

STATE OF VERMONT

SUPERIOR COURT  
WASHINGTON UNIT

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

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CIVIL DIVISION  
DOCKET NO. - - Wncv

**AFFIDAVIT OF J. DAVID LESLIE**

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

1. The Commissioner of the Department of Financial Regulation (the “Commissioner”) has been monitoring the affairs and financial condition of Emergency Physicians Insurance Exchange Risk Retention Group (the Company or EPIX) and in that regard engaged me to assist in his conservation efforts. I submit this Affidavit in support of the Commissioner’s Petition for Order of Rehabilitation 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. Medical malpractice insurance was not then readily available at a reasonable price for

emergency physician groups. The Company operated from a California location as Emergency Physicians Insurance Company Risk Retention Group. Over time, the market softened and coverage became available from other carriers on competitive terms. Written premium declined and operations were accordingly reduced. 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. § 7051. See also 8 V.S.A. §§ 6018 and 7031(13)(H).

3. As of December 31, 2020, the Company was registered in 30 states but all its in-force business had been cancelled as of September 1, 2020.

4. The Commissioner has monitored the Company's financial condition since its re-domestication to Vermont. Written premium dropped throughout this period, the operations in California were downsized, and operations were ultimately transferred to Madison, Wisconsin, where they have been conducted by independent contractors. 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. Following review of the Company's most recent financial statements, a recent report from its consulting actuary concerning unpaid claim liabilities as of December 31, 2020, discussions with management, and consideration of other materials the Commissioner concluded that EPIX was insolvent and that continued transaction of business would be hazardous financially to policyholders, claimants, and the insurer's creditors.

5. The Company's actuaries, The Actuarial Advantage ("TAA"), have completed an Actuarial Review of Loss and Loss Adjustment Expense Reserves as of December 31, 2020 (the "TAA Report") and discussed its findings and implications with the Department. The TAA

Report presents a range of reasonable reserve estimates with a low (optimistic), high (conservative) and central (select) estimate. The select estimate is a point within the range of reasonable estimates that represents an expected value over the range of reasonably possible outcomes.

6. EPIX reports \$10.7 million of cash and invested assets. If EPIX were to establish loss and defense and cost containment (“DCC”) claim reserves consistent with TAA’s select estimate (\$11.0 million), those reserves alone would exceed EPIX’s assets (\$10.7 million) by \$0.3 million, and would be \$1.3 million less than the statutory minimum surplus of \$1.0 million. See, 8 V.S.A. §§ 6001(4) and 6004(a)(5). EPIX also has \$0.9 million of accrued expenses and the Department estimates (on a conservative basis) that the costs of running off EPIX’s obligations would be \$1.9 million. Using TAA’s select estimate for unpaid loss and DCC claim liabilities, adding accrued expenses and the Department’s estimate of runoff expenses means that EPIX’s surplus would be negative \$3.1 million. Using the high TAA reserve estimate, the Company’s surplus would be negative \$5.3 million. If EPIX were to establish unpaid claim reserves at the most optimistic level estimated by TAA, its surplus would still be a negative \$1.7 million, which is \$2.7 million less than the statutory minimum.

7. For the reasons described above, the Commissioner has concluded that EPIX is insolvent and that continuing operations on the current basis would be hazardous to the public, its policyholders, and its creditors. The Department advised the Company’s board of directors of these conclusions and requested their consent to an order of rehabilitation. EPIX has consented to the entry of an order of rehabilitation pursuant to the Stipulation of Emergency Physicians Insurance Exchange Risk Retention Group to Entry of Order for Rehabilitation filed herewith. Grounds for an order authorizing the Commissioner to rehabilitate EPIX therefore exist. See 8 V.S.A. §§ 7051(1), (12), and (13);

8. As a risk retention group, EPIX's policyholders and claimants are not eligible for guaranty fund protection. 15 U.S.C.A. § 3902(a)(2) (Risk retention groups are "exempt from any State law" that would "require or permit [them] to participate in any insurance insolvency guaranty association..."). This means that EPIX's assets are the sole source of recovery for the Company's creditors (including those with policy-related claims). The distribution percentage that can finally be paid to EPIX creditors is therefore the ratio of court-allowed claim amounts (based on the creditor priority levels established by law) to the assets available after deductions for administrative expenses. The principal variables that will impact the ultimate distribution percentage are therefore the allowed claim amounts and the expenses of administration. As Rehabilitator, the Commissioner will investigate whether it is possible to cede EPIX's insured obligations to another insurer at a lower cost than the estimates described above. He will also seek to reduce administrative expenses to the lowest level possible. It is possible that EPIX's ultimate claim obligations will prove to be less than TAA's low range estimate. For the foregoing reasons, since there is no guaranty fund protection, and since EPIX creditors would do no better from a financial perspective in a straight liquidation proceeding, the Commissioner proposes the runoff rehabilitation receivership set forth below.

