

CAVELL USA INC

MEMORANDUM

To : Mr. Kenneth Randall

From : Robert B. Burns

Date : November 17, 2005

Subject : Stonewall

Ken:

As an officer of your organization, I feel compelled to bring to your attention a situation that I believe is having a serious economic impact on Stonewall (SICO) and suggest a solution to the problem. I submitted this idea to Pam 18 months ago and still believe it is a viable concept.

In observing the day to day operations and claim handling as ordered by the National Indemnity Company Representative (Tom Ryan), I have serious concerns that Tom Ryan may have breached his fiduciary responsibilities to SICO under the reinsurance "cap cover" agreement.

In looking at the past six years of indemnity and ALE payments, the following information is available:

Year	Indemnity	ALE	Total
1999	\$27,739,084	\$7,087,000	\$34,826,084
2000	\$3,077,482	\$3,002,000	\$6,079,482
2001	\$5,350,449	\$4,591,000	\$9,941,449
2002	\$6,477,403	\$4,115,295	\$10,592,698
2003	\$9,971,952	\$7,376,967	\$17,348,919
2004	\$11,645,198	\$4,559,294	\$16,204,492
2005 (Sept.05)	\$15,375,092	\$2,470,355	\$17,845,447

As is evident from these numbers since Mr. Ryan's arrival in 2002, SICO's numbers are trending upwards. Based on my experience and expectations with the SICO book I would have expected these numbers to be trending down or leveling out, not increasing. As regards the ALE numbers, there are a number of outstanding invoices that I suspect will significantly increase SICO's ALE numbers, some dating back 12 months or more. Tom mentioned at the last meeting that these bills totaled \$3-4 MM and should be allocated to the 2004 and 2005 ALE.

The reasons for these increases are:

- 1) SICO being required to participate in trials and settlements it should not be in. This is due to SICO being forced to join with primary carriers (managed by NICO) and to accept/abide by arguments favorable to primary carriers which are disadvantageous to excess carriers.
- 2) SICO being forced to pay legal expenses at a higher percentage than warranted, in shared representation cases with other carriers managed by NICO. CU and Kemper are getting a reduction in their ALE at SICO's expense.

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- 3) Not allowing SICO to utilize a "business decision" approach to settle out of litigation or a claim at a reasonable level thereby capping the costs.
- 4) Poor claim management decisions.

As a case in point, I would refer you to Fuller Austin (there are many others I could have chosen). This case was positioned to settle in 2002 for \$18MM over a 3-6 year period of payments, in exchange for which the unfavorable "drop down" court ruling would be stricken from the record. Tom Ryan opted to litigate this. Now SICO owes \$55MM, plus interest, plus appeal bond costs, plus attorney's fees. The appeal bond so far has cost @\$1.5MM. Attorney fees and expenses total \$5,908,839. The last I heard SICO's chances of success or appeal were 20%. Assuming 20% is correct for our chances of success on appeal this means SICO's expected value for this claim is \$51,400,000. SICO will pay \$33,400,000 more than the proposed settlement. I submit to you that the \$18MM deal was in hindsight a fantastic deal. Bottom line, Tom Ryan's actions are causing unwarranted erosion of the cap cover.

My suggestion to correct this is that you place someone here to oversee all SICO decisions on a daily basis and approve all SICO transactions and settlements. This person would be able to approve or disapprove all actions by Tom Ryan involving SICO. Currently One Beacon has one person performing this function. As a result the One Beacon 2003 YTD results of \$238,814,113 were reduced to \$163,879,080 in 2004 and as of October 2005 they were at \$ 124,531,017. Also I have been advised that ACE is currently hiring for two positions to perform a similar oversight/approval function for the Brandywine book of business handled by Resolute (a NICO company) in Philadelphia. I have been advised that Mr. Bill O'Ferrall is the person hiring for these positions.

In the event you would like to discuss this further, I am at your disposal. Additionally should you decide to create such a position I would like to volunteer for the position. There should not be any problem with Tom Ryan approving such, as he has advised for the past year that I should look for other employment opportunities and Pam has stated that I should do what the client wants.

Ken- as of 3PM today I was dismissed from my position by Pam. The allegations surrounding this are without merit or support. Since I have been working on this for the past few days I resolved to send this to you. It has been a privilege working for your organization. I must say though that I am appalled by this turn of events ordered by Tom Ryan and implemented by Pam. Should you wish to discuss this further please feel free to call me at home- 508-381-0128.

Robert B. Burns