

STATE OF VERMONT
WASHINGTON COUNTY, SS

_____)
COMMISSIONER OF THE)
DEPARTMENT OF FINANCIAL)
REGULATION)
PLAINTIFF,)
v.)
EMERGENCY PHYSICIANS INSURANCE)
EXCHANGE RISK RETENTION GROUP)
RESPONDENT.)
_____)

SUPERIOR COURT
DOCKET NO. 21-cv-348 Wncv

AFFIDAVIT OF J. DAVID LESLIE, SPECIAL DEPUTY REHABILITATOR

I, J. David Leslie, being sworn, hereby state as follows:

1. On February 26, 2021, the Court entered an Order for Rehabilitation of Emergency Physicians Insurance Exchange Risk Retention Group (“Rehab Order”), appointing the Commissioner of the Department of Financial Regulation (“Commissioner”) as Rehabilitator. The Rehabilitator appointed me Special Deputy Rehabilitator. I submit this Affidavit in support of the Rehabilitator’s Petition for Order of Liquidation for Emergency Physicians Insurance Exchange Risk Retention Group (the “Petition”). The facts and information set forth in this affidavit are either within my own knowledge and gained through my involvement in this matter, in which case I confirm they are true, or are based on information provided to me by others, in which case they are true to the best of my knowledge, information, and belief.

2. Respondent EPIX was originally organized on July 21, 2003 as a Nevada-domiciled risk retention group to write medical malpractice insurance for emergency physician groups. The Company operated from a California location as Emergency Physicians Insurance

Company Risk Retention Group. During the first quarter of 2015, the Company's name was changed to Emergency Physicians Insurance Exchange Risk Retention Group and it re-domesticated to Vermont. The Company is therefore a "domestic insurer" within the meaning of 8 V.S.A. § 7055(a) and 7056.

3. Over time, the market softened, and coverage became available from other carriers on competitive terms. Written premium declined and operations were accordingly reduced. By late 2019, it became clear that EPIX was experiencing a surge in high severity claims which generated a consequent reduction in surplus. As of December 31, 2019, the Company recorded its liability for unpaid claims at the low end of the range provided by its consulting actuary. The Company entered voluntary run-off in September 2020 and all in-force policies were cancelled as of September 1, 2020. Following review of the Company's financial statements as of December 31, 2020, a report from its consulting actuary concerning unpaid claim liabilities, discussions with management, and consideration of other materials, the Commissioner concluded in early 2021 that EPIX was insolvent and that continued transaction of business would be hazardous financially to policyholders, claimants, and the insurer's creditors.

4. On February 18, 2021, with the Company's consent, the Commissioner filed a Petition for Order of Rehabilitation of Emergency Physicians Insurance Exchange Risk Retention Group ("Rehab Petition"). The Rehab Petition alleged that EPIX was insolvent and that continuing operations on the current basis would be hazardous to the Company's policyholders, its creditors, and the public generally. The Commissioner accordingly requested an order appointing him as rehabilitator and authorizing him, among other things, to continue paying administrative expenses in the ordinary course, and to make immediate reimbursement

payments equivalent to 40% of defense costs and indemnity values (the “Plan of Rehabilitation”). Since there is no guaranty fund protection for risk retention groups and because creditors would do no better from a financial perspective in a straight liquidation proceeding, the Commissioner recommended a runoff rehabilitation to be followed by liquidation.

5. On February 26, 2021, the Court entered its Order for Emergency Physicians Insurance Exchange Risk Retention Group (“Rehab Order”), appointing the Commissioner as Rehabilitator and authorizing him to implement the Plan of Rehabilitation. Pursuant to the Rehab Order, the Rehabilitator continued paying all reasonable administrative expenses in full in the ordinary course of business, adjusting and determining policyholder-level claims and other policy-related obligations as set forth, reimbursing policyholders for 40% of the costs of defense and indemnity for such claims, and deferring the remainder.

