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November 29, 2004

VIA OVERNIGHT DELIVERY

The Honorable Joel H. Peck, Clerk
State Corporation Commission
Tyler Building - 1st Floor
1300 East Main Street
Richmond, Virginia 23219

2004 NOV 30 A 11:12

DOCUMENT CONTROL

ATTN.: DOCUMENT CONTROL CENTER

Re: Commonwealth of Virginia at the Relation of the State Corporation Commission v. HOW Insurance Company, et al.; Case No. INS-1994-00218; Our File No. 25000-000

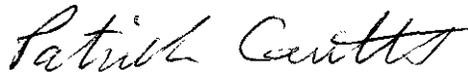
Dear Mr. Peck:

On behalf of Alfred W. Gross, Deputy Receiver of HOW Insurance Company, Home Warranty Corporation, and Home Owners Warranty Corporation, please find enclosed for filing an original and 16 copies of the following:

- Application for Orders Setting Hearing on Plans of Liquidation for HOW Insurance Company, a Risk Retention Group, Home Owners Warranty Corporation, and Home Warranty Corporation, Establishing Response Date, Approving Plans of Liquidation, Approving Claims Bar Date, and Related Matters
- [Proposed] Order Setting Hearing on Plans of Liquidation
- [Proposed] Order Approving Plans of Liquidation

Please date stamp the extra copy and return in the enclosed, self-addressed, stamped envelope. Thank you for your kind assistance in regard to this matter. Please let us know if you have any questions.

Respectfully submitted,



Patrick H. Cantilo
Counsel to the Deputy Receiver

PHC:jmw
Enclosures

Liquidation, (3) approving notice procedures for the hearing on the Plans of Liquidation, and (4) approving, after the hearing, the Plans of Liquidation, the proposed claims bar date and notice procedures related thereto, and all related matters for the Plans of Liquidation as described herein (the "Application"). In support of the Application, the Deputy Receiver would show the Commission the following:

I. BACKGROUND

1. On October 14, 1994, the Circuit Court for the City of Richmond entered its Final Order Appointing Receiver for Rehabilitation or Liquidation (the "Receivership Order") which appointed the State Corporation Commission of the Commonwealth of Virginia (the "Commission") as Receiver (the "Receiver"), Steven T. Foster, the Commissioner of Insurance of the Commonwealth of Virginia as Deputy Receiver, and Patrick H. Cantilo as Special Deputy Receiver (the "Special Deputy Receiver"), and authorized and directed them to administer the business and affairs of the HOW Companies, and to do all acts necessary or appropriate for the rehabilitation or liquidation of the HOW Companies. On May 1, 1996, by Order of this Commission, Alfred W. Gross succeeded Steven T. Foster as Commissioner of Insurance and Deputy Receiver of the HOW Companies. As a result of the receivership, the affairs and business of HWC are administered by the Receiver, the Deputy Receiver, and the Special Deputy Receiver, who are vested with all the powers and authority expressed or implied under the provisions of Title 38.2, Chapter 15 of the Virginia Code.

a plan of liquidation for HOW and HWC (the "HOW/HWC Plan of Liquidation").

2. In the Receivership Order, which the parties proffered to the Circuit Court of the City of Richmond, the Court found that the HOW Companies were in a hazardous financial condition. An audit of the HOW Companies as of December 31, 1994, indicated that their liabilities exceeded their admitted assets by \$117,531,322 (HOWIC's 1994 annual statement reflected that, as of the same date, its liabilities exceeded its admitted assets by \$116,244,100). An audit of the HOW Companies as of December 31, 1995, indicated that their liabilities exceeded their admitted assets by \$54,729,964 (HOWIC's 1995 annual statement reflected that, as of the same date, its liabilities exceeded its admitted assets by \$53,472,156). Annual statements filed by the Deputy Receiver for every year through 2001 continued to reflect that HOWIC's liabilities exceeded its admitted assets by a substantial sum. In short, HOWIC separately, and the HOW Companies collectively, were insolvent in 1994 and 1995, and remained insolvent through 2001.

3. Pursuant to the Receivership Order and applicable Virginia law, the Deputy Receiver and Special Deputy Receiver have devoted their efforts to marshaling the assets and discharging the liabilities of the HOW Companies. In doing so, HOWIC returned to solvency as endorsed by HOWIC's 2002 annual statement, which reflected that, as of December 31, 2002, its admitted assets exceeded its liabilities by \$12,647,675. Likewise, the HOW Companies' audit report showed that their admitted assets, on a consolidated basis, exceeded their liabilities by \$11,576,907 as of December 31, 2002². Despite HOWIC's and the HOW Companies' return to solvency over the last few years, the Deputy Receiver has determined, and will show the Commission, that efforts to

² A draft audit report of the HOW Companies as of December 31, 2003, indicated that their admitted assets, on a consolidated basis, exceeded their liabilities by \$6,924,123 (HOWIC's 2003 annual statement reflected that, as of the same date, its admitted assets exceeded its liabilities by \$7,994,697).

rehabilitate the HOW Companies would be useless, and that an order of liquidation should be entered pursuant to VA. CODE ANN. § 38.2-1519.B. Therefore, as management of the HOW Companies' affairs in receivership has progressed, the Deputy Receiver and Special Deputy Receiver have developed Plans of Liquidation, the intent of which is to facilitate the orderly wind-down and dissolution of the HOW Companies' affairs, with due regard to the interests of affected constituencies.

4. Before the inception of receivership proceedings, the HOW Companies marketed a home warranty insurance program pursuant to which were issued hundreds of thousands of builder liability insurance policies and home owner warranty certificates providing coverage for at least ten years to homes throughout the United States, with the exception of Alaska (the "HOW Program"). There remain in effect thousands of such insurance policies and warranty certificates, some of which will provide such coverage at least through the year 2004.

5. The Deputy Receiver gave consideration to the early cancellation of such insurance policies and warranty certificates, but concluded that he could not implement such measures without material adverse consequences to the home owners to whom they provide benefits. Even if unearned premiums could have been calculated upon premature cancellation (for which the insurance policies and warranty certificates make no provision), payment thereof would most likely have been in small amounts to builders and not home owners, while the latter would thereupon have completely lost all benefits afforded to them. In short, premature cancellation might have occasioned a windfall for some (builder recipients of unearned premiums) and substantial harm to others (home owners losing all benefits). Consequently, the Deputy Receiver concluded that premature cancellation of insurance

policies and warranty certificates was not a viable option consistent with the mandates and purposes of the receivership proceeding.

6. The Deputy Receiver has continued managing the affairs of the HOW Companies with the principal intent of protecting their insureds, warranty certificate holders, and creditors. Upon inception of receivership proceedings, the Deputy Receiver was advised by consulting actuaries and other consultants that he could not safely pay more than 40% of amounts approved for covered claims without creating a danger that improper preferences would result from inability, as the receivership progressed, to pay later claimants the same percentage of their approved claims as was paid to earlier claimants. As management of the HOW Companies in receivership continued, it became possible, gradually, to increase this percentage of covered claims safely payable, first to 50% in January 1996, then to 60% in December 1998, then to 70% in August 1999, and finally to 100% in November 2000, by directive of the Deputy Receiver in each instance. In each instance, the Deputy Receiver was advised that the financial affairs of the HOW Companies had improved sufficiently, and that payment of the increased percentage to claimants would not create an unreasonable risk that later claimants might be paid a lower percentage. Moreover, in each instance, claimants having previously received a lower percentage were now paid the difference unless they had been otherwise compensated. Thus, as of the date of this Application, the Deputy Receiver has caused the HOW Companies to pay covered claims in full as approved, with the proviso described in the following paragraph.

7. After each directive by the Deputy Receiver regarding an increased percentage payable for approved claims, a letter was mailed to each builder requesting information about any payments they may have made to home owners to pay the balance of approved claims previously left

unpaid by the HOW Companies. Each home owner was then mailed a letter (a "Distribution Notification") explaining that the percentage payable for approved claims had been increased, and an affidavit to be completed regarding whether the home owner had already recovered the remaining percentage of the approved claim from another source. The last such Distribution Notification, dated March 23, 2001, provided the following notice in all-capital, bold type:

THE HOW COMPANIES MUST RECEIVE THE COMPLETED AFFIDAVIT, PROPERLY SIGNED AND SWORN TO IN THE PRESENCE OF A NOTARY PUBLIC, ON OR BEFORE THIRTY (30) DAYS FROM DATE OF THIS LETTER. IF THE HOW COMPANIES DO NOT RECEIVE THE AFFIDAVIT BY THIS DATE, IT MAY CONSTITUTE A WAIVER OF YOUR RIGHT TO RECEIVE ANY FURTHER DISTRIBUTIONS ON YOUR CLAIM.

To those home owners who did not return the affidavit, the HOW Companies mailed two additional notices. The address of each non-responsive home owner was researched in an attempt to determine whether the home owner had moved. If a new address could be found, the Distribution Notification (including affidavit) was mailed to that address. As of September 30, 2004, there were 306 approved claim files reflecting a total unpaid distribution of \$709,477 attributable to home owners who had not responded to the Distribution Notification by submitting affidavits documenting their entitlement to additional percentage payments.

8. The availability of assets to thus increase the percentage paid to covered claims principally has been the result of two causes. First, the Deputy Receiver has concluded that the inception of receivership proceedings had the effect of reducing substantially both the number and the amount of covered claims. This was due to a variety of factors, key among which were: (1) publicity about the HOW Companies' financial difficulties (leading some potential claimants to seek redress elsewhere—such as directly from builders, or simply to abandon their claims), (2) restrictions

on amounts payable, imposed by receivership orders (which largely eliminated treble and exemplary damages and other extra-contractual obligations), and (3) successful efforts by the Deputy Receiver to induce builders to resolve some claims directly, not at the expense of the HOW Companies. Second, improvement in operating results (which reduced net operating expenses and improved the performance of the HOW Companies' asset portfolios) have also improved the availability of assets.

9. Thus far, the Deputy Receiver has not arranged for payment to general creditors, but he has computed the aggregate amount that is owed to them according to receivership records. Based on information currently available, the total amount of approved general creditor claims filed to date is approximately \$1,826,292.27, which includes \$555,727.92 in approved subordinate claims, but excludes all approved capital contribution claims. It appears that payments of approved general creditor claims may now be made, given that the HOW Companies' admitted assets now exceed their liabilities.

10. In addition, the Deputy Receiver has determined that among the HOW Companies' actual or potential liabilities are approximately \$11,271,225 in "vested" capital contributions returnable to certain builders whose capital contributions vested pursuant to the terms of their builder agreements with HWC ("Builder Agreements"), and who either: (a) after the inception of the receivership, had their Builder Agreements automatically terminated during 1994 and 1995 upon expiration of their Builder Agreements' one-year terms, or (b) voluntarily terminated their Builder Agreements, either before inception of the receivership, or prior to the date that such Builder Agreements would have terminated automatically during 1994 or 1995 upon expiration of their one-

year terms, and who at the time of termination had been members in good standing for at least five consecutive years (collectively, "Eligible Builders").³

11. In the case of an insolvent estate, Virginia law prohibits creditors from earning interest on their claims. Swiss Re Life Co. America v. Gross, 253 Va. 139, 147, 479 S.E.2d 857, 861 (1997). However, if it appears that the estate will prove sufficient to discharge all claims, then the claimants are also entitled to receive interest on their claims. American Iron & Steel Co. v. Seaboard Air Line Ry., 233 U.S. 261, 266 (1914); People v. Merchants' Trust Co., 79 N.E. 1004, 1005 (N.Y. 1907). Pursuant to VA. CODE ANN. § 6.1-330.53 (Michie 1999), interest should be paid at an annual rate of eight percent (8%).

12. The question arises whether the Deputy Receiver should: (1) pay interest on home owner claims before making any payments on general creditor claims, or (2) pay general creditor claims, then pay interest on home owner claims, and then pay interest on general creditor claims. Of course, if the estate is sufficient to pay all claims, and to pay interest on all claims, both approaches will yield the same result. However, the Deputy Receiver believes that the second

³ There were 447 Member-Builders with \$1,315,470 in non-vested capital contributions who were in good standing as of October 14, 1994, but who had not been members in good standing for at least five continuous years as of the date their Builder Agreements were terminated automatically for non-renewal. The Deputy Receiver believes that such Member-Builders should be treated as if they meet the five year vesting requirement, because their Builder Agreements were terminated neither voluntarily, nor for cause, but as the result of the receivership. In addition, the Deputy Receiver believes that twenty-three (23) Member-Builders with \$8,130 in non-vested capital contributions, who were terminated only for filing bankruptcy prior to receivership, should be treated as if they meet the five year vesting requirement because their terminations were pursuant to so-called *ipso facto* clauses, which federal bankruptcy courts have held are void as a matter of law. HWC holds an additional \$4,721,595 in capital contributions that are not refundable, because the builders in question did not satisfy the contractual requirements for refund, as discussed below. Those non-refundable capital contributions are deemed by the Deputy Receiver to belong to HWC for the benefit of its owners.

approach is most consistent with the law. Following the first approach, the estate might prove sufficient to pay all homeowner claims and interest thereon, but then prove insufficient to pay all general creditor claims in full (much less any interest thereon). But paying interest on homeowner claims without paying general creditor claims in full would be contrary to the rule that interest may only be paid when the estate is sufficient to pay all claims in full. Therefore, the Deputy Receiver proposes to pay the underlying claims pursuant to the priority scheme set forth by statute, to ensure that the condition for paying interest is satisfied, after which he will pay interest on the underlying claims pursuant to the same priority scheme.⁴

13. Next, the Deputy Receiver must consider the appropriate period of time for which to pay interest on claims. The Deputy Receiver proposes to pay interest on the unpaid portion of a claim from the date of the Notice of Claim Determination approving the claim to the date the claim is paid in full.

14. It now appears possible that, after satisfaction of the costs and expenses of administration and all the actual and potential liabilities identified above, there may remain in the HOW receivership estate assets of substantial aggregate value. As he continues the administration of the estate, the Deputy Receiver believes that it is important that plans be adopted and approved for the eventual disposition of all of the estate's affairs, including all liabilities and assets. An important aspect of any such plans must be the disposition of any assets remaining after satisfaction

⁴ The choice between the two approaches will most likely be academic in this receivership, because the Deputy Receiver currently estimates that the estate will be sufficient to pay all claims in full and pay interest at the legal rate on all underlying claims.

of the costs and expenses of administration, and all the actual and potential liabilities identified above (the "Residual Assets").

15. Traditionally, in the rare cases in which a receivership is concluded with assets remaining after satisfaction of all liabilities (and interest thereon), such assets are allocated among, and delivered to, the owners of the enterprise.

16. As a starting point, the Deputy Receiver articulates the fundamental goals underlying his analysis of how best to conclude this receivership. First, assets of the HOW receivership estate must be disbursed as they become available in the order of priority promulgated in VA. CODE ANN. § 38.2-1509 (Michie 2002)⁵ and the Commission's orders. Second, contingent and unsettled claims must be resolved and liquidated. Third, disputes arising from contested claims must be brought to final resolution. Fourth, adequate provision must be made for taxes and other such liabilities. Fifth, a determination must be made pursuant to VA. CODE ANN. § 38.2-1519 as to whether further efforts to rehabilitate the insurer would be useless and liquidation should be sought.

17. Measures have been developed and implemented by the Deputy Receiver to identify and resolve the claims of creditors in all the categories identified in VA. CODE ANN. § 38.2-1509. Completion of this process is expected to occur some time in 2006 or beyond because of the duration of insurance and warranty coverages issued by HOWIC. Thus, current receivership management protocols will satisfy the first three goals identified in the preceding paragraph.

⁵ VA. CODE ANN. § 38.2-1509 provides that after reserving for the payment of the costs and expenses of administration, assets of an insolvent insurer shall be disbursed as they become available in the following manner: (i) secured creditor claims, (ii) policyholder claims, (iii) taxes, (iv) wages entitled to priority, and (v) general creditor claims.

18. Identification and resolution of tax and similar actual and potential liabilities depends significantly on the nature and elements of the final wind down plans. Until such plans are adopted, an effective program for resolving tax and similar liabilities cannot be implemented with sufficient certainty.

