2008 that a copy of the within Decision and Notice of Appellate Rights was sent electronically to

Roger C. Ross, Esq.
Blais, Cunningham, Crow & Chester LLP
150 Main Street
Pawtucket, Rhode Island 02860

Ellen M. Dunn, Esq.
John M. Nonna, Esq.
Dewey & LeBeouf, LLP
125 West 55th Street
New York, New York 10019

Michael A Knoerzer, Esq.
Clyde & Co. US LLP
The Chrysler Building
405 Lexington Avenue, 11th Floor
New York, New York 10174

Steven D. Zubiago, Esq.
Nixon Peabody
One Citizens Plaza, Suite 500
Providence, Rhode Island 02903

Mary Kohart, Esq.
Daniel Krane, Esq.
Drinker Biddle & Reath, LLP
18th & Cherry Streets
Philadelphia, Pennsylvania 19103

Shawn Kelly, Esq.
Riker Danzig Scherer Hyland & Perretti LLP
Headquarters Plaza
One Speedwell Avenue
Morristown New Jersey 07962-1981