6. When the Rehab Order entered on February 26, 2021, EPIX had fifty-six open claims, forty-two of which involved active litigation. As of December 31, 2023, forty-seven of the original open claims had been resolved through judgment, settlement, closure of the underlying matter (e.g., a disciplinary proceeding), or the issuance of coverage denial letters. The Rehabilitator also received one new claim (submitted under a “tail coverage”) leaving twelve open claims as of December 31, 2023. Through that date, the Rehabilitator has received invoices for defense costs which (after adjustment) totaled \$1,742,751.05 while the settlements and judgments totaled \$8,995,909.46. At the 40% initial distribution rate, this produced payments totaling \$4,295,100.42.

7. Since December 31, 2023, two claims have been resolved by settlement and a third has been resolved (pending any appeal) by entry of a defense verdict after trial. Of the nine

remaining open claims, three have trials scheduled in the coming twelve months, one has a trial date scheduled more than twelve months in the future, and one has received a defense verdict that is currently is awaiting appellate review. Discovery has been completed with regard to most of the other open claims which are therefore “on hold” pending a trial date.

8. The Rehabilitator initially retained the EPIX claims staff to continue providing, as vendors, the services they had rendered as employees. However, an insolvent estate cannot offer long-term employment prospects, so it was anticipated that the Rehabilitator would ultimately need to engage consultants or other vendors to provide services. In January 2022, the final EPIX claims staffer gave notice of resignation and the Rehabilitator engaged VCM (Vertical Claims Management, a division of Cannon Cochrane Management Services, Inc.) to provide certain third-party administrator services. The transition process was smooth and the current contract with VCM runs through 2024.

9. The Rehabilitator has held the Company in rehabilitation for nearly three years because of the flexibility afforded by the rehabilitation process and ability to pay policyholder-level obligations promptly at the 40% initial distribution rate. Rehabilitation also minimized the disruption to policyholders and overall estate liabilities (maintaining stability in claim defense and adjustment likely reduced the total defense and indemnity costs). The Rehabilitator’s recent status reports have noted, however, that the benefits of continued rehabilitation are diminishing (e.g. fewer open claims means fewer creditors benefiting from the ability to make prompt payments) and that the benefits of liquidation (e.g. the ability to secure recovery of reinsurance receivable and thus an increased distribution percentage) would soon weigh in favor of converting the proceeding from rehabilitation to liquidation. In the most recent status report, the

Rehabilitator advised that due to this shifting balance of interests a petition for liquidation would likely be filed in early 2024.

10. The Commissioner filed the Rehab Petition in 2021 because EPIX was insolvent. The purpose of the rehabilitation, however, was not to return EPIX to solvency but to run off its operations in the most efficient manner while minimizing the burdens the Company's insolvency placed on creditors, policyholders, and the public generally. At this point, with the great majority of EPIX claims having been resolved, the benefits of remaining in rehabilitation (e.g. flexibility and more rapid payment of claims) may now be outweighed by the costs (e.g. inability to collect reinsurance and to increase the distribution percentage.) Accordingly, the Rehabilitator believes that continuation of the rehabilitation would be futile and conversion to a liquidation is appropriate.

11. As of December 31, 2023, EPIX had liquid assets of \$5.87 million consisting of the \$2.17 million in cash and cash equivalents and \$3.70 million of invested assets consisting of laddered U.S. Treasury bonds reported at market value. In addition to the liquid assets, the EPIX estate will be entitled to credit for approximately \$4.30 million in reimbursements that have been paid as of December 31, 2023 on policy level claims pursuant to the Plan of Rehabilitation. The reinsurance receivable figure is the Rehabilitator's estimate based on reserves at December 31, 2023.

12. With regard to priority class 1 (administrative expenses), the Petition for Order of Rehabilitation noted that the Company had accrued \$0.9 million in administrative expense and that, on a conservative basis, total administrative costs to complete run-off and liquidation might total \$1.9 million. The Rehabilitator has drawn down on this reserve as the proceeding has continued and it now stands at \$1.18 million.