19. A determination as to whether further efforts to rehabilitate the insurer would be useless depends entirely on how rehabilitation is defined. Neither the applicable Virginia statutes, nor the Receivership Order, nor any other Commission order, provides a clear definition by which such a determination can be gauged. However, VA. CODE ANN. § 1519.A implies that further efforts to rehabilitate the insurer would not be useless if it appears likely that the insurer could safely and properly resume possession of its property and the conduct of its business. The Deputy Receiver believes, therefore, that rehabilitation must include at least the following:

- a. payment of the costs and expenses of administration, pursuant to VA. CODE ANN. §§ 38.2-1509(B)(1) and 38.2-1510 (Michie 2002),
- b. payment of the claims of secured creditors, pursuant to VA. CODE ANN. § 38.2-1509.B.1(i),
- c. payment of claims of policyholders arising out of insurance contracts, pursuant to VA. CODE ANN. § 38.2-1509.B.1(ii),
- d. payment of taxes, pursuant to VA. CODE ANN. § 38.2-1509.B.1(iii),
- e. payment of wages entitled to priority, pursuant to VA. CODE ANN. § 38.2-1509.B.1(iv),
- f. payment of general creditor claims, pursuant to VA. CODE ANN. § 38.2-1509.B.1(v),

g. payment of interest on claims, pursuant to the same priority as the payment of the underlying claims,

h. removal of the causes and conditions having given rise to the receivership, and

i. ability of the insurer to continue as a viable business.

20. The Deputy Receiver does not believe that a plan for rehabilitation of the HOW Companies can be designed and implemented that would satisfy the last two of these elements. The HOW Companies' insurance and warranty coverage obligations have been breached before and through the receivership and cannot reasonably be fulfilled *ex post facto*. Thousands of home owners' claims arising from defects or damage arguably covered by HOW warranties were waived, rejected, or compromised based on misinterpretations of that coverage, or because of the HOW Companies' poor financial condition. The Deputy Receiver cannot identify and compensate reasonably the holders of such claims.

21. It is the firm view of the Deputy Receiver that the coverages issued by the HOW Companies, and the principles underlying the HOW Program, were fundamentally flawed. Specifically, the scope, duration, and pricing of such coverage did not correspond appropriately to what reasonably should have been expected to be the resulting liabilities. The Deputy Receiver does not believe that insurance policies and warranty certificates actually providing the coverages marketed by the HOW Companies could be structured in an actuarially sound manner and priced reasonably. No more telling proof of this conclusion can be found than the complete absence from

the marketplace of such coverages in the decade since the demise of the HOW Companies.⁶ Consequently, the Deputy Receiver does not believe that it would be possible to return the HOW Companies to the insurance/warranty marketplace without an unreasonable likelihood that the causes of the receivership would recur promptly with similar results.

22. Moreover, resumption by the HOW Companies of their historical business would, in the judgment of the Deputy Receiver, be contrary to law. Releasing the HOW Companies from receivership would likely result in a gradual or immediate return to pre-receivership claims experience, for which the HOW Companies' assets might prove insufficient, and improper preferences would be all but unavoidable. That is, there would be a substantial probability that newly assumed insurance and warranty obligations could not be fulfilled. Thus, the HOW Companies have not issued any new coverages since the inception of receivership proceedings. The HOW Companies' marketing facilities were dismantled shortly after receivership proceedings commenced. The HOW Program itself came to an end in 1994, except for the adjudication and payment of claims, and the marshaling of assets.

23. For these reasons, the Deputy Receiver has concluded that further efforts at rehabilitation, however that term might reasonably be defined, would be useless. Accordingly, he has devoted attention to the development of alternative wind down or liquidation plans. In these efforts, he has first sought to determine whether it would be possible, in any event, to return any Residual Assets to the HOW Companies' owners.

⁶ There are, to be sure, other companies marketing new home warranties. But these differ in very material respects from those that had been offered by the HOW Companies.

24. In order to effect a plan of liquidation, it will be necessary to identify and resolve all claims against the HOW Companies. The Deputy Receiver believes that the current administration of the HOW receivership estate will accomplish that result. Upon conclusion of those steps, it appears that there will be Residual Assets that should be returned to the HOW Companies' owners upon the liquidation of the companies, but the return of such assets will first require the identification of such owners.

25. In determining who would be the owners of any Residual Assets, it is necessary to note that the rights and liabilities of creditors, policyholders, stockholders, members, and all other persons interested in the property and assets of the HOW Companies will be fixed as of the date of the entry of the order directing liquidation. VA. CODE ANN. § 38.2-1512 (Michie 2001); see also Receivership Order ¶ 22.

26. The HOW Companies were organized in the familiar corporate pyramid structure in which a parent corporation wholly owns operating subsidiaries. Owners of the parent, therefore, indirectly own the entire enterprise (or "holding company system" in insurance terminology). The parent in the HOW Companies structure is HWC, a Delaware member non-stock company. Therefore, in order to identify the owners of the HOW Companies who would be entitled to receive any Residual Assets upon liquidation of the HOW Companies, it is necessary only to identify the owners of HWC as of the date of the entry of an order directing liquidation.

27. In order to determine who are the owners of HWC, the Deputy Receiver began by analyzing the Builder Agreements in conjunction with HWC's Bylaws and Certificate of Incorporation, as well as applicable laws. The Deputy Receiver has concluded, among other things, that the Builder Agreements:

- a. resulted in the contracting builders becoming member-builders of HWC (“Member-Builders”), with certain voting rights,
- b. required the Member-Builders to make periodic capital contributions,
- c. entitled the Member-Builders to recover their capital contributions in at least some cases, the requirements for refund generally being that the builder: (1) was a member of HWC for five continuous years,⁷ (2) was a member in good standing, and (3) terminated his Builder Agreement voluntarily,
- d. did not provide the Member-Builders the right to distributions of profit,
- e. did not provide the Member-Builders the right to distributions of assets upon liquidation,
- f. did not characterize the Member-Builders as owners of HWC,
- g. were for one-year terms, renewable by the Member-Builders with the approval of HWC and HOW, and
- h. did not provide for rights of distribution surviving termination or non-renewal.

Therefore, although the Builder Agreements address the issue of return of capital contributions, which the Deputy Receiver considers to be a contractual matter, they do not address the issue of who is entitled to share in the distribution of any surplus upon the dissolution of HWC and its subsidiaries. Nor do HWC’s Certificate of Incorporation or Bylaws address the disposition of any surplus remaining upon dissolution of the company and its subsidiaries.

⁷ But see note 3, *supra*.

28. The home owners owned neither HWC nor HOWIC. In fact, HOWIC's insurance policies were issued to the Member-Builders, who were considered the insureds, not to the home owners. The latter received warranty certificates which did not contain any indicia of ownership. The home owners were third-party beneficiaries of the HOW insurance policies, not insureds. HWC did not, at any time, issue shares of stock, partnership interests, or other ownership instruments to home owners.

29. Thus, HWC's Certificate of Incorporation, Bylaws, and Builder Agreements are of no assistance in identifying HWC's owners. However, the Deputy Receiver believes that consideration of relevant statutes, case law, and equity should lead the Commission to conclude that HWC's owners, who would be entitled to any Residual Assets as of the date of an order of liquidation, are those builders who were insured under unexpired HOWIC insurance policies on the date the Receivership Order was entered (the "Builder Distributees"). Under the applicable law discussed below, the Deputy Receiver believes that even those builders who are not contractually entitled to a refund of capital contributions would, if they were insureds as of the date of the Receivership Order, be entitled to share in any Residual Assets. On the other hand, even builders who are contractually entitled to a refund of capital contributions would not, if they were not insured as of the date of the Receivership Order, be entitled to share in any Residual Assets.

30. HOWIC is a risk retention group organized pursuant to the federal Risk Retention Act, which provides that a "risk retention group" is a corporation or other limited liability association:

(E) which—

(i) has as its owners only persons who comprise the membership of the risk retention group and who are provided insurance by such group, or

- (ii) has as its sole owner an organization which has as—
- (I) its members only persons who comprise the membership of the risk retention group, and
 - (II) its owners only persons who comprise the membership of the risk retention group and who are provided insurance by such group.

15 U.S.C. § 3901(a)(4)(E) (1997 Supp.). It is logical to conclude that Congress intended to treat risk retention groups like mutual insurance companies, because the idea behind both is the same or similar. Attorneys' Liab. Assur. Soc'y, Inc. v. Fitzgerald, 174 F. Supp. 2d 619, 633 (W.D. Mich. 2001). It is well established in the case law that ownership of a mutual insurance company derives from one's status as a policyholder:

The policyholders of the mutual insurance company are the "owners" of the company, in that upon liquidation, if assets exceed liabilities, the surplus is distributable to the policyholders.

Stern v. Commissioner, 66 T.C. 91, 93 (1976).

[I]t is well established that a mutual insurance company is a cooperative enterprise in which the members are both insurers and insured; the Company is owned and managed by the policyholders; the business is conducted for their benefit; they are the owners of the profits and the surplus and thus a policyholder has rights, both as an insured and as a co-owner of the assets of the Company.

Public Hous. Admin. v. Housing Auth. of Bogalusa, 137 So. 2d 315, 321 (La. 1961).

[A mutual insurance company's] policyholders sustain a double relationship to it: (1) That of contractors with it, and (2) resulting therefrom, that of *pro tempore* owners of it. They are owners in a qualified sense. They change from day to day, not by a mere transfer of interests which persist in others, but by utter cancellation of the interests of some and the acquirement by new contracts of newly created and temporary interests by others. The policyholder whose connection with the company expires by lapse, surrender, or death has no interest which he may transmit in the continued existence of the company.

New York Life Ins. Co. v. Burbank, 216 N.W. 742, 743 (Iowa 1929). A "member" of a mutual insurance company is an "owner" of the company by virtue of owning a policy with the

company. Cf. Ohio Farmers Indem. Co. v. Comm'r of Intern. Rev., 108 F.2d 665, 667 (6th Cir. 1940). The legislative history of the federal Risk Retention Act notes:

Membership in a risk retention group should be limited to active participants in a risk retention program. Active participants include persons whose own product liability or completed operations liability is currently assumed, in whole or in part, by the risk retention group.

H.R. 97-190 at 10-11, 1981 U.S. Code Cong. & Ad. News at 1438-39. Whatever Congress may have intended by the term “member” of a risk retention group, Congress intended to prevent ownership of a risk retention group by non-insureds. Attorneys’ Liab. Assur. Soc’y, Inc., 174 F. Supp. at 634.

31. Clearly, a person who is not insured by a risk retention group cannot be a member or owner of the risk retention group (or of the risk retention group’s holding company). But is it possible for a person to be insured by a risk retention group without being an owner or member thereof? Although not expressly stated by the federal Risk Retention Act and the relevant case law interpreting it, it is at least implied that owners and policyholders of a risk retention group are coterminous classes. Moreover, if, as the courts have determined, Congress intended that risk retention groups be treated like mutual insurance companies, then there does not appear to be any serious argument that an insured builder can have his membership (at least for purposes of his ownership rights) terminated so long as his policy is still in effect:

A mutual insurance company is an association to provide mutual relief for loss, and all policyholders are members, with each having the same proportionate interest and each being liable to the same proportionate extent. As regards their rights and remedies, the policyholders in a mutual company have been considered stockholders therein the same as owners of stock in a stock corporation, where there is no charter provision to the contrary.

Appleman’s Insurance Law and Practice, Chapter 344, Section 10047, page 100.

32. In compliance with the requirements for qualifying as a risk retention group pursuant to 15 U.S.C. § 3901(a)(4)(E), HOWIC had as its sole owner HWC, which had as its members only persons who comprised the membership of HOWIC.⁸ However, HWC did not, as required by the statute, purport to have as its owners only persons who comprised the HOWIC membership and who were provided insurance by HOWIC. HWC's Certificate of Incorporation, Bylaws, and Builder Agreements were silent as to who owned the Company. As a Delaware non-stock corporation, its owners would presumptively be its member builders. As a risk retention group, its owners would presumptively be the builders who were insured under unexpired policies. Here, the federal Risk Retention Act conflicts with, and preempts, Delaware's General Corporation Law—the "owners" of HWC are the insured builders, regardless of whether they are still "members" under the terms of the Builder Agreements.

33. Because the insured builders are the owners of HOWIC and HWC pursuant to the federal Risk Retention Act, the Deputy Receiver has concluded that those builders who have unexpired policies as of the date of the entry of the order directing the liquidation of the HOW Companies are entitled to any Residual Assets upon liquidation, independently of whether or not they are contractually entitled to a refund of capital contributions. However, the Deputy Receiver must determine whether those builders who had unexpired policies as of October 14, 1994, the date of the Receivership Order, should also be deemed to be among the HOW Companies' owners.

⁸ Although the Deputy Receiver is unaware of there ever having been reference to "HOWIC members" *per se*, it appears that HWC members were implicitly deemed automatically to be HOWIC members. Pursuant to the Builder Agreements, only HWC members were entitled to enroll homes in the HOW Program, thereby becoming HOWIC insureds. Effectively, therefore, HWC membership and HOWIC membership were one and the same, as was required for HOWIC to qualify as a risk retention group pursuant to 15 U.S.C. § 3901(a)(4)(E).

Despite the fact that most of those builders no longer have policies currently in effect, it would be inequitable to prevent them from being deemed owners. Because approximately ten years have elapsed since the Companies were placed in receivership, most of the HOWIC policies have expired through no fault of the policyholders, who were subsequently not permitted to renew their policies. To deem the owners of the HOW Companies (and of any Residual Assets) to be those few builders whose policies have not expired would be inequitable and would result in their obtaining a windfall. The Deputy Receiver recommends that the Commission, as a court of equity, deem that builders with active policies on the date of the Receivership Order should share in the HOW Companies' Residual Assets as owners. On the other hand, even builders who are contractually entitled to a refund of capital contributions should not, if they were not insureds as of the date of the Receivership Order, be entitled to share in any Residual Assets.

34. Although the federal Risk Retention Act, together with the Deputy Receiver's equitable powers, resolves the question of who are the members/owners of the HOW Companies entitled to any Residual Assets as of the date of the Commission's order of liquidation, the federal Risk Retention Act does not provide any guidance as to how any Residual Assets should be allocated among those members/owners. To address that issue, the Deputy Receiver has consulted statutes and case law applicable to nonstock corporations like HWC and to mutual insurance companies, to which a risk retention group is closely analogous.

35. A venerable and universal axiom applied by federal and state courts, referred to as the *lex incorporationis* or "internal affairs doctrine," is that the law of the state of incorporation should determine issues relating to internal corporate affairs. McDermott, Inc. v. Lewis, 531 A.2d 206, 214-17 (Del. 1987); Restatement (Second) of Conflict of Law § 302(2); cf. VA. CODE ANN. §

13.1-923 (Michie 1999) (“[The Virginia Nonstock Corporation] Act does not authorize this Commonwealth to regulate the organization or internal affairs of a foreign corporation authorized to transact business in this Commonwealth”). Matters falling within the scope of this rule include the issuance of corporate shares, charter and by-laws amendments, reorganizations, and the declaration and payment of dividends. Restatement (Second) of Conflict of Law § 302 cmt. a. Therefore, the rights of members or shareholders of HWC, HOW, and HOWIC to dividends, or to the corporations’ assets upon dissolution, would be governed by the laws of their respective states of incorporation.

36. Upon dissolution, HOWIC, as a Virginia stock corporation, would be required to discharge its liabilities and distribute any remaining property among its shareholders according to their interests. VA. CODE ANN. § 13.1-745 (Michie 1999). Because HWC is HOWIC’s sole shareholder, any surplus assets remaining in HOWIC upon its dissolution must be distributed to HWC.

37. Upon dissolution, HOW, as a District of Columbia stock corporation, would be required to distribute any surplus among the stockholders in proportion to the respective amounts paid in by them severally on their shares of stock. D.C. CODE § 29-412 (2002). Because HWC is HOW’s sole shareholder, any surplus assets remaining in HOW upon its dissolution must be distributed to HWC.

38. HWC is a Delaware nonstock corporation. Under 8 DEL. CODE ANN. § 278 (2002), a corporation will continue after dissolution for purposes of any action, suit, or proceeding begun against the corporation prior to its dissolution, until such time as any judgments, orders, or decrees therein shall be fully executed. After all other obligations have been paid, the members receive the

residual assets. 8 DEL. CODE ANN. §§ 276, 275 (2002). As discussed above, the Deputy Receiver submits respectfully that, pursuant to VA. CODE ANN. § 38.2-1512, the federal Risk Retention Act, and the relevant facts and documents, it is those builders who had unexpired policies on the date of the Receivership Order who should be deemed entitled to any distribution of Residual Assets. The Deputy Receiver has also considered how those Residual Assets should be allocated equitably among these Builder Distributees.