- EPIX would continue to incur and pay all reasonable administrative expenses associated with its operation. Cf. 8 V.S.A. § 7081 (In liquidation, claims entitled to Class 1 priority include "[t]he costs and expenses of administration, during conservation, rehabilitation, and liquidation...").
- The Company, pursuant to the Rehabilitator's control, would continue to adjust policy-level claims and other policy-related obligations and make immediate reimbursement payments equivalent to 40% of such defense costs and indemnity values (the "Initial Distribution Rate") while deferring payment of the remainder. Cf.

8 V.S.A. § 7081(3) (in liquidation, claims under policies are entitled to Class 3 priority).<sup>1</sup> Policyholders would assume the immediate responsibility for all defense costs and indemnity payments and EPIX would promptly reimburse such defense costs and indemnity payments at the Initial Distribution Rate. As policyholders see fit, EPIX claim staff would continue to be available (at EPIX's expense) to coordinate the defense and adjustment of claims but policyholders would advance defense costs and indemnity amounts to be promptly reimbursed by EPIX at the Initial Distribution Rate. The Commissioner believes that such partial payments reasonably balance the risk of preferential transfers (payments to some policyholders that might need to be clawed-back in a liquidation proceeding if insufficient funds are available to pay other policyholders) against the desire to minimize disruption to policyholder-level claimants and overall estate liabilities (maintaining stability in claim defense and adjustment should reduce total defense and indemnity costs). See 8 V.S.A. § 7067 (regarding voidable preferences) and 7081 (regarding equality of treatment within priority classes). The Commissioner recommends that the Court adopt a 40% Initial Distribution Rate, as reasonable and prudent in light of the fact that, using TAA's conservative reserve estimate, estate assets may be sufficient to permit a 66.6% distribution on policy-related claims.<sup>2</sup> It is appropriate to use this conservative figure

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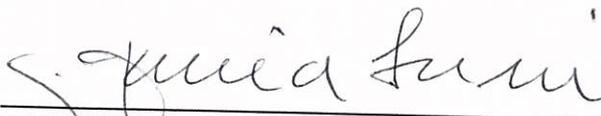
<sup>1</sup> The liquidation priority statute assigns the administrative expenses of guaranty associations to priority Class 2. See 8 V.S.A. § 7081(2). Because EPIX is a risk retention group and therefore prohibited by federal law from participating in guaranty associations, Class 2 would be empty in a liquidation. All assets available to the estate after payment of administrative expenses would therefore be dedicated to the payment of policy-related claims. See 8 V.S.A. § 7081(3).

<sup>2</sup> Current liquid estate assets (cash & invested assets) total approximately \$10.7 million. After payment of administrative expenses (the equivalent of Class 1 claims in liquidation) conservatively estimated at \$1.9 million, this would leave \$8.8 million in assets available to pay policy-related claims (the equivalent of Class 3 claims in liquidation). The high (conservative) end of TAA's estimate of EPIX's policy-related exposures is \$13.2 million. Potential distribution can therefore be calculated as follows: \$8.8 million in assets available to pay policy-related claims / \$13.2 million in policy-related claims = 66.6%.

for purposes of recommending an Initial Distribution Rate and the Commissioner notes that, if EPIX's loss experience develops in conformity with the more favorable scenarios envisioned in TAA's central (\$11.0 million) or low (\$9.6 million) loss and DCC reserve estimates, an ultimate distribution of 80% or more could be possible on policy-related claims.

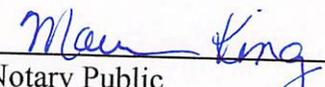
- The Company would defer payment of liabilities that would fall within priority classes 4 through 10 in liquidation. See 8 V.S.A. § 7081. It does not appear that EPIX assets would be sufficient to make any distribution to such creditors if the Company were placed in liquidation so deferral of payment during rehabilitation does not place the such creditors in a worse position than they would face in liquidation.

9. When EPIX's claim obligations can be estimated with a high level of confidence, the Rehabilitator will propose to the Court an additional (final) distribution. At that time, the Rehabilitator will most likely request that the Court convert this proceeding into a liquidation in order to fix EPIX's obligations and facilitate a final distribution.

  
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J. David Leslie

Dated this 17<sup>th</sup> day of February, 2021.

Subscribed and sworn before me this 18<sup>th</sup> day of February, 2021.

  
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Notary Public  
My commission expires: 3/8/2024