13. With regard to priority class 3 (policyholder level claims), “resolved claims” are those for which a value has been fixed through judgment, settlement, closure of the underlying matter (e.g., a disciplinary proceeding), or the issuance of coverage denial letters. Because the “resolved claims” value in Table 1 reflects data as of December 31, 2023, it does not reflect the January 2024 resolution of additional claims discussed above at ¶ 7.

14. The Rehabilitator has investigated the remaining open claims with the assistance of his consultant, Patrick McGrath of McGrath Associates Claims & Risk Services, Inc. This process has permitted Mr. McGrath to form a judgment as to the range of potential EPIX exposures presented by each claim. Specifically, for each claim, Mr. McGrath has offered his opinion both as to a “best estimate” of the exposure presented as well as a “pessimistic scenario” which reflects the adverse end of the expected range of potential exposure. The total of Mr. McGrath’s “best estimate” projections for undetermined potential class 3 claims is approximately \$3.9 million while the total in a “pessimistic scenario” is approximately \$5.1 million.

15. The Commissioner (as Rehabilitator) has concluded that both grounds for liquidation – futility and increased risk of loss – presently exist and that it is therefore appropriate to convert this proceeding from a rehabilitation to a liquidation.

16. The Commissioner filed the Rehab Petition in 2021 because EPIX was insolvent. The purpose of the rehabilitation, however, was not to return EPIX to solvency but to run off its operations in the most efficient manner while minimizing the burdens the Company’s insolvency placed on creditors, policyholders, and the public generally. At this point, with the great majority of EPIX claims having been resolved, the benefits of remaining in rehabilitation (e.g., flexibility and more rapid payment of claims) may now be outweighed by the costs (e.g.,

inability to collect reinsurance and to increase the distribution percentage.) Accordingly, the Rehabilitator believes that continuation of the rehabilitation would be futile and conversion to a liquidation is appropriate.

17. The Rehabilitator believes that further attempts to rehabilitate EPIX would increase the risk of loss to creditors, policyholders, and the public such that liquidation is necessary. Specifically, the Rehabilitator is concerned that the Company is unable to effectively marshal assets (reinsurance) in rehabilitation creating a substantial risk of loss to creditors, policyholders, and the public in the form of delayed and reduced distributions from the estate.

18. In addition to allowing for evaluation as to whether EPIX's insolvency could be cured, the Rehabilitation Plan was designed to manage the risk of loss to creditors, policyholders, and the public. Specifically, if the Company could not be returned to health, the Rehabilitation Plan sought to protect creditors by respecting the priorities that would apply in a liquidation and seeking equal treatment of similarly-situated claimants. The flexible structure of the Rehabilitation Plan was superior to liquidation in many ways. Most notably, the Rehabilitation Plan allowed third-party claimants and policyholders to continue resolving disputes in their home jurisdictions, it avoided the disruption and expense of establishing a claim determination procedure and moving such disputes to Vermont, and it permitted a partial payment to claimants in the ordinary course of business

19. The key to the Rehabilitation Plan was the initial distribution rate under which all policyholder-level claimants were to receive payment (and bear losses) at an equal rate. So long as the initial distribution rate was set at an appropriate level, it was possible to balance the interest of claimants with liquidated/determined claims (these claimants want prompt payment) and the interest of claimants with unliquidated/undetermined claims (these claimants want

sufficient assets reserved to pay their claims). The initial distribution rate, however, must be set at a conservative level to avoid the creation of preferences or subclasses. The Rehabilitator could not, therefore, propose an initial distribution rate based on hoped-for collections of contingent and unquantified assets, including recoveries under the Company's reinsurance contracts which may be receivable in liquidation but not rehabilitation.