DISTRIBUTION OF RESIDUAL ASSETS TO BUILDER DISTRIBUTEES

39. There is no guidance provided by Chapter 15 of Title 38.2 as to the manner in which the Residual Assets should be allocated among the Builder Distributees. In fact, Virginia law does not specifically address this issue. However, the Deputy Receiver believes that reference to the laws of other jurisdictions and general legal principles provide useful guidance. It should be noted *ab initio* that the Deputy Receiver has no economic stake in the manner in which the Residual Assets should be allocated among the Builder Distributees. His only goal as to this issue is to propose a methodology that is fair and reasonable under the circumstances.

40. In Huber v. Marin, 105 N.W. 1031 (Wis. 1906), a case involving a nonstock corporation operating as a mutual insurance company, the Wisconsin Supreme Court held that when a nonstock corporation is wound up, its net assets constitute a fund for distribution between those persons who are members at the time of dissolution, according to their respective contributions to the company's treasury. Id. at 1040. The Deputy Receiver believes that this is an equitable and practicable method to allocate any Residual Assets. Therefore, the Deputy Receiver proposes to distribute any Residual Assets to the Builder Distributees in amounts proportionate to a reasonable estimate of each respective Builder Distributee's relative contribution to HWC's treasury.

41. The Deputy Receiver proposes to allocate to each Builder Distributee a portion of the total Residual Assets pursuant to the methodology described in Exhibit "A-1" attached hereto ("Residual Assets Allocation Memorandum").

42. In this process, a determination must be made regarding the treatment of Builder Distributees who can no longer be found. Over the nearly 20-year span of the HOW Program, there have been over 20,000 Member-Builders. As of the date of the Receivership Order, 6,026 builders were insured under unexpired HOWIC policies. To be sure, there are a number of those builders, particularly the larger companies, who continue in business to this day.⁹ However, some of the builders with unexpired policies on the date of the Receivership Order were individuals or small companies who have since ceased conducting business. Some have become insolvent and others have simply wound down. In addition, many others have been sold or merged. Still others simply cannot be located. As discussed in greater detail below, the Deputy Receiver has concluded that under applicable law, shares of Residual Assets owed to Builder Distributees who could not be found must be distributed pursuant to applicable state laws governing the distribution of unclaimed property.

43. It is the well-established general rule that unclaimed liquidation distributions are to be delivered to the appropriate states pursuant to their unclaimed property laws, rather than, on a tontine principle, to the remaining owners of the liquidated corporation who can be found. See, e.g., In re Northeast Utils., 479 F. Supp. 194, 199 (D. Conn. 1979); In re Monks Club, Inc., 394 P.2d 804, 849-50 (Wash. 1964); State by Parsons v. Fidelity Union Trust Co., 136 A.2d 636, 641 (N.J. 1957).

⁹ As of November 1, 2004, twenty-one (21) builders remain insured under HOWIC policies that have not yet expired.

Generally, the dissolved corporation's receiver must hold unclaimed liquidation distributions until such time as they are claimed by the owners, or until such time as the unclaimed funds may be surrendered to the states pursuant to their unclaimed property laws. In re Monks Club, Inc., 934 P.2d at 850. However, the Deputy Receiver must first determine whether state unclaimed property laws are preempted by the federal Risk Retention Act.

44. The Deputy Receiver submits that the federal Risk Retention Act does not preempt state unclaimed property laws. The mere presence and operation of a federal regulatory statute does not, in every case, preempt state unclaimed property laws—if the state unclaimed property laws do not conflict with the federal statute, the state unclaimed property laws are not preempted. In re Northeast Util., 479 F. Supp. at 199. In the case at bar, the federal Risk Retention Act establishes a risk retention group's owner, but does not address the issue of the disposition of the interest of those owners who cannot be found. Because the federal Risk Retention Act is silent as to the issue addressed by state unclaimed property laws, the federal and state laws do not conflict and the state unclaimed property laws apply. However, the Deputy Receiver must determine to which state(s) he should surrender the HOW Companies' unclaimed property. The Deputy Receiver finds guidance in Virginia's unclaimed property statutes and relevant case law.

45. Virginia has adopted the Uniform Disposition of Unclaimed Property Act (the "UDUPA"). McDonald v. Treasurer of Virginia, 26 Va. Cir. 75, 76 (1991). The UDUPA is remedial legislation that puts an end to private escheats. Goldstein v. PHH Corp., 717 A.2d 950, 952 (Md. Ct. Spec. App. 1998); Riggs Nat'l Bank v. District of Columbia, 581 A.2d 1229, 1262 (D.C. 1990). The *lex fori* controls all that is connected merely with the remedy. Jones v. R.S. Jones &

Assocs., 246 Va. 3, 5, 431 S.E.2d 33, 34 (1993). Therefore, the Deputy Receiver looks first to the Virginia UDUPA.

46. The Virginia UDUPA does not provide for the reporting and remitting of all abandoned property in the possession of the holder. The statute provides that unless otherwise provided thereby or by other Virginia law, intangible property is subject to the custody of Virginia as unclaimed property if the conditions leading to a presumption of abandonment are satisfied and:

1. The last known address, as shown on the records of the holder, of the apparent owner is in this Commonwealth.

2. The records of the holder do not reflect the identity of the person entitled to the property and it is established that the last known address of the person entitled to the property is in this Commonwealth,

3. The records of the holder do not reflect the last known address of the apparent owner, and it is established that: (i) the last known address of the person entitled to the property is in this Commonwealth, or (ii) the holder is a domiciliary or a government or governmental subdivision or agency of this Commonwealth and has not previously paid the property to the state of the last known address of the apparent owner or other person entitled to the property,

4. The last known address, as shown on the records of the holder, of the apparent owner or other person entitled to the property is in a state that does not provide by law for the escheat or custodial taking of the property or its escheat or unclaimed property law is not applicable to the property and the holder is a domiciliary or a government or governmental subdivision or agency of this Commonwealth,

5. The last known address, as shown on the records of the holder, of the apparent owner is in a foreign nation and the holder is a domiciliary or a government or governmental subdivision or agency of this Commonwealth, or

6. (i) The transaction out of which the property arose occurred in this Commonwealth, and the last known address of the apparent owner or other person entitled to the property is unknown, or the last known address of the apparent owner or other person entitled to the property is in a state that does not provide by law for the escheat or custodial taking of the property or its escheat or unclaimed property law is not applicable to the property, and (ii) the holder is a domiciliary of a state that

does not provide by law for the escheat or custodial taking of the property or its escheat or unclaimed property law is not applicable to the property.

VA. CODE ANN. § 55-210.2:2 (Michie 2001 Supp.) (emphases added to highlight provisions which most likely will apply). Paragraph four of § 55-210.2:2 will not apply because every state other than Alaska provides for the escheat or custodial taking of intangible property, and the HOW Program was not active in Alaska.

47. The Virginia statute also includes a reciprocity provision whereby specific property otherwise deemed abandoned is not presumed abandoned in Virginia if it is payable to an owner whose last known address is in another state by a holder who is subject to the jurisdiction of that state and if:

a. [The property] may be claimed as abandoned or escheated under the laws of such other state, and

b. The laws of such other state make reciprocal provision that similar specific property is not presumed abandoned or escheatable by such other state when payable to an owner whose last known address is within this Commonwealth by a holder who is subject to the jurisdiction of this Commonwealth.

VA. CODE ANN. § 55-210.11 (Michie 2001 Supp.). Therefore, the Deputy Receiver must look to the state unclaimed property laws of the state of the last known address of each owner to whom unclaimed property is payable. For purposes of the statute, “last known address” is defined as “a description of the location of the apparent owner sufficient to identify the state of residence of the apparent owner for the purpose of the delivery of mail.” VA. CODE ANN. § 55-210.2 (Michie 2001 Supp.).

48. The Virginia statute, as applied to this receivership, would be consistent with decisions of the United States Supreme Court regarding abandoned property, which have held, with

regard to abandoned intangible property, that the state of the creditor's last known address, as shown by the debtor's books and records, is entitled to custody of the property owed him, except that if his address does not appear on the debtor's books or is in a state that does not provide for escheat or custodial taking of intangibles, then the state of the debtor's incorporation may take custody of the funds until some other state comes forward with proof that it has a superior right to custody or escheat. Pennsylvania v. New York, 407 U.S. 206, 210-11 (1972); Texas v. New Jersey, 379 U.S. 674, 681-82 (1965).

49. Therefore, as a general matter, the Deputy Receiver would be required to apply, to a distribution of Residual Assets owed to any Builder Distributee whose last known address is invalid, the unclaimed property laws of the state of the last known address. Most states appear to have shortened waiting periods, ranging from six months to two years, for determining abandonment in the case of corporations which have been dissolved. In some states, this shortened period applies to either voluntary or involuntary dissolution. In other states, the shortened period applies only to voluntary dissolution. Absent an applicable shortened waiting period, property is not considered abandoned until after the expiration of three to seven years, depending upon the state. The Deputy Receiver concludes that he should be authorized to create a trust to hold unclaimed distributions of Residual Assets (and unclaimed funds due to creditors) which could not, under applicable law, be delivered to the custody of the relevant states prior to the date that HWC would cease to exist.

50. As an example of the process of disposition of unclaimed property, the Deputy Receiver discusses briefly the applicable provisions of Virginia's UDUPA. For purposes of Virginia's UDUPA, "moneys" and "intangible ownership interests in business associations" are both considered intangible assets, and the Deputy Receiver is the "holder" of such assets with respect to

the Builder Distributees' ownership interests in HWC. VA. CODE ANN. § 55-210.2 (definitions of "intangible property" and "holder"). All intangible property, less any lawful charges, that is held, issued, or owing in the ordinary course of the holder's business, and has remained unclaimed by the owner for more than five years after it became payable is presumed abandoned, except as otherwise provided by statute. VA. CODE ANN. § 55-210.2:1 (Michie 2001 Supp.). However, all intangible property distributable in the course of a voluntary or involuntary dissolution of a business association which remains unclaimed by the owner for more than one year after the date for specified final distribution is presumed abandoned. VA. CODE ANN. § 55-210.7 (Michie 2001 Supp.). Therefore, the relevant period for determining when HWC liquidation distributions shall be presumed abandoned would be one year, rather than five years. In any event, any holder of tangible or intangible personal property, the owner of which cannot be located, may voluntarily report the property to the State Treasurer, prior to the statutory due dates, whereupon the property shall be presumed abandoned. VA. CODE ANN. § 55-210.10:2 (Michie 1995).¹⁰

II. PLANS OF LIQUIDATION

51. The Deputy Receiver has devised proposed Plans of Liquidation for the satisfaction of all the HOW Companies' liabilities and the subsequent wind down and liquidation of their affairs.

52. By this Application, the Deputy Receiver seeks authority from the Commission, to adopt the HOWIC Plan of Liquidation (a summary of which is included in Exhibit "A" hereto), if

¹⁰ Pursuant to reciprocity arrangements between Virginia and certain other states, the Deputy Receiver may voluntarily report to the Virginia State Treasurer, prior to the statutory due dates, unclaimed property whose owners' last known addresses were in those other states, whereupon the property shall be presumed abandoned and may be distributed to the reciprocal states by the Virginia State Treasurer.

and when he files a written report with the Commission advising that he has received an actuarial projection that HOWIC has sufficient assets to satisfy its liabilities, and to declare a dividend to HWC sufficient for HWC to satisfy its liabilities, including the refund of all vested capital contributions. Pursuant to the HOWIC Plan of Liquidation, which shall be consistent with the IRS Ruling, the Deputy Receiver would:

- a. **Be authorized to liquidate HOWIC and transfer its assets, along with any remaining liabilities, to HWC,**
- b. **Issue a directive establishing a period for the filing of proofs of claims against the HOW Companies, beginning on the date of issuance of the directive and ending on a specified deadline (the "Bar Date"), and mail and publish notices of such Bar Date to all interested parties, as described in greater detail below,**
- c. **Pay the costs and expenses of the HOW Companies' administration, pursuant to VA. CODE ANN. §§ 38.2-1509(B)(1) and 38.2-1510,**
- d. **Pay the claims of the HOW Companies' secured creditors, pursuant to VA. CODE ANN. § 38.2-1509.B.1(i),**
- e. **Adjudicate, and pay in full, the claims of policyholders arising out of the HOW Companies' insurance contracts, pursuant to VA. CODE ANN. § 38.2-1509.B.1(ii),**
- f. **Pay the HOW Companies' taxes, pursuant to VA. CODE ANN. § 38.2-1509.B.1(iii),**
- g. **Pay wages of the HOW Companies' employees entitled to priority, pursuant to VA. CODE ANN. § 38.2-1509.B.1(iv),**

h. Adjudicate, and pay in full, general creditor claims against the HOW Companies, pursuant to VA. CODE ANN. § 38.2-1509.B.1(v),

i. Pay interest on claims in the same order of priority as the payment of the underlying claims, and

j. Begin the liquidation of HOWIC in the year in which HOWIC makes its first distribution of assets to HWC (the "Distribution Year") and, under applicable tax rules, complete the liquidation of HOWIC by the end of the third calendar year following the Distribution Year (the "Liquidation Period").

53. The Deputy Receiver also proposes that if he does not issue a directive adopting the HOWIC Plan of Liquidation within three years of the Commission's order, then the order should require him to return to the Commission for further instruction.

54. Contingent upon the Deputy Receiver adopting the HOWIC Plan of Liquidation and completing the actual liquidating distributions from HOWIC to HWC pursuant thereto, the Deputy Receiver seeks authority to issue another directive adopting the HOW/HWC Plan of Liquidation (a summary of which is included in Exhibit "A" hereto), pursuant to which the Deputy Receiver would:

a. Continue managing the affairs of the HOW Companies until such time as they are liquidated and dissolved,

b. Pay the costs and expenses of the HOW Companies' administration, pursuant to VA. CODE ANN. §§ 38.2-1509(B)(1) and 38.2-1510,

c. Adjudicate, and pay in full, the claims of policyholders arising out of the HOW Companies' insurance contracts, pursuant to VA. CODE ANN. § 38.2-1509.B.1(ii),

- d. Pay the HOW Companies' taxes, pursuant to VA. CODE ANN. § 38.2-1509.B.1(iii),
- e. Pay wages of the HOW Companies' employees entitled to priority, pursuant to VA. CODE ANN. § 38.2-1509.B.1(iv),
- f. Adjudicate, and pay in full, general creditor claims against the HOW Companies, including the refund of all vested capital contributions to Eligible Builders, pursuant to VA. CODE ANN. § 38.2-1509.B.1(v),
- g. Pay interest on claims in the same order of priority as the payment of the underlying claims,
- h. **Take all** steps necessary and appropriate to liquidate and dissolve HOW as soon as reasonably practicable,
- i. **Be authorized** to cause any third party or contractor of the HOW Companies to assume remaining obligations and contingencies of HOWIC, HOW, or HWC, in exchange for reasonable consideration, to complete the liquidation and dissolution of such entities, and be authorized to obtain an independent opinion from an actuarial or accounting firm regarding the reasonableness of consideration paid for the assumption of HOWIC, HOW, or HWC obligations or contingencies,
- j. **Be authorized** to maintain a \$10 million reserve for claims, costs, expenses, unknown claims, and contingencies, over and above any existing reserves for insurance/warranty claims, until final liquidation of HWC,

k. Return to the Commission for further instruction if he determines that the amount of Residual Assets is so small as to make a distribution to Builder Distributees impracticable,

l. After the final wind down of HOWIC is completed, be authorized to cause HWC to distribute any Residual Assets to those builders who were HOWIC insureds as of the date of the Receivership Order, with each such Builder Distributee receiving a share of any Residual Assets which is proportionate to the Builder Distributee's respective contribution to HWC's treasury, under the following conditions: (i) the Deputy Receiver adopts a directive implementing the HOWIC Plan of Liquidation, (ii) the Deputy Receiver completes the HOWIC Plan of Liquidation and distributes HOWIC's assets and remaining liabilities to HWC during the Liquidation Period, and (iii) after receipt of HOWIC's assets and remaining liabilities, HWC first satisfies its own liabilities and those of HOW and HOWIC before distributing any Residual Assets to the Builder Distributees. The proposed methodology for allocating Residual Assets among Builder Distributees is described in Exhibit "A-1" hereto,

m. In the event that he could not find any person owed funds by the HOW Companies, including any Builder Distributee owed a distribution of Residual Assets, deliver such unclaimed funds to the custody of the state of that person's last known address, as shown by the HOW Companies' books and records, pursuant to the procedures established by that state's unclaimed property laws (or, if permitted by reciprocity arrangements, to the Virginia State Treasurer on behalf of such other state),

n. Be authorized to create a trust to hold any unclaimed funds if the applicable state unclaimed property laws do not permit him to deliver any such unclaimed funds to the relevant

states prior to the date that HWC would cease to exist and the receivership would terminate (and if no reciprocity arrangement allows him to deliver the unclaimed funds to the Virginia State Treasurer on such other states' behalf), and

o. Dissolve HWC upon: (i) payment of its liabilities with all available assets, or (ii) distribution of all Residual Assets.

55. In support of the Application, the Deputy Receiver brings certain matters to the Commission's attention.

56. HWC was organized for the following purposes: (1) to provide a program whereby consumers could be better assured that new homes they purchased were produced to an acceptable standard and were the subject of a warranty, with such warranty being backed by HWC, its subsidiary corporations, and/or one or more insurance companies, (2) to provide a program whereby home builders provided warranty coverage on new homes they constructed backed by HWC, its subsidiary corporations, and/or one or more insurance companies, and (3) to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware.

57. Prior to the receivership of the HOW Companies, any builder who executed a Builder Agreement became a Member-Builder registered under, and entitled to participate in, the HOW Program. The primary purpose of membership in HWC was to allow the Member-Builder to participate in the HOW Program for a one-year period. Membership in HWC entitled the Member-Builder to enroll new homes in the HOW Program.

58. The Builder Agreement did not vest the Member-Builder with any rights to distributions of profits or other assets of the HOW Companies, other than: (1) return of vested

builder capital contribution amounts upon termination, other than for cause, if the builder had been a member in good standing for at least five continuous years, and (2) in some cases, a refund of certain loss reserve deposits.

59. Under its terms, each Builder Agreement terminated automatically if the Member-Builder did not, prior to the expiration of the one-year term thereof, submit an application for re-registration, accompanied by a non-refundable enrollment fee, and receive approval of such application. After inception of the receivership on October 14, 1994, the Deputy Receiver did not approve any applications for re-registration, and each Builder Agreement terminated automatically during calendar year 1994 or 1995, at the expiration of its one-year term. However, by the terms of the Builder Agreements, termination did not waive or limit HOW's remedies, including any rights of defense, indemnification, or reimbursement of HOW or HOWIC under Sections 4.07, 6.03, 7.05, or 9.04 of the Builder Agreement and similar provisions for previously enrolled homes. All builders in good standing continue to be entitled to insurance coverage under their ten-year policies until expiration thereof, as to each home enrolled in the HOW Program.

60. Because all Builder Agreements terminated automatically within one year of the receivership, the Deputy Receiver believes that it is necessary and appropriate, in furtherance of the proposed HOW/HWC Plan of Liquidation, for HWC to refund such capital contributions to Eligible Builders as are refundable pursuant to the terms of the Builder Agreements, if and when sufficient funds become available for HWC to do so. There were Builder Agreements with former Member-Builders which terminated for cause before or after October 14, 1994, and these former Member-Builders are, pursuant to the terms of the Builder Agreements, ineligible to receive a return of capital contributions. In addition, there were Member-Builders who terminated their Builder

Agreements voluntarily, but whose capital contributions had not vested prior to the date the receivership was initiated, and which are, therefore, not refundable under the terms of such Builder Agreements. Finally, there were Member-Builders who were in good standing as of October 14, 1994, but who had not been members in good standing for at least five continuous years as of the date their Builder Agreements were terminated automatically for non-renewal. The Deputy Receiver believes that this latter group of Member-Builders should be treated as if they meet the five-year requirement, because their Builder Agreements were terminated neither voluntarily nor for cause but as the result of the receivership.

61. The Deputy Receiver further believes that he should be authorized to liquidate and dissolve HOW in calendar year 2005, or as soon thereafter as reasonably possible, because this subsidiary of HWC no longer serves a useful purpose.

62. The Deputy Receiver further believes that because HOWIC has returned to solvency and the vast majority of HOWIC certificates and policies have expired, he should be authorized to issue a directive whereby HOWIC would be liquidated and its assets transferred, along with any remaining liabilities, into HWC over the Liquidation Period. HOWIC's activities are limited to the run off of obligations under the HOW warranties. The substantial majority of HOW warranties will have expired by the end of 2004, and the Deputy Receiver should be able to pay, or make adequate provision for, HOWIC's obligations and contingencies by the end of calendar year 2005 or soon thereafter.

63. The Deputy Receiver further believes that after the dissolution and liquidation of HOW and HOWIC, he should be authorized, subject to the conditions set forth in paragraph 54 hereof, to cause HWC to distribute any Residual Assets to those persons who were HOWIC insureds

as of the date of the Receivership Order, with each such Builder Distributee receiving a share of any Residual Assets which is proportionate to the Builder Distributee's respective contribution to HWC's Residual Assets pursuant to the methodology set forth in Exhibit "A-1" hereto. HWC does not conduct any business outside of its operating subsidiaries. HWC would be dissolved upon: (i) payment of its liabilities with all available assets, or (ii) distribution of Residual Assets to the Builder Distributees.¹¹ In the event that the amount of Residual Assets were to be so small as to make a distribution to Builder Distributees impracticable, the Deputy Receiver should be authorized to return to the Commission for further instruction. The Deputy Receiver requests that the Commission's order provide that upon the completion of such liquidations and dissolutions of HOW, HOWIC, and HWC pursuant to the Plans of Liquidation, the receivership proceeding would be terminated without the necessity of further order unless the Deputy Receiver determines that he should seek a specific order of discharge or some other order from the Commission.

64. In order to bring finality to the financial affairs of the HOW Companies, in furtherance of the Plans of Liquidation, it would be both necessary and appropriate to establish a deadline (the "Bar Date") for filing all claims against the HOW Companies (including contingent claims, claims of Eligible Builders for refunds of capital contributions, and claims for increased percentage payments on previously approved claims), with the exception of the following specifically enumerated types of claims, which would not be subject to the Bar Date:

a. Claims of any kind that have already been submitted properly to the Deputy Receiver, whether general creditor claims, claims for repairs of Major Structural Defects, claims for

¹¹ But see note 10, *supra*.

payment of builder defense costs, claims for breach of warranty, or any other claims, except that, to the extent that a claimant has not submitted the affidavit required to perfect a claim for an increased percentage payment of an approved claim pursuant to a Distribution Notification, such claim for an increased percentage payment of a previously approved claim shall be subject to the Bar Date,

b. Proper administrative expense claims (*i.e.*, claims for payment of services rendered, or goods supplied, to the HOW Companies at the request of the Deputy Receiver after October 14, 1994),

c. Claims covered by the HOW Companies' policies and certificates for the repair of covered Major Structural Defects that have not yet manifested themselves as of the Bar Date,

d. Claims by builders for refund of Loss Reserve Deposits, or release of letters of credit, and

e. Claims by Builder Distributees to a share of the Residual Assets.

65. The Deputy Receiver submits that the Plans of Liquidation should provide for his establishment by directive of a period for filing proofs of claims against the HOW Companies, such filing period to end on the Bar Date. The Bar Date would be no less than 180 days, nor more than 365 days, following the date of the Deputy Receiver's issuance of the directive establishing the filing period and Bar Date. The Deputy Receiver requests authority, in his reasonable discretion as part of the Plans of Liquidation, to extend the initial Bar Date by directive to a date no more than 365 days following the date of the directive establishing the initial Bar Date, if the initial Bar Date provides for a filing period of less than 365 days. The Deputy Receiver requests approval for a requirement that all claims against the HOW Companies, except those falling in categories "a"

through "e" described in the preceding paragraph, be filed before the Bar Date. He requests, in addition, that approved claims filed after the Bar Date (including contingent claims, claims of Eligible Builders for refunds of capital contributions, and claims for increased percentage payments on previously approved claims), with the exception of claims falling in categories "a" through "e" described in the preceding paragraph, be subordinated in payment to all timely filed claims. All claims of whatsoever nature should be permanently barred from sharing in the assets of the HOW Companies if such claims are not submitted to the Deputy Receiver before closure of the receivership, with the exception of the claims described in category "e" in the preceding paragraph, which shall be governed by the unclaimed property laws. The Deputy Receiver would provide written notice by first-class United States mail to all known claimants, creditors, and former Member-Builders of the Bar Date (and any extension thereof) and proof of claim instructions at their last known address disclosed in the books and records of the HOW Companies, in a form reasonably calculated to provide interested persons with notice of the Bar Date (and any extension thereof) and the consequences of failing to timely file claims against the HOW Companies. However, the Deputy Receiver requests authority for the following modifications:

- a. the Deputy Receiver should not be required to mail a notice if he reasonably believes that the last known address is no longer valid, and
- b. The Deputy Receiver should also publish notice of the Bar Date (and any extension thereof) for one day each week for two consecutive weeks in the Richmond Times-Dispatch, The Wall Street Journal, and USA Today. The publication notice would be of a form reasonably calculated to provide sufficient notice to any claimant, creditor, or former Member-Builder who does not receive written notice of the Bar Date (and any extension thereof).

III. HEARING

66. The Deputy Receiver requests that the Commission hold a hearing for the consideration of the foregoing.

67. No later than 60 days before the hearing, the Deputy Receiver would provide written notice by first-class United States mail, in a form reasonably calculated to provide sufficient notice of the hearing on the Plans of Liquidation, to the last known address on the books and records of the HOW Companies of all known creditors, claimants, and former Member-Builders of the HOW Companies.

68. Beginning no later than 60 days before the hearing, the Deputy Receiver proposes to publish notice in a form reasonably calculated to provide sufficient notice of the hearing on the Plans of Liquidation to any creditor, claimant, former Member-Builder, or interested party of the HOW Companies who does not receive direct notice by first-class United States mail. Such notice would be published for at least one day each week for two consecutive weeks in the Richmond Times-Dispatch, The Wall Street Journal, and USA Today. The Deputy Receiver requests authority to use publication notice, in lieu of notice by first-class United States mail, if the Deputy Receiver reasonably believes that the last known address is no longer valid for any creditor, claimant, or former Member-Builder of the HOW Companies.

69. The Deputy Receiver requests that all persons who expect to appear at the hearing for the purpose of supporting or opposing the Plans of Liquidation or related actions requested in the Application be required, no later than 30 days before the hearing, to file with the Commission, and provide a copy to the Deputy Receiver, a Notice of Participation as Respondent, which shall set forth a full statement of the basis of the support or opposition, including: (i) a precise statement of the

interest of the respondent, (ii) a statement of the specific relief sought, to the extent then known, (iii) the factual and legal basis for the relief sought, (iv) the substance of the anticipated testimony in support or opposition, and (v) a list of exhibits to be offered in support of, or in opposition to, the Plans of Liquidation.

70. The Deputy Receiver further requests that all persons who timely file a Notice of Participation as Respondent, and who wish to participate in the hearing thereon, be required to file with the Commission and deliver a copy to the Deputy Receiver, no later than 20 days before the hearing, the prepared testimony and exhibits of each witness expecting to present direct testimony in support of, or in opposition to, the Plans of Liquidation or related actions requested in the Application.

WHEREFORE, PREMISES CONSIDERED, the Deputy Receiver requests:

1. An order:
 - a. **Setting a hearing for the consideration and requested approval of the Plans of Liquidation,**
 - b. Approving the Deputy Receiver's proposal to provide notice by first-class United States mail to all known claimants, creditors, and former Member-Builders of the HOW Companies, such notice to be mailed no later than 60 days before the hearing by first-class United States mail to the last known address of known creditors, claimants, and former Member-Builders as disclosed in the books and records of the HOW Companies, and to be of a form reasonably calculated to provide sufficient notice of the hearing on the Plans of Liquidation,
 - c. Approving publication of notice, in a form reasonably calculated to provide sufficient notice of the hearing on the Plans of Liquidation to any creditor, claimant, former Member-

Builder, or interested party of the HOW Companies who does not receive direct notice by first-class United States mail, in the Richmond Times-Dispatch, The Wall Street Journal, and USA Today, for at least one day each week for two consecutive weeks beginning no later than 60 days before the hearing,

d. Approving that Notice by publication as sufficient notice, in lieu of notice by first-class United States mail, if the Deputy Receiver reasonably believes that the last known address is no longer valid,

e. Directing all persons who expect to appear at the hearing for the purpose of supporting or opposing the Plans of Liquidation or related actions requested by the Application, no later than 30 days before the hearing, to file with the Commission, and provide a copy to the Deputy Receiver, a Notice of Participation as Respondent, which shall set forth a full statement of the basis of the support or opposition, including: (i) a precise statement of the interest of the respondent, (ii) a statement of the specific relief sought, to the extent then known, (iii) the factual and legal basis for the relief sought, (iv) the substance of the anticipated testimony in support or opposition, and (v) a list of exhibits to be offered in support of, or in opposition to, the Plans of Liquidation, and

f. Directing all persons who expect to appear at the hearing for the purpose of supporting or opposing the Plans of Liquidation or related actions requested by the Application to file with the Commission and deliver a copy to the Deputy Receiver, no later than 20 days before the hearing, the prepared testimony and exhibits of each witness expecting to present direct testimony in support of, or in opposition to, the Plans of Liquidation or related actions requested in the Application.

g. Providing that all Notices of Participation as Respondent, pre-filed testimony and exhibits, and all other pleadings or related documents shall be deemed filed with the Commission only upon receipt of the original and fifteen (15) copies thereof by the Clerk of the Commission at the following address: State Corporation Commission, P.O. Box 1197, Richmond, Virginia 23218; and that service of one complete copy of any required filing shall also be made on the Special Deputy Receiver at 7501C North Capital of Texas Highway, Suite 200, Austin, Texas 78731, on or before the date required for filing with the Commission.

2. Following the hearing, a second order (the "Order Approving Plans of Liquidation"):

a. Declaring that further efforts to rehabilitate the HOW Companies would be useless, and that the HOW Companies should be liquidated pursuant to the Plans of Liquidation,

b. Authorizing the Deputy Receiver to adopt a directive implementing the HOWIC Plan of Liquidation, described in paragraph 52 hereof and in Exhibit "A" hereto, if and when he files a written report with the Commission advising that he has received an actuarial projection that HOWIC has sufficient assets to satisfy its liabilities and to declare a dividend to HWC sufficient for HWC to satisfy its liabilities, including the refund of all vested capital contributions,

c. Requiring the Deputy Receiver, if he does not issue a directive adopting the HOWIC Plan of Liquidation within three years of the Order Approving Plans of Liquidation, to return to the Commission for further instruction,

d. Contingent upon the Deputy Receiver adopting the HOWIC Plan of Liquidation and completing the actual liquidating distributions from HOWIC to HWC pursuant

thereto, authorizing him to issue a second directive adopting the HOW/HWC Plan of Liquidation, described in paragraph 54 hereof and in Exhibit "A" hereto,

e. Declaring that the rights, interests, and contingent claims of all builders, policyholders, certificate holders, and creditors of the HOW Companies are fixed as of the date of the entry of the Order Approving Plans of Liquidation,

f. Declaring that the only former members of HWC who are entitled to any refund of capital contributions pursuant to the Builder Agreements are those whose capital contributions vested pursuant to the terms of the Builder Agreements and who either: (i) after the inception of the receivership, had their Builder Agreements automatically terminated during 1994 and 1995 upon expiration of their Builder Agreements' one-year terms, or (ii) voluntarily terminated their Builder Agreements either before inception of the receivership or prior to the date that such Builder Agreements would have terminated automatically during 1994 or 1995 upon expiration of their one-year terms, and who at the time of termination had been members in good standing for at least five consecutive years (collectively, "Eligible Builders"),¹²

¹² There were Member-Builders who were in good standing as of October 14, 1994, but who had not been members in good standing for at least five continuous years as of the date their Builder Agreements were terminated automatically for non-renewal. The Deputy Receiver believes that such Member-Builders should be treated as if they meet the five-year vesting requirement, because their Builder Agreements were terminated neither voluntarily, nor for cause, but as the result of the receivership. In addition, the Deputy Receiver believes that Member-Builders who were terminated only for filing bankruptcy prior to receivership should be treated as if they meet the five-year vesting requirement because their terminations were pursuant to so-called *ipso facto* clauses which federal bankruptcy courts have held are void as a matter of law. Other builders are not eligible for capital contribution refunds because they were terminated for cause other than bankruptcy or terminated their Builder Agreements voluntarily prior to the vesting of capital contributions. Those non-refundable capital contributions are deemed by the Deputy Receiver to belong to HWC, for the benefit of its owners.

g. Declaring that the HOW Companies' owners, who are entitled to any Residual Assets upon dissolution, are those persons who were HOWIC insureds as of the date of the Receivership Order (regardless of whether those persons are also Eligible Builders), with each such Builder Distributee to receive a share of any Residual Assets which is proportionate to the Builder Distributee's respective contribution to HWC's treasury, pursuant to the methodology set forth in Exhibit "A-1" hereto,

h. Authorizing the Deputy Receiver, in his reasonable discretion, to establish by directive a period for filing proofs of claims against the HOW Companies, such filing period to end on the Bar Date (such Bar Date to be no less than 180 days, nor more than 365 days, following the date of the Deputy Receiver's issuance of the directive). All Claims (including contingent claims, claims of Eligible Builders for refunds of capital contributions, and claims for increased percentage payments on previously approved claims) against the HOW Companies would be required to be filed before the Bar Date except that the following claims would not be subject to the Bar Date:

i. Claims of any kind that have already been submitted properly to the Deputy Receiver, whether general creditor claims, claims for repairs of Major Structural Defects, claims for payment of builder defense costs, claims for breach of warranty, or any other claims, except that, to the extent that a claimant has not submitted the affidavit required to perfect a claim for an increased percentage payment of an approved claim pursuant to a Distribution Notification, such claim for an increased percentage payment of a previously approved claim shall be subject to the Bar Date.

ii. Proper administrative expense claims (*i.e.*, claims for payment of services rendered, or goods supplied, to the HOW Companies at the request of the Deputy Receiver after October 14, 1994),

iii. Claims covered by HOW Companies' policies and certificates for the repair of covered Major Structural Defects that have not yet manifested themselves as of the Bar Date,

iv. Claims by builders for refund of Loss Reserve Deposits, or release of letters of credit, and

v. Claims by Builder Distributees to a share of the Residual Assets.