20. As shown in the 12/31/23 Balance Sheet, the Rehabilitator believes that reinsurance receivable is a material estate asset which, when collected, would permit a material increase in the distributions on claims allowed in priority class 3. Continuance of the rehabilitation may, therefore, expose creditors, policyholders, and the public generally to risk in the form of delayed and reduced distributions from the estate.

21. Pursuant to the Plan of Liquidation, the liquidator would issue notice in the manner specified by statute and set a claim filing deadline not less than six months after entry of the liquidation order. Policyholders will remain, as they have been throughout rehabilitation, responsible for defending their claims and paying all claims and defense costs. As proofs of claim are received, the liquidator would review them and make determinations as to priority.¹ Estate assets are unlikely to permit full payment of class 3 claims. Accordingly, if the liquidator concludes that a claim falls in priority classes 4 through 10, he would typically issue a determination as to priority classification only. Claimants receiving notices of determination assigning their claims to subordinate priority classes would have the standard statutory rights to request reconsideration and to file objections with the Court.

22. The standard liquidation practice would involve a stay of proceedings involving

¹ A proposed Proof of Claim form and Notice of Liquidation are attached to the Plan of Liquidation.

claims defended by EPIX for a period of sixty days from the date of the entry of the order for liquidation. Such time is ordinarily necessary for the orderly transition of the defense of claims. EPIX insureds, however, assumed responsibility for the defense of claims filed against them when the Company was placed in rehabilitation. Since this transition has already occurred, the shift from rehabilitation to liquidation does not require a stay of proceedings in this instance.

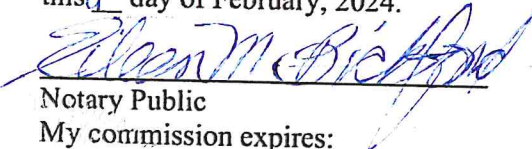
23. The standard liquidation practice would also involve a substantial delay between entry of a liquidation order and any motion for an interim distribution pursuant to 8 V.S.A. § 7083. This is because, in most insolvencies, a significant period of time is required to marshal assets, identify all potential claims, investigate them, and develop a firm understanding of how claims are developing and how much can be distributed without the risk of creating preferences (i.e. paying some creditors in a priority class more than others). In this instance, however, the Company's liabilities are reasonably understood -- EPIX has had no in-force policies since September 1, 2020, has been in rehabilitation since February 26, 2021, and the universe of claims is largely settled. Asset collection should also proceed quickly once claims are determined in liquidation. The Commissioner therefore anticipates that it will be possible to immediately request authority for an interim distribution and expects that the request will be made for a rate substantially greater than the 40% currently approved in rehabilitation. For example, the Rehabilitator's analysis suggests that a 56% interim distribution on claims falling in priority class 3 would be possible using the conservative assumptions that only current liquid assets are available and claims develop in line with the "pessimistic scenario". Further, an ultimate distribution of 70% or more would be probable if current financial projections (e.g. reinsurance collections, claim reserves, and administrative expenses) bear out.

24. No purpose would be served by requesting authority to make such a distribution

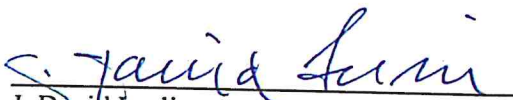
at this point since there are no allowed claims on which a distribution might be made. The Liquidation Plan therefore contemplates that a request for authority to make a distribution would be submitted at the same time as the first report of claims. The Commissioner anticipates that such a filing could be made within 90 days after entry of the liquidation order. The financial condition of the Company would then be monitored and requests for increased distribution percentages submitted when it appears reasonable and prudent.

Dated this 2nd day of February, 2024.

Subscribed and sworn before me
this 2nd day of February, 2024.


Notary Public

My commission expires:


J. David Leslie
Special Deputy Rehabilitator



EILEEN M. BICKFORD
Notary Public
Commonwealth of Massachusetts
My Commission Expires
February 3, 2028