Claims submitted after the Bar Date, if approved, would be subordinated in payment to all timely filed claims, with the exception of the claims described in categories "i" through "v" above, which would not be subject to the Bar Date. All claims of whatsoever nature would be permanently barred from sharing in the assets of the HOW Companies if such claims were not submitted to the Deputy Receiver before closure of the receivership, with the exception of claims described in category "v" above, which would be governed by the unclaimed property laws,

i. Ordering that disputes concerning any claims against the assets of the HOW Companies shall be resolved in accordance with the Receivership Appeal Procedure adopted by the Circuit Court in the Receivership Order,

j. Authorizing the Deputy Receiver, in his reasonable discretion as part of the Plans of Liquidation, to extend the initial Bar Date by directive to a date no more than 365 days following the date of the directive establishing the initial Bar Date, if the initial Bar Date results in a filing period of less than 365 days,

k. Approving the Deputy Receiver's proposal to provide written notice of the Bar Date (and any extension thereof) and proof of claim instructions, by first-class United States mail to all known claimants, creditors, and former Member-Builders at their last known address disclosed in the books and records of the HOW Companies, in a form reasonably calculated to provide interested persons with notice of the proposed Bar Date (and any extension thereof), and the consequences of failing to timely file claims against the HOW Companies, except that the Deputy Receiver would not be required to mail a notice if he reasonably believes that the last known address is no longer valid,

l. Approving the Deputy Receiver's proposal to publish notice of the Bar Date (and any extension thereof) and proof of claim instructions for one day each week for two consecutive weeks in the Richmond Times-Dispatch, The Wall Street Journal, and USA Today. The publication notice would be of a form reasonably calculated to provide sufficient notice to any claimant, creditor, or former Member-Builder who does not receive direct notice by first-class United States mail of the Bar Date (and any extension thereof) and proof of claim instructions,

m. Approving the termination and closure of these receivership proceedings without the necessity for further order of the Commission upon completion of the liquidation and dissolution of HOW, HOWIC, and HWC pursuant to the Plans of Liquidation, unless the Deputy Receiver were to determine that he should seek a specific order of discharge or some other order from the Commission, and

n. Granting such other and further relief as the Commission may deem proper under the circumstances.

Respectfully submitted,

Alfred W. Gross, Commissioner of Insurance, State
Corporation Commission, Bureau of Insurance, as
Deputy Receiver of HOW Insurance Company, a Risk
Retention Group, Home Owners Warranty
Corporation, and Home Warranty Corporation

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EXHIBITS:

- A. Summary of Plans of Liquidation
- A-1 Residual Assets Allocation Memorandum

EXHIBIT A

SUMMARY OF PLANS OF LIQUIDATION FOR HOW INSURANCE COMPANY, A RISK RETENTION GROUP, HOME OWNERS WARRANTY CORPORATION, AND HOME WARRANTY CORPORATION

THE HOWIC PLAN OF LIQUIDATION:

The Deputy Receiver shall be authorized to adopt a directive implementing the HOWIC Plan of Liquidation if, within three years of the date of entry of the Order, he files a written report with the Commission advising that: (i) the Deputy Receiver has obtained a "tax free liquidation" private letter ruling from the Internal Revenue Service, establishing that the liquidation of a solvent HOWIC, and transfer of its assets and any remaining liabilities into HWC would qualify as a liquidation for which no gain or loss would be recognized by HOWIC or HWC, and (ii) the Deputy Receiver has received an actuarial projection that HOWIC has sufficient assets to satisfy its liabilities and to declare a dividend to HWC sufficient to enable HWC to satisfy all of HWC's liabilities, including the refund of all vested capital contributions. If the Deputy Receiver does not issue a directive implementing the HOWIC Plan of Liquidation within three years of the date of the Order, the Deputy Receiver shall return to the Commission for further instruction. Pursuant to the HOWIC Plan of Liquidation, the Deputy Receiver shall:

1. Liquidate HOWIC and transfer its assets, along with any remaining liabilities, to HWC,
2. Issue a directive establishing a period for the filing of proofs of claims against the HOW Companies, beginning on the date of issuance of the directive and ending on a specified deadline (the "Bar Date"), and mail and publish notices of such Bar Date to all interested parties,
3. Pay the costs and expenses of the HOW Companies' administration, pursuant to VA. CODE ANN. §§ 38.2-1509(B)(1) and 38.2-1510,
4. Pay the claims of the HOW Companies' secured creditors, pursuant to VA. CODE ANN. § 38.2-1509.B.1(i),
5. Adjudicate, and pay in full, the claims of policyholders arising out of the HOW Companies' insurance contracts, pursuant to VA. CODE ANN. § 38.2-1509.B.1(ii),
6. Pay the HOW Companies' taxes, pursuant to VA. CODE ANN. § 38.2-1509.B.1(iii),
7. Pay wages of the HOW Companies' employees entitled to priority, pursuant to VA. CODE ANN. § 38.2-1509.B.1(iv),
8. Adjudicate, and pay in full, general creditor claims against the HOW Companies, pursuant to VA. CODE ANN. § 38.2-1509.B.1(v), and
9. Begin the liquidation of HOWIC in the year in which HOWIC makes its first distribution of assets to HWC (the "Distribution Year") and, under applicable tax rules, complete the liquidation of HOWIC by the end of the calendar year following the Distribution Year (the "Liquidation Period").

THE HOW/HWC PLAN OF LIQUIDATION:

Contingent upon the Deputy Receiver adopting the HOWIC Plan of Liquidation and completing the actual liquidating distributions from HOWIC to HWC pursuant thereto, the Deputy Receiver is authorized to issue a second directive adopting and implementing the HOW/HWC Plan of Liquidation, pursuant to which he shall:

1. Continue managing the HOW Companies' affairs until such time as they are liquidated and dissolved,
2. Pay the costs and expenses of the HOW Companies' administration, pursuant to VA. CODE ANN. §§ 38.2-1509(B)(1) and 38.2-1510,
3. Adjudicate, and pay in full, the claims of policyholders arising out of the HOW Companies' insurance contracts, pursuant to VA. CODE ANN. § 38.2-1509.B.1(ii),
4. Pay the HOW Companies' taxes, pursuant to VA. CODE ANN. § 38.2-1509.B.1(iii),
5. Pay wages of the HOW Companies' employees entitled to priority, pursuant to VA. CODE ANN. § 38.2-1509.B.1(iv),
6. Adjudicate, and pay in full, general creditor claims against the HOW Companies, including the refund of all vested capital contributions to Eligible Builders, pursuant to VA. CODE ANN. § 38.2-1509.B.1(v),
7. Take all steps necessary and appropriate to liquidate and dissolve HOW as soon as reasonably practicable,
8. Be authorized to cause any third party or contractor of the HOW Companies to assume remaining obligations and contingencies of HOWIC, HOW, or HWC, in exchange for reasonable consideration, to complete the liquidation and dissolution of such entities, and be authorized to obtain an independent opinion from an actuarial or accounting firm regarding the reasonableness of consideration paid for the assumption of HOWIC, HOW, or HWC obligations or contingencies,
9. Be authorized to maintain a \$10 million reserve for claims, costs, expenses, unknown claims, and contingencies, over and above any existing reserves for insurance/warranty claims, until final liquidation of HWC,
10. Return to the Commission for further instruction if the amount of Residual Assets were to be so small as to make a distribution to Builder Distributees impracticable,
11. After the final wind down of HOWIC is completed, be authorized to cause HWC to distribute any Residual Assets to those builders who were HOWIC insureds as of the date of the Commission's order placing HOWIC in receivership, with each such Builder Distributee receiving a share of any Residual Assets which is proportionate to the Builder Distributee's respective contribution to HWC's treasury, under the following conditions: (i) the Deputy Receiver adopts a directive implementing the HOWIC Plan of Liquidation, (ii) the Deputy Receiver completes the HOWIC Plan of Liquidation and distributes HOWIC's assets and remaining liabilities to HWC during the Liquidation Period, and (iii) after receipt of HOWIC's assets and

- remaining liabilities, HWC first satisfies all liabilities of itself, HOW, and HOWIC before distributing any Residual Assets to the Builder Distributees,¹
12. In the event that he cannot find any person owed funds by the HOW Companies, including any Builder Distributee owed a distribution of Residual Assets, deliver such unclaimed funds to the custody of the State of that person's last known address, as shown by the HOW Companies' books and records, pursuant to the procedures established by that State's unclaimed property laws,
 13. Be authorized to create a trust to hold any unclaimed funds if the applicable State unclaimed property laws did not permit him to deliver any such unclaimed funds to the relevant States prior to the date that HWC would cease to exist and the receivership would terminate, and
 14. Dissolve HWC upon: (i) payment of its liabilities with all available assets, or (ii) distribution of Residual Assets.

¹The methodology for allocating Residual Assets among Builder Distributees is described in Exhibit "A-1" to the Application.

EXHIBIT A - SUMMARY OF PLANS OF LIQUIDATION FOR HOW INSURANCE COMPANY,
A RISK RETENTION GROUP, HOME OWNERS WARRANTY CORPORATION, AND
HOME WARRANTY CORPORATION

EXHIBIT A.1

RESIDUAL ASSETS ALLOCATION MEMORANDUM

TABLE OF CONTENTS

I. OVERVIEW 1

II. BASIC PRINCIPLES AND METHODOLOGY 1

 A. Introduction 1

 B. General Methodology for Distribution(s) of Residual Assets 3

 C. Assumptions and Practices 6

 D. Detailed Methodology 7

RESIDUAL ASSETS ALLOCATION MEMORANDUM

I. OVERVIEW

This memorandum describes the methodology for calculating each Builder Distributee's allocated share of any Residual Assets remaining upon the liquidation of Home Warranty Corporation ("HWC"), including each Builder Distributee's share of any interim distribution of assets, pursuant to the plan of liquidation for HWC (the "HWC Plan of Liquidation").

The methodology described herein is intended to provide a fair and equitable allocation of any Residual Assets among the Builder Distributees.¹

Capitalized terms used in this Exhibit have the meanings ascribed to them in the HWC Plan of Liquidation, in the Deputy Receiver's Application for Approval of the HWC Plan of Liquidation, or in this Exhibit.

II. BASIC PRINCIPLES AND METHODOLOGY

A. Introduction

Upon liquidation of HWC, Residual Assets are expected to remain.² Those Residual Assets will be allocated among, and distributed to, the Builder Distributees, in one or more installments, as follows:

1. The Main Distribution

The Main Distribution will account for the bulk of any Residual Assets. The Main Distribution will be calculated as of December 31st of the calendar year in which the last HOWIC policy expires or a subsequent date chosen by the Deputy Receiver at his sole discretion. However, the Main Distribution shall be calculated as of a date no later than December 31st of the calendar year immediately following the year in which the last outstanding HOWIC insurance/warranty claim is finally settled or adjudicated (the "Claims Resolution Date"). If, in his sole discretion, the Deputy Receiver selects the Claims Resolution Date as the calculation date for the Main Distribution, the Main Distribution will be the ultimate distribution and no subsequent Final Distribution (see below) will be necessary. Alternatively, the Deputy Receiver may, at his sole discretion, select for the Main

¹ See In re Reorganization of Medical Inter-Ins. Exchange of New Jersey, 746 A.2d 25, 33, 36 (N.J. Super. Ct. App. Div. 2000) (affirming hearing officer's finding that insurance company's allocation plan was fair, where a company officer testified, albeit without the benefit of an actuarial opinion, that the allocation plan was a fair and reasonable compromise between a potentially unfair approach and a practically impossible approach).

² Pursuant to the HWC Plan of Liquidation, capital contributions are refunded to Eligible Builders pursuant to the terms of the Builder Agreements as a contractual matter, before the calculation and distribution of any Residual Assets.

Distribution a calculation date earlier than the Claims Resolution Date. In that event, a subsequent Final Distribution may be required after all HOW Companies' losses, expenses, and other liabilities have been paid in full and HWC may be finally liquidated. The detailed methodology for calculating the Main Distribution is described in Part II.D, *infra*.

2. Interim Distribution(s)

At his sole discretion, the Deputy Receiver may, after giving consideration to assets available, anticipated losses and expenses, and other relevant factors:

- a. direct that one or more per Interim Distribution(s) be made to all Builder Distributees prior to the Main Distribution,
- b. limit any Interim Distribution(s) to Builder Distributees who do not have open claims,
- c. decide that no Interim Distribution(s) shall be made, and/or
- d. either calculate the Interim Distribution(s) pursuant to the detailed methodology described in Part II.D, *infra*, or limit any Interim Distribution(s) to a partial advance of his best estimate of what will be the Fixed Component of the Main Distribution (in which case the Deputy Receiver shall deduct any amounts owed to the HOW Companies by Builder Distributees for loss participation or other items).

3. The Final Distribution

In the event that the Main Distribution is made before the Claims Resolution Date, a subsequent, Final Distribution may be necessary. Any such Final Distribution will be made after all HOW Companies' losses, expenses, and other liabilities have been paid in full, upon the final liquidation of HWC, in order to distribute any remaining loss reserves and any remaining portion of the \$10 million contingency reserves. The detailed methodology for calculating any Final Distribution is described in Part II.D, *infra*.

4. Deputy Receiver May Withhold Distributions Pending Receipt of Loss Participation Payments

The Deputy Receiver may withhold any and all distributions from a Builder Distributee until such time as the Builder Distributee settles any outstanding claims of the HOW Companies against the Builder Distributee for loss participation payments.

5. All Distributions Net of Costs

Prior to making any distribution of Residual Assets, the Deputy Receiver shall deduct an amount sufficient to meet the expenses of calculating and making the distribution (the "Distribution Administration Costs"). If the Distribution Administration Costs exceed the amount of assets available for distribution prior to deduction of the Distribution Administration Costs, the Deputy Receiver shall return to the Commission for further guidance. If, in the Deputy Receiver's sole determination, the amount of assets available for distribution exceed the Distribution Administration Cost by such a small amount as to render any resulting distribution *de minimis*, the Deputy Receiver shall return to the Commission for further guidance.

B. General Methodology for Distribution(s) of Residual Assets

The first distribution of Residual Assets will be either an Interim Distribution or the Main Distribution and is referred to herein as the "First Distribution," except that the term First Distribution shall not include any Interim Distribution which, at his sole discretion, the Deputy Receiver limits to partial advances of his best estimate of what will be the Fixed Component of the Main Distribution (see Part II.A.2, *supra*). A portion of the First Distribution will be allocated among the Builder Distributees based upon their relative estimated contributions to the Residual Assets (the "Variable Component"). The remainder of the First Distribution will be allocated among the Builder Distributees on a per capita basis (the "Fixed Component"). Fifty percent (50%) of the First Distribution will be dedicated to the Fixed Component, and the remaining fifty percent (50%) will be dedicated to the Variable Component.

The Fixed Component is intended to compensate Builder Distributees for intangible attributes of membership in HWC, including the right to vote for directors and to vote on other important matters. The Fixed Component takes into account HWC's voting policy, pursuant to which each Builder Distributee had an equal right to vote.³ Accordingly, the Fixed Component will

³ Not every participating HOW builder was a HOWIC policyholder or a HWC member entitled to vote. Article III of HWC's Bylaws provided, *inter alia*:

Section 1. *Authorized Membership.* The authorized membership of the Corporation shall consist of registered participants in the Home Owners Warranty program.

Section 2. *Application for Membership.* Application for membership shall be presented to the Corporation and shall be acted upon promptly. All applicants who are found acceptable shall enter into a Builder Agreement with the Corporation or Home Owners Warranty Corporation.

In the case of affiliated builders, the parent builder was the sole policyholder of the HOWIC policy, and the Builder Agreement was executed only by the parent builder. The Builder Agreement provided, *inter alia*:

be distributed equally among the Builder Distributees regardless of the number of homes enrolled by each Builder Distributee and its affiliates.

The Variable Component is intended to take into account that individual Builder Distributees made unequal "profitability contributions" (positive or negative) to the HOW Companies, depending upon the claims history on the homes enrolled by each Builder Distributee and its affiliates. Accordingly, the Variable Component is allocated on the basis of the Builder Distributees' relative profitability contributions to the HOW Companies. The profitability contributions are calculated on an individual policy basis because policy-specific data is available in the records of the HOW Companies. The first year for calculation of the Variable Component is 1982, because that is the first year in which HOWIC became the underwriter for the Program.

Conceptually, each Builder Distributee's annual profitability contribution is estimated from the total cash inflows to the HOW Companies, less the total cash outflows from the HOW Companies, attributable in that year to homes enrolled by the Builder Distributee and its affiliated builders: (1) On the positive side, the inflows credited in the methodology consist of enrollment premiums and administrative fees received, (2) on the negative side, the outflows debited in the methodology are losses paid, including allocated loss adjustment expenses ("LAE"), (3) for the year in which the First Distribution calculation date falls only, loss reserves as of the First Distribution calculation date less anticipated loss participation payments on such estimated losses, which will

4.01 Home Enrollment Procedures. The Builder shall submit for enrollment all homes on which it and its affiliates commence construction during the term of this Agreement and pay, with respect to each such home, the enrollment fees

Accordingly, only the parent builder was a HWC member with a right to vote. Subsidiaries or affiliates of the parent builder could participate in the HOW Program as beneficiaries of the parent builder's policy and Builder Agreement, but were not themselves policyholders or members with a right to vote. With regard to voting, Article V of HWC's Bylaws provided, *inter alia*:

Section 7. *Voting.* At every meeting of the members each member present, either in person or by proxy, shall have the right to cast votes. The vote of the majority of those present in person or by proxy shall decide any questions brought before such meeting, unless the question is one upon which, by express provision of statute or of the Certificate of Incorporation or of these Bylaws, a different vote is required, in which case such express provision shall govern and control.

Thus, each parent builder was entitled to one vote regardless of the number of homes enrolled by the parent builder and its affiliates. Because the fixed component of consideration has often been considered to be compensation for the loss of the policyholders' right to vote, the Fixed Distribution is allocated among the Builder Distributees on a per capita basis, consistent with HWC's voting system of one vote per parent builder.

provide an estimate of post-First Distribution calculation date negative drains on Residual Assets, (4) LESS gross recoveries, which include subrogation recoveries and builder loss participation payments received, minus recovery expenses, and (5) for the year in which the First Distribution calculation date falls only, any balance owed to the HOW Companies for builder loss participation.

On a year-to-year basis, interest is calculated on each Builder Distributee's running total, based upon the HOW Companies' historical gross rate of return on cash and invested assets.⁴ A Builder Distributee's profitability contribution in a particular year is treated as bearing interest over the next year at the HOW Companies' historical gross rate of return on cash and invested assets for that year. To the resulting amount is added the next year's profitability contribution.

Negative values of cumulative totals of profitability contributions for individual Builder Distributees as of the First Distribution calculation date are set to zero prior to allocating the Variable Component among the individual Builder Distributees.

After each Builder Distributee's cumulative total of profitability contributions as of the First Distribution calculation date is determined (and negative values set to zero), the allocation of the Variable Component is calculated. The Variable Component is allocated among the Builder Distributees proportionate to the relative weights of their individual cumulative totals of profitability contributions.

Each Builder Distributee's share of the Fixed Component is calculated by dividing fifty percent (50%) of the First Distribution by the number of Builder Distributees.

Next, each Builder Distributee's presumptive share (expressed as a percentage) of the First Distribution is determined by adding its Variable Component to its Fixed Component. The sum of all individual presumptive shares of the First Distribution will equal one hundred percent (100%) of the First Distribution. The same presumptive share percentages will be used for any subsequent distribution(s) of Residual Assets, except to the extent that subsequent events affect a particular Builder Distributee's cumulative total disproportionately from effects on all Builder Distributees' cumulative totals. This could occur, for example, because of losses yet to be settled or recoveries yet to be realized. For purposes of the remainder of the description of the general methodology, the term "Distribution" refers to the First Distribution or any subsequent distribution(s) of Residual Assets, as applicable.

The Builder Distributee's net presumptive share of the Distribution is determined by reducing the Builder Distributee's presumptive share of the Distribution by any amount still owed by the Builder Distributee for loss participation, etc.

⁴ The HOW Companies' historical gross rates of return on cash and invested assets are determined from the HOW Companies' annual statements, as discussed in Part II.C.3, *infra*.

Finally, each Builder Distributee's share of the Distribution is determined by re-allocating, among those Builder Distributees with positive net presumptive shares, the sum of reductions (in presumptive shares) applied to Builder Distributees which had outstanding balances owed to the HOW Companies.⁵

C. Assumptions and Practices

1. All Policies Expired as of First Distribution Calculation Date; Loss Reserves; Additional Reserves

It is assumed that all policies will have expired as of the First Distribution calculation date. Therefore, the Variable Component calculation takes into account primarily historic profitability contributions. However, in the event that the First Distribution is made before the Claims Resolution Date, some losses will continue to be paid on open claims that were filed prior to the First Distribution calculation date. The Variable Component takes such future negative profitability contributions into account through the loss reserves established for each Builder Distributee as of the First Distribution calculation date, adjusted for any anticipated loss participation by the Builder Distributee.⁶ In order to pay losses adjusted after the First Distribution calculation date, as well as costs, expenses, and other contingencies, the Deputy Receiver's HWC Plan of Liquidation seeks approval to maintain a \$10 million reserve, over and above existing loss reserves, for the payment of all losses, costs, and expenses until such time as HWC can be liquidated and a Final Distribution made of any remaining assets.

2. All Builders Treated Alike Regardless of Program

All Builder Distributees are treated equally whether they participated in the regular builder program, the remodeler program, the volume builder program, or the national accounts program. In whichever program a Builder Distributee and its affiliates participated, enrollment fees were paid for each home enrolled, and the HOW Companies became obligated to pay covered losses on those homes under the HOW Warranty and Insurance policy.

⁵ Note that the maximum of such a reduction for any Builder Distributee is the amount of its presumptive share, because presumptive shares are not reduced below zero. Thus, the amount re-distributed cannot exceed a Builder Distributee's presumptive share. Note also that the reduction in many cases will be less than the affected Builder Distributee's presumptive share. In such cases, the affected Builder Distributee will receive a partial reallocation (in the amount of its proportionate share) of the sum of all such reductions.

⁶ Any loss participation payments owed by a Builder Distributee on losses paid after the First Distribution calculation date will be deducted from the Builder Distributee's share of any subsequent distribution(s).

3. HOW Companies' Historical Gross Rates of Return on Cash Investments, Per Calendar Year

For each calendar year, the HOW Companies' historical gross rate of return on cash and invested assets is calculated by dividing gross investment income by the average of the cash and invested assets for the current year and the prior year. Those rates of return are as follows:

<u>Year</u>	<u>Rate</u>	<u>Year</u>	<u>Rate</u>	<u>Year</u>	<u>Rate</u>
1982	14.30	1991	8.14	2000	6.92
1983	8.62	1992	7.55	2001	6.47
1984	9.44	1993	6.84	2002	6.08
1985	9.51	1994	6.38	2003	4.81
1986	9.19	1995	6.61	2004	2.31
1987	8.44	1996	7.09	2005	2.31
1988	8.08	1997	7.02	2006	2.31
1989	8.74	1998	6.75	2007	2.31
1990	8.14	1999	6.87		

D. Detailed Methodology

NOTE: Calculation of the First Distribution involves Steps 1 through 9. Calculation of subsequent distribution(s), if any, will involve only Steps 7 through 9, and will begin with the value of "pd" calculated in Step 6 for purposes of the First Distribution.

1. First, for each Builder Distributee, the Deputy Receiver will compute "s-ann," the estimated profitability contribution or loss for each calendar year. For each Builder, s-ann will be calculated, on a calendar-year basis, for every year beginning with 1984 and continuing up to, but excluding, the year in which the First Distribution calculation date falls. Specifically, $s\text{-ann} = P - L + GR$

Where:

- P equals total premiums and administrative fees paid to the HOW Program during the calendar year for homes enrolled by the Builder Distributee and its affiliates,
- L equals total losses paid by the HOW Program during the calendar year on homes enrolled by the Builder Distributee and its affiliates, including LAE, and

GR equals total gross recoveries attributable to the Builder Distributee during the calendar year, including loss participation payments made to the HOW Program during the calendar year by the Builder Distributee and its affiliates, and total subrogation recoveries collected by the HOW Program during the calendar year for losses previously paid on homes enrolled by the Builder Distributee and its affiliates, minus recovery expenses.

2. Second, for the year in which the First Distribution calculation date falls, the Deputy Receiver will compute "s-cdy," the Builder Distributee's estimated contribution or loss to Residual Assets beginning in the year which includes the Main Distribution calculation date and ending in the year in which HWC will be liquidated and the Final Distribution of Residual Assets, if any, will be paid. Specifically, $s-cdy = GR - L - LR$

Where:

L equals total losses paid by the HOW Program during the calendar year on homes enrolled by the Builder Distributee and its affiliates, including LAE,

LR in the event that all losses have not yet been paid as of the First Distribution calculation date, equals loss reserves maintained as of the First Distribution calculation date for homes enrolled by the Builder Distributee and its affiliates, less any loss participation payments that would be due if losses were to be paid in the amount of the loss reserves, and

GR equals total gross recoveries attributable to the Builder Distributee during the calendar year, including loss participation payments made to the HOW Program during the calendar year by the Builder Distributee and its affiliates, and total subrogation recoveries collected by the HOW Program during the calendar year for losses previously paid on homes enrolled by the Builder Distributee and its affiliates, minus recovery expenses.

3. Third, the running total of each Builder Distributee's estimated profitability contributions will be computed. By way of illustration only, assume that a particular Builder Distributee had a running total of \$0 as of the end of 1987. Assume that the historical gross rates of return on cash and invested assets were: 6% in 1989, 8% in 1990, and 7% in 1991. Assume further that the Builder Distributee's estimated profitability contribution or loss (s-ann) for the calendar years 1988 through 1990 were as follows:

YEAR	POSITIVE INFLOWS (PREMIUMS, ETC.)	NEGATIVE OUTFLOWS (LOSSES, ETC.)	NET ANNUAL CONTRIBUTION OR LOSS ("s-ann")
1988	\$237,000	\$150,000	\$87,000
1989	\$250,000	\$350,000	-\$100,000
1990	\$270,000	\$235,000	\$35,000

The \$87,000 profitability contribution for 1988 would be added to the 1987 year-end running total of \$0, leaving a new running total at year-end 1988 of \$87,000. That amount would bear interest in 1989 at 6% and at year-end would total \$92,220. From that amount would be subtracted 1989's \$100,000 net loss, leaving a running total of -\$7,780, accruing 8% interest over 1990. At year-end, the resulting -\$8,402 would be added to 1990's \$35,000 net contribution, and the resulting \$26,598 would accrue 7% interest through 1991, becoming \$28,459 by year-end. To that amount would be added (or from it would be subtracted) the 1991 net contribution (or net loss). The resulting sum would then accrue interest at HOW's historical gross rate of return on cash and invested assets for 1992. This process is repeated for each year through the year preceding the year in which falls the First Distribution calculation date, by adding the s-ann value for that year, the balance accruing interest at HOW's historical gross rate of return on cash and invested assets for the subsequent year, with the calculation being completed as of the year in which falls the First Distribution calculation date by adding s-cdy. The resulting value constitutes that Builder Distributee's profitability contribution ("PC"), with negative values of PC set to zero.

The foregoing may be represented by the following formula:

$$PC = (((((((s\text{-ann}Y * \pi Y+1) + s\text{-ann}Y+1) * \pi Y+2) + s\text{-ann}Y+2) * \pi Y+3) \dots + s\text{-ann}CDY-1) * \pi CDY) + s\text{-cdy}$$

Where:

Y equals the first year in which the Builder Distributee and/or its affiliates enrolled homes. Successive years are designated as Y+1, Y+2, etc., through CDY-1, the year preceding the year in which falls the First Distribution calculation date, and CDY, the year in which falls the First Distribution calculation date,

s-annY equals the s-ann value for the first year in which the Builder Distributee or its affiliates enrolled homes. The s-ann values for successive years are designated s-annY+1, s-annY+2, etc., through s-annCDY-1, which is the s-ann value for the year preceding the year in which falls the First Distribution calculation date,

π Y+1 equals the HOW Companies' historical gross rate of return on cash and invested assets in year Y+1. The π values for successive years are designated as π Y+2, π Y+3, etc., through π CDY, which is the π value for the year in which falls the First Distribution calculation date,

s-cdy equals the Builder Distributee's estimated contribution or loss to Residual Assets beginning in the year which includes the First Distribution calculation date and ending in the year in which HWC will be liquidated and the Final Distribution of Residual Assets, if any, will be paid, and

PC equals the individual Builder Distributee's estimated profitability contribution to the HOW Companies (negative values having been set to zero).

4. Next, the Deputy Receiver will compute each Builder Distributee's share of the Variable Component "v," expressed as a percentage of the First Distribution of Residual Assets, so that $v = (PC/\sum PC) * 50$

Where:

PC equals the individual Builder Distributee's estimated profitability contribution to the HOW Companies (negative values set to zero),

$\sum PC$ equals the sum of PC values for all Builder Distributees,

50 equals the percentage of the First Distribution dedicated to the Variable Component, and

v equals the individual Builder Distributee's share of the Variable Component, expressed as a percentage of the First Distribution of Residual Assets.

NOTE: The sum of all "v" values will equal 50, which is the percentage of the First Distribution of Residual Assets dedicated to the Variable Component.

5. The Deputy Receiver will then compute each Builder Distributee's share of the Fixed Component "f," expressed as a percentage of the First Distribution of Residual Assets, so that $f = 50/N$

Where:

50 equals the percentage of the First Distribution dedicated to the Fixed Component,

N equals the total number of Builder Distributees, and

f equals the individual Builder Distributee's share of the Fixed Component, expressed as a percentage of the First Distribution of Residual Assets.

NOTE: The sum of all f values will equal 50, which is the percentage of the First Distribution of Residual Assets dedicated to the Fixed Component.

6. Sixth, the Deputy Receiver will compute each Builder Distributee's presumptive share of the First Distribution, **pd%**, expressed as a percentage of the distribution. This will also be the Builder Distributee's presumptive share of any subsequent distribution(s) of Residual Assets. The sum of all **pd%** values will equal 100%. Specifically, $pd\% = f + v$

Where:

f equals the individual Builder Distributee's share of the Fixed Component, expressed as a percentage of the First Distribution of Residual Assets, and

v equals the individual Builder Distributee's share of the Variable Component, expressed as a percentage of the First Distribution of Residual Assets.

NOTE: Steps 7 through 10 apply both to the calculation of the First Distribution and to the calculation of any subsequent distribution(s) of Residual Assets. Therefore, the term "Distribution" in Steps 7 through 10 refers to the First Distribution or any subsequent distribution(s) of Residual Assets, as applicable.

7. Each Builder Distributee's presumptive share of the Distribution (in dollars), **pd\$**, is determined, so that $pd\$ = pd\%/100 * RAD$

Where:

$pd\%$ equals the individual Builder Distributee's presumptive share of the Distribution, expressed as a percentage of the distribution, and

RAD equals the dollar amount of Residual Assets available for the Distribution.

8. Each Builder Distributee's net presumptive share of the Distribution (in dollars), $npd\$,$ is determined by reducing the Builder Distributee's presumptive share of the Distribution (in dollars) by any amount still owed by the Builder Distributee for loss participation, etc. Thus, $npd\$ = pd\$ - o1$ where $o1$ equals, for each Builder, an offset representing all sums still owed to the HOW Companies by the Builder Distributee for loss participation payments (in dollars) but not more than $pd\$$. This cannot produce negative $npd\$\$ values because only that portion of amounts owed to the HOW Companies that does not exceed $pd\$\$ will be deducted from $pd\$\$. In other words, $o1 \leq pd\$\$.
9. Each Builder Distributee's share of the Distribution, in dollars, $d\$,$ is determined by re-allocating, among those Builder Distributees whose net presumptive share values ($npd\$\$) are positive, sums not distributed to Builder Distributees whose net presumptive share values were reduced because of amounts owed by them to the HOW Companies. The amount reallocated will be $\sum o1$, the sum of $o1$ for all such Builder Distributees. Thus,

$$d\$ = npd\$ + [(RAD - \sum npd\$) * (npd\$) / (\sum npd\$)]$$

Where:

$npd\$\$ equals the Builder Distributee's net presumptive share of the Distribution, in dollars,

RAD equals the dollar amount of Residual Assets available for the Distribution, and

$\sum npd\$\$ equals the sum of all values of $npd\$\$.

NOTE: The sum of all $d\$\$ should equal RAD and $(RAD - \sum npd\$)$ should = $\sum o1$ so that $d\$\$ could also be expressed as $npd\$ + [\sum o-1] * (npd\$) / (\sum npd\$)$

10. If desired for reporting purposes, each Builder Distributee's share of the Distribution may be determined as a percentage of the Distribution, **d%**, so that $d\% = d\$/RAD * 100$

Where:

d\$ equals the Builder Distributee's share of the Distribution, in dollars,
and

RAD equals the dollar amount of Residual Assets available for the
Distribution.

NOTE: Whereas the values of pd% for an individual Builder Distributee will be the same for all distributions, the values of d% for an individual Builder Distributee may vary from one distribution to the next. The sum of all d% values should equal 100%.

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

COMMONWEALTH OF VIRGINIA)
at the Relation of the)
STATE CORPORATION COMMISSION,)
)
Plaintiffs,)
v.)
HOW INSURANCE COMPANY, A)
RISK RETENTION GROUP,)
HOME WARRANTY CORPORATION,)
and HOME OWNERS WARRANTY)
CORPORATION,)
)
Defendants.)

Case No. INS-1994-00218

**ORDER SETTING HEARING ON PLANS OF LIQUIDATION FOR HOW
INSURANCE COMPANY, A RISK RETENTION GROUP, HOME OWNERS
WARRANTY CORPORATION, AND HOME WARRANTY CORPORATION,
ESTABLISHING RESPONSE DATE, APPROVING PLANS OF LIQUIDATION,
APPROVING CLAIMS BAR DATE, AND RELATED MATTERS**

ON A FORMER DAY CAME Alfred W. Gross, as Deputy Receiver (the "Deputy Receiver") of HOW Insurance Company, a Risk Retention Group ("HOWIC"), Home Owners Warranty Corporation ("HOW"), and Home Warranty Corporation ("HWC") (collectively, the "HOW Companies"), and filed with the Clerk of the Commission his Application for Orders Setting Hearing on Plans of Liquidation of HOW Insurance Company, a Risk Retention Group, Home Owners Warranty Corporation, and Home Warranty Corporation, Establishing Response Date, Approving Plans of Liquidation, Approving Claims Bar Date, and Related Matters (the "Application"), seeking a hearing for the Commission's review and approval of plans of liquidation for the HOW Companies (the "Plans of Liquidation") and matters related thereto.

AND THE COMMISSION, having considered the Application, sets a hearing on the Plans of Liquidation. At such hearing, the Commission shall determine whether further efforts to rehabilitate the HOW Companies would be useless such that the Plans of Liquidation should be approved. THE COMMISSION, having further considered the Notice and Procedural requests made in the Application by the Deputy Receiver relative to the efficient handling of the hearing, hereby adopts the notice procedures set forth in the Application, finds that such notice procedures are reasonably appropriate for the proper and efficient disposition of this hearing, and for the protection of all interested parties involved therein.

THEREFORE, IT IS ORDERED that:

1. A hearing for the consideration and requested approval of the Plans of Liquidation be, and is hereby, set for _____, 20__, in the State Corporation Commission, 1300 East Main Street, 2nd Floor, Richmond, Virginia,

2. No later than 60 days before the hearing, the Deputy Receiver shall cause to be sent forthwith the Notice of said hearing and related documents, together with a copy, or a summary including instructions on how to obtain a copy, of this order by first-class United States mail, to the last known address on the books and records of the HOW Companies as follows: to all builders who at one time were members of HWC, to the owners of all homes which are currently enrolled in the HOW Program, and to known creditors of the HOW Companies. The Notice will also be published in the Richmond Times Dispatch, the Wall Street Journal, and USA Today, beginning no later than 60 days before the hearing, for at least one day each week for two consecutive weeks. Notice by publication will apply for all persons or entities for whom the Deputy Receiver does not have a

ORDER SETTING HEARING ON PLANS OF LIQUIDATION FOR HOW INSURANCE COMPANY, A RISK RETENTION GROUP, HOME OWNERS WARRANTY CORPORATION, AND HOME WARRANTY CORPORATION, ESTABLISHING RESPONSE DATE, APPROVING PLANS OF LIQUIDATION, APPROVING CLAIMS BAR DATE, AND RELATED MATTERS

current or valid address, as well as all unknown creditors, claimants, former member-builders, or interested parties of the HOW Companies,

3. No later than 30 days before said hearing, all persons who expect to appear at the hearing for the purpose of supporting or opposing the Plans of Liquidation or related actions requested by the Application shall file with the Commission, and provide a copy to the Deputy Receiver, a Notice of Participation as Respondent, which shall set forth a full statement of the basis of the support or opposition, including: (i) a precise statement of the interest of the respondent, (ii) a statement of the specific relief sought, to the extent then known, (iii) the factual and legal basis for the relief sought, (iv) the substance of the anticipated testimony in support or opposition, and (v) a list of exhibits to be offered in support of, or in opposition to, the Plans of Liquidation,

4. No later than 20 days before said hearing, all persons who have timely filed a Notice of Participation as Respondent in accordance with paragraph 3 above, and who still desire to participate in the hearing for the purpose of supporting or opposing the Plans of Liquidation or related actions requested by the Application, shall file with the Commission the prepared testimony and exhibits of each witness expecting to present direct testimony for the purposes set forth above, and provide a copy to the Deputy Receiver,

5. All Notices of Participation as Respondent, pre-filed testimony and exhibits, and other pleadings or related documents shall be deemed filed with the Commission only upon receipt of the original and fifteen (15) copies thereof by the Clerk of the Commission at the following address: State Corporation Commission, P.O. Box 1197, Richmond, Virginia 23218; and service of one complete copy of any required filing shall also be made upon the Special Deputy Receiver

at 7501C North Capital of Texas Highway, Suite 200, Austin, Texas 78731, on or before the dates and times required above, and

6. These proceedings shall be subject to the Commission's Rules of Practice and Procedure to the extent not modified by order of the Commission.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to:

ORDER SETTING HEARING ON PLANS OF LIQUIDATION FOR HOW INSURANCE COMPANY,
A RISK RETENTION GROUP, HOME OWNERS WARRANTY CORPORATION, AND HOME
WARRANTY CORPORATION, ESTABLISHING RESPONSE DATE, APPROVING PLANS OF
LIQUIDATION, APPROVING CLAIMS BAR DATE, AND RELATED MATTERS

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

COMMONWEALTH OF VIRGINIA)
at the Relation of the)
STATE CORPORATION COMMISSION,)
)
Plaintiffs,)
v.)
)
HOW INSURANCE COMPANY, A)
RISK RETENTION GROUP,)
HOME WARRANTY CORPORATION,)
and HOME OWNERS WARRANTY)
CORPORATION,)
)
Defendants.)

Case No. INS-1994-00218

**ORDER APPROVING PLANS OF LIQUIDATION
FOR HOW INSURANCE COMPANY, A RISK RETENTION GROUP, HOME OWNERS
WARRANTY CORPORATION, AND HOME WARRANTY CORPORATION,
APPROVING CLAIMS BAR DATE, AND RELATED MATTERS**

By order of [DATE], the Commission set for hearing the Deputy Receiver's application (the "Application") for approval of proposed plans of liquidation (the "Plans of Liquidation") for HOW Insurance Company, a Risk Retention Group ("HOWIC"), Home Owners Warranty Corporation ("HOW"), and Home Warranty Corporation ("HWC") (collectively, the "HOW Companies"), in receivership.¹

Pursuant to notice given to interested parties, the hearing was held on [DATE]. Parties appearing, by counsel, were: the Deputy Receiver for the "HOW Companies" and [LIST OTHER

¹ "Plans of Liquidation," as used herein, refers to the proposed plans of liquidation for the HOW Companies (HOW, HWC, HOWIC), collectively. As explained below, the Plans of Liquidation consist of two separate plans, the first being a plan of liquidation for HOWIC (the "HOWIC Plan of Liquidation"), and the second, contingent upon completion of the first, being a plan of liquidation for HOW and HWC (the "HOW/HWC Plan of Liquidation").

PARTIES]. Peter B. Smith, Esq., appeared as counsel for the staff of the Commission. As predicate for this order, the Commission notes certain facts.

INTRODUCTION

1. On October 14, 1994, the Circuit Court for the City of Richmond entered its Final Order Appointing Receiver for Rehabilitation or Liquidation (the "Receivership Order") which appointed the State Corporation Commission of the Commonwealth of Virginia (the "Commission") as Receiver (the "Receiver"), Steven T. Foster, the Commissioner of Insurance of the Commonwealth of Virginia as Deputy Receiver, and Patrick H. Cantilo as Special Deputy Receiver (the "Special Deputy Receiver"), and authorized and directed them to administer the business and affairs of the HOW Companies, and to do all acts necessary or appropriate for the rehabilitation or liquidation of the HOW Companies. On May 1, 1996, by order of this Commission, Alfred W. Gross succeeded Steven T. Foster as Commissioner of Insurance and Deputy Receiver of the HOW Companies. As a result of the receivership, the affairs and business of HWC are administered by the Receiver, the Deputy Receiver, and the Special Deputy Receiver, who are vested with all the powers and authority expressed or implied under the provisions of Title 38.2, Chapter 15 of the Virginia Code.

2. In the Receivership Order, which the parties proffered to the Circuit Court of the City of Richmond, the Court found that the HOW Companies were in a hazardous financial condition. An audit of the HOW Companies as of December 31, 1994, indicated that their liabilities exceeded their admitted assets by \$117,531,322 (HOWIC's 1994 annual statement reflected that, as of the same date, its liabilities exceeded its admitted assets by \$116,244,100). An audit of the HOW

Companies as of December 31, 1995, indicated that their liabilities exceeded their admitted assets by \$54,729,964 (HOWIC's 1995 annual statement reflected that, as of the same date, its liabilities exceeded its admitted assets by \$53,472,156). Annual statements filed by the Deputy Receiver for every year through 2001 continued to reflect that HOWIC's liabilities exceeded its admitted assets by a substantial sum. In short, HOWIC separately, and the HOW Companies collectively, were insolvent in 1994 and 1995 and remained insolvent through 2001. Pursuant to the Receivership Order and applicable Virginia law, the Deputy Receiver and Special Deputy Receiver have devoted their efforts to marshaling the assets and discharging the liabilities of the HOW Companies. HOWIC's 2002 annual statement reflected that, as of December 31, 2002, its admitted assets exceeded its liabilities by \$12,647,675 (*i.e.*, HOWIC had returned to solvency).² Despite this return to solvency, however, the Deputy Receiver asserts that further efforts to rehabilitate the HOW Companies would be useless and seeks an order of liquidation pursuant to VA. CODE ANN. § 38.2-1519.B (Michie 2002).

3. As will be seen below, management of the HOW Companies in receivership has progressed to a point at which it appears that all of their liabilities may be satisfied, and that substantial residual assets (the "Residual Assets") should remain. The Deputy Receiver has presented the Application to propose liquidation of the HOW Companies and an appropriate disposition for any such Residual Assets.

² An audit of the HOW Companies as of December 31, 2003, indicated that their admitted assets, on a consolidated basis, exceeded their liabilities by \$6,924,123 (HOWIC's 2003 annual statement reflected that, as of the same date, its admitted assets exceeded its liabilities by \$7,994,699).

FINDINGS AND CONCLUSIONS

Based upon the arguments and evidence adduced by the parties and counsel, we now make the following findings of fact and conclusions of law:

DETERMINATION OF WHETHER FURTHER EFFORTS TO REHABILITATE THE HOW COMPANIES WOULD BE USELESS

4. HWC was organized for the following purposes: (1) to provide a program whereby consumers can be better assured that new homes they are buying are produced to an acceptable standard and are the subject of a warranty, the terms of which are backed by HWC, its subsidiary corporations, and/or one or more insurance companies, (2) to provide a program whereby home builders provide warranty coverage on new homes they construct backed by HWC, its subsidiary corporations, and/or one or more insurance companies, and (3) to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware.

5. Before the inception of receivership proceedings, the HOW Companies marketed a program pursuant to which were issued hundreds of thousands of insurance policies and certificates providing coverage for at least ten years to homes throughout the United States, with the exception of Alaska (the "HOW Program"). There remain in effect thousands of such policies and certificates, some of which will provide such coverage at least through the year 2004.

6. Early cancellation of such policies and certificates would have material adverse consequences to the home owners to whom they provide coverage. Even if unearned premiums could be calculated upon premature cancellation (for which the policies and certificates make no provision), payment thereof would most likely be in small amounts to builders and not home owners, while the latter would thereupon completely lose all coverage currently afforded by such policies and

certificates. Premature cancellation, therefore, would occasion a windfall for builder recipients, and substantial harm to home owners.

7. Improvement in the financial condition of the HOW Companies since 1994 has enabled the Deputy Receiver to pay covered claims in full, subject to reasonable conditions imposed by the receivership and, as discussed above, has resulted in the HOW Companies returning to solvency sometime in 2002.

8. Based on information currently available, the total amount of approved general creditor claims filed to date is approximately \$1,826,292.27, which includes \$555,727.92 in approved subordinated claims, and excludes all approved capital contribution claims.

9. It appears that payments of approved general creditor claims may now be made, given that the HOW Companies' admitted assets now exceed their liabilities.

10. Builders who desired to participate in the HOW Program entered into annually renewable builder agreements (the "Builder Agreements") providing them limited membership and voting rights and permitting them to obtain warranty insurance coverage for enrolled homes. Under certain circumstances upon termination, such member-builders (the "Member-Builders") could recover part, or all, of their capital contributions and certain loss reserve deposits. The Builder Agreements did not vest the Member-Builders with any rights to distributions of profits or other earnings of the HOW Companies.

11. Builder Agreements terminated automatically if not renewed annually with HOW approval. No Builder Agreement was renewed after receivership and all, therefore, terminated by the end of 1995. However, termination of membership did not end prematurely the insurance

coverage provided under the ten-year policies for homes enrolled by the Member-Builder in the HOW Program prior to termination.

12. Among the HOW Companies' actual or potential liabilities are approximately \$11,271,225 in "vested" capital contributions returnable to certain former Member-Builders. The only former Member-Builders of HWC who are entitled to any refund of capital contributions, pursuant to the Builder Agreements, are those whose capital contributions vested pursuant to the terms of the Builder Agreements and who either: (a) after the inception of the receivership, had their Builder Agreements automatically terminated during 1994 and 1995 upon expiration of their Builder Agreements' one-year terms, or (b) voluntarily terminated their Builder Agreements either before inception of the receivership, or prior to the date that such Builder Agreements would have terminated automatically during 1994 or 1995 upon expiration of their one-year terms, and who at the time of termination had been members in good standing for at least five consecutive years (collectively, "Eligible Builders").³

³ There were 447 Member-Builders with \$1,315,470 in non-vested capital contributions who were in good standing as of October 14, 1994, but who had not been members in good standing for at least five continuous years as of the date their Builder Agreements were terminated automatically for non-renewal. The Commission agrees with the Deputy Receiver that such Member-Builders should be treated as if they meet the five-year vesting requirement, because their Builder Agreements were terminated neither voluntarily nor for cause, but because of the receivership. In addition, the Commission agrees with the Deputy Receiver that twenty-three (23) Member-Builders with \$8,130 in non-vested capital contributions, who were terminated only for filing bankruptcy prior to the receivership should be treated as if they meet the five-year vesting requirement, because their terminations were pursuant to so-called *ipso facto* clauses, which federal bankruptcy courts have held to be void as a matter of law. HWC holds an additional \$4,721,595 in capital contributions that are not refundable, because the builders in question did not satisfy the contractual requirements for refund, as discussed below. The Commission concurs with the Deputy Receiver's conclusion that those non-refundable capital contributions belong to HWC for the benefit of its owners.

13. Among the charges to the Deputy Receiver was a determination of rehabilitation prospects for the HOW Companies. A determination as to whether further efforts to rehabilitate the HOW Companies would be useless depends entirely on how rehabilitation is defined. Neither applicable Virginia law nor the Receivership Order provides a definition by which such a determination can be gauged. However, VA. CODE ANN. § 1519.A implies that further efforts to rehabilitate the insurer would not be useless if it appears likely that the insurer could safely and properly resume possession of its property and the conduct of its business. The Commission concludes, therefore, that effective rehabilitation would have to include at least the following:

- a. payment of the costs and expenses of administration, pursuant to VA. CODE ANN. §§ 38.2-1509(B)(1) and 38.2-1510 (Michie 2002),
 - b. payment of the claims of secured creditors, pursuant to VA. CODE ANN. § 38.2-1509.B.1(i),
 - c. payment of claims of policyholders arising out of insurance contracts, pursuant to VA. CODE ANN. § 38.2-1509.B.1(ii),
 - d. payment of taxes, pursuant to VA. CODE ANN. § 38.2-1509.B.1(iii),
 - e. payment of wages entitled to priority, pursuant to VA. CODE ANN. § 38.2-1509.B.1(iv),
 - f. payment of general creditor claims, pursuant to VA. CODE ANN. § 38.2-1509.B.1(v),
 - g. removal of the causes and conditions having given rise to the receivership,
- and

h. ability of the insurer to continue as a viable business.

14. The Deputy Receiver has reported, and the Commission has determined, that no plan for rehabilitation of the HOW Companies can be designed and implemented that would satisfy the last two of these elements. The HOW Companies' contractual and insurance coverage obligations have been breached before and through the receivership and cannot reasonably be fulfilled *ex post facto*. Thousands of home owners' claims arising from defects or damage arguably covered by HOW policies were waived, rejected, or compromised based on misinterpretations of that coverage or because of the HOW Companies' poor financial condition. It is not reasonably practicable for the Deputy Receiver to identify and compensate the holders of such claims.

15. Moreover, releasing the HOW Companies from receivership would likely result in a gradual or immediate return to pre-receivership claims experience, for which the HOW Companies' assets might prove insufficient, and improper preferences would be all but unavoidable. That is, there would be a substantial probability that newly assumed insurance obligations could not be fulfilled. Not surprisingly, therefore, the HOW Companies have not issued any new coverages since the inception of receivership proceedings. The HOW Companies' marketing facilities were dismantled shortly after receivership proceedings commenced. The HOW Program itself came to an end in 1994, except for the adjudication and payment of claims and the marshaling of assets.

16. For these reasons, the Commission finds that further efforts at rehabilitation, however that term might reasonably be defined, would be useless. Accordingly, the Commission has considered the Plans of Liquidation presented by the Deputy Receiver, pursuant to which any Residual Assets would be distributed to the owners of the HOW Companies.

DETERMINATION OF ISSUES RELATED TO THE OWNERSHIP OF ANY RESIDUAL ASSETS OF THE HOW COMPANIES

17. The rights and liabilities of creditors, policyholders, stockholders, members, and all other persons interested in the property and assets of the HOW Companies will be fixed as of the date of the entry of the order directing liquidation. VA. CODE ANN. § 38.2-1512 (Michie 2002); see also Receivership Order ¶ 22.

18. The HOW Companies were organized in the familiar corporate pyramid structure in which a parent corporation wholly owns operating subsidiaries. Owners of the parent, therefore, indirectly own the entire enterprise (or “holding company system” in insurance terminology). The parent in the HOW Companies structure is HWC, a Delaware member nonstock company. In order to identify the owners of the HOW Companies who would be entitled to receive any Residual Assets upon liquidation of the HOW Companies, it is necessary only to identify the owners of HWC.

19. The Builder Agreements:

- a. resulted in the contracting Member-Builders receiving certain voting rights,
- b. required the Member-Builders to make periodic capital contributions,
- c. entitled the Member-Builders to recover their capital contributions in at least some cases, the requirements for refund generally being that the builder: (1) was a member of HWC

for five continuous years,⁴ (2) was a member in good standing, and (3) terminated his membership voluntarily,

- d. did not provide the Member-Builders the right to distributions of profit,
- e. did not provide the Member-Builders the right to distributions of assets upon liquidation,
- f. did not characterize the Member-Builders as owners of HWC,
- g. were for one-year terms, renewable by the Member-Builders with the approval of HWC and HOW; and
- h. did not provide for rights of distribution surviving termination or non-renewal.

Therefore, although the Builder Agreements address the issue of return of capital contributions, which the Deputy Receiver considers to be a contractual matter, they do not address the issue of who is entitled to share in the distribution of any surplus upon the dissolution of HWC and its subsidiaries. Nor do HWC's Certificate of Incorporation or Bylaws address the disposition of any surplus remaining upon dissolution of the company and its subsidiaries.

20. The home owners owned neither HWC nor HOWIC. In fact, HOWIC's policies were issued to the Member-Builders, who were considered the insureds, not to the home owners. The latter received warranty certificates which did not contain any indicia of ownership. The home

⁴ The Commission approves the Deputy Receiver's proposal to treat any builder who was in good standing on the date that his Builder Agreement was terminated automatically because of the receivership, but who at that time had been a member of HWC for less than five continuous years, as satisfying the five year requirement, since satisfaction of that requirement was rendered impossible by the receivership.

owners were third-party beneficiaries of the HOW policies, not insureds. HWC did not at any time issue shares of stock, partnership interests, or other ownership instruments to home owners.

21. HOWIC is a risk retention group organized pursuant to the federal Risk Retention Act, which provides that a “risk retention group” is a corporation or other limited liability association:

(E) which—

(i) has as its owners only persons who comprise the membership of the risk retention group and who are provided insurance by such group; or

(ii) has as its sole owner an organization which has as—

(I) its members only persons who comprise the membership of the risk retention group; and

(II) its owners only persons who comprise the membership of the risk retention group and who are provided insurance by such group.

15 U.S.C. § 3901(a)(4)(E) (1997 Supp.). It is logical to conclude that Congress intended to treat risk retention groups like mutual insurance companies, because the idea behind both is the same or similar. Attorneys’ Liab. Assur. Soc’y, Inc. v. Fitzgerald, 174 F. Supp. 2d 619, 633 (W.D. Mich. 2001). A “member” of a mutual insurance company is an “owner” of the company by virtue of owning a policy with the company. Cf. Ohio Farmers Indem. Co. v. Comm’r of Intern. Rev., 108 F.2d 665, 667 (6th Cir. 1940). Similarly, the legislative history of the federal Risk Retention Act notes:

Membership in a risk retention group should be limited to active participants in a risk retention program. Active participants include persons whose own product liability or completed operations liability is currently assumed, in whole or in part, by the risk retention group.

H.R. 97-190 at 10-11, 1981 U.S. Code Cong. & Ad. News at 1438-39. Whatever Congress may have intended by the term “member” of a risk retention group, Congress intended to prevent

ownership of a risk retention group by non-insureds. Attorneys' Liab. Assur. Soc'y, Inc., 174 F. Supp. at 634.

22. Because the insured builders are the owners of HOWIC and HWC pursuant to the federal Risk Retention Act, the Commission concludes that those builders who have unexpired policies as of the date of the entry of the order directing the liquidation of the HOW Companies, are entitled to any Residual Assets upon liquidation, independently of whether or not they are contractually entitled to a refund of capital contributions.

23. However, the Deputy Receiver must determine whether those builders who had unexpired policies as of the date of the Receivership Order should also be deemed to be among the HOW Companies' owners. Despite the fact that most of those builders no longer have policies currently in effect, it would be inequitable to prevent them from being deemed owners. Because approximately ten years have elapsed since the Companies were placed in receivership, most of the HOWIC policies have expired through no fault of the policyholders, who were subsequently not permitted to renew their policies. To deem the owners of the HOW Companies (and of any Residual Assets) to be those few builders whose policies have not expired would be inequitable and would result in their obtaining a windfall. The Deputy Receiver recommends that the Commission, as a court of equity, deem that builders with active policies on the date of the Receivership Order (the "Builder Distributees") should share in the HOW Companies' Residual Assets as owners. On the other hand, even builders who are contractually entitled to a refund of capital contributions should not, if they were not insureds as of the date of the Receivership Order, be entitled to share in any

Residual Assets. The Commission concurs that this is an equitable and practicable determination of ownership of the HOW Companies.

ALLOCATION OF ANY RESIDUAL ASSETS AMONG HWC'S OWNERS

24. Although the federal Risk Retention Act resolves the question of who are the owners entitled to any Residual Assets upon liquidation of the HOW Companies, the federal Risk Retention Act does not provide any guidance as to how any Residual Assets should be allocated among those owners. The rights of members or shareholders of HWC, HOW, and HOWIC to dividends, or to the corporations' assets upon dissolution, are governed by the laws of their respective states of incorporation.

25. Upon dissolution, HOWIC, as a Virginia stock corporation, would be required to discharge its liabilities and distribute any remaining property among its shareholders according to their interests. VA. CODE ANN. § 13.1-745 (Michie 1999). Because HWC is HOWIC's sole shareholder, any surplus assets remaining in HOWIC upon its dissolution must be distributed to HWC.

26. Upon dissolution, HOW, as a District of Columbia stock corporation, would be required to distribute any surplus among the stockholders in proportion to the respective amounts paid in by them severally on their shares of stock. D.C. Code § 29-412 (2002). Because HWC is HOW's sole shareholder, any surplus assets remaining in HOW upon its dissolution must be distributed to HWC.

27. HWC is a Delaware nonstock corporation. Under 8 DEL. CODE ANN. § 278 (2002), a corporation will continue after dissolution for purposes of any action, suit, or proceeding begun

against the corporation prior to its dissolution, until such time as any judgments, orders, or decrees therein shall be fully executed. After all other obligations have been paid, the members receive the residual assets. 8 DEL. CODE ANN. §§ 276, 275 (2002). As discussed above, pursuant to VA. CODE ANN. § 38.2-1512 and the federal Risk Retention Act, it is those builders with unexpired policies on the date of the Commission's order of liquidation who are entitled to receive any Residual Assets.

28. The Deputy Receiver has also addressed in his Application how those Residual Assets should be allocated equitably among these Builder Distributees. He notes that there is no specific guidance provided by Chapter 15 of Title 38.2, or other Virginia law, as to the manner in which the Residual Assets should be allocated among the Builder Distributees. While the Deputy Receiver has no economic stake in the manner in which the Residual Assets should be allocated among the Builder Distributees, he has suggested a methodology that he believes is fair and reasonable under the circumstances. Fundamentally, the proposal seeks to allocate the Residual Assets among the Builder Distributees in proportion to their presumed respective contributions to HWC's surplus. The Commission concurs that this is an equitable and reasonable approach for allocating any Residual Assets.

29. Specifically, the Commission approves of the Deputy Receiver's proposal to distribute any Residual Assets to each Builder Distributee pursuant to the methodology set forth in Exhibit "A-1" to the Application.

30. Next, a determination must be made regarding the disposition of any Residual Assets owed to Builder Distributees who can no longer be found. Over the nearly 20-year span of the HOW

Program, there have been over 20,000 Member-Builders. The Deputy Receiver reports that, as of the date of the Receivership Order, 6,026, builders were insured under unexpired HOWIC policies, a number of whom (particularly the larger companies) continue in business to this day.⁵ However, some of the builders with unexpired policies are individuals or small companies who have ceased conducting business. Some have become insolvent and others have simply wound down. In addition, many others have been sold or merged. Still others simply cannot be located. As discussed in greater detail below, the Commission concludes that under applicable law, shares of any Residual Assets owed to Builder Distributees who cannot be found should be disposed of pursuant to unclaimed property laws of the appropriate states.

31. The Commission notes that the federal Risk Retention Act does not preempt state unclaimed property laws. The mere presence and operation of a federal regulatory statute does not in every case preempt state unclaimed property laws—if the state laws do not conflict with the federal statute, the state laws are not preempted. In the case at bar, the federal Risk Retention Act establishes a risk retention group's owners but does not address the issue of the disposition of the interest of those owners who cannot be found. Because the federal Risk Retention Act is silent as to this issue addressed by state unclaimed property laws, the federal and state laws do not conflict and the state unclaimed property laws shall apply. However, it is also necessary to determine to which state(s) the Deputy Receiver should surrender the HOW Companies' unclaimed property. The Commission finds guidance in Virginia's unclaimed property statutes and relevant case law.

⁵ As of November 1, 2004, twenty-one (21) builders remain insured under HOWIC policies that have not yet expired.

32. Virginia has adopted the Uniform Disposition of Unclaimed Property Act (the "UDUPA"). McDonald v. Treasurer of Virginia, 26 Va. Cir. 75, 76 (1991). The UDUPA is remedial legislation which puts an end to private escheats. Goldstein v. PHH Corp., 717 A.2d 950, 952 (Md. Ct. Spec. App. 1998); Riggs Nat'l Bank v. District of Columbia, 581 A.2d 1229, 1262 (D.C. 1990). The *lex fori* controls all that is connected merely with the remedy. Jones v. R.S. Jones & Assocs., 246 Va. 3, 5, 431 S.E.2d 33, 34 (1993). Therefore, the Commission looks first to the Virginia UDUPA.

33. The Virginia UDUPA does not provide for the reporting and remitting of all abandoned property in the possession of the holder. The statute provides that unless otherwise provided thereby or by other Virginia law, intangible property is subject to the custody of Virginia as unclaimed property if the conditions leading to a presumption of abandonment are satisfied and:

1. The last known address, as shown on the records of the holder, of the apparent owner is in this Commonwealth,
2. The records of the holder do not reflect the identity of the person entitled to the property and it is established that the last known address of the person entitled to the property is in this Commonwealth,
3. The records of the holder do not reflect the last known address of the apparent owner, and it is established that: (i) the last known address of the person entitled to the property is in the Commonwealth or (ii) the holder is a domiciliary or a government or governmental subdivision or agency of this Commonwealth and has not previously paid the property to the state of the last known address of the apparent owner or other person entitled to the property,
4. The last known address, as shown on the records of the holder, of the apparent owner or other person entitled to the property is in a state that does not provide by law for the escheat or custodial taking of the property or its escheat or unclaimed property law is not applicable to the property and the holder is a domiciliary or a government or governmental subdivision or agency of this Commonwealth,

5. The last known address, as shown on the records of the holder, of the apparent owner is in a foreign nation and the holder is a domiciliary or a government or governmental subdivision or agency of this Commonwealth, or

6. (i) The transaction out of which the property arose occurred in this Commonwealth, and the last known address of the apparent owner or other person entitled to the property is unknown, or the last known address of the apparent owner or other person entitled to the property is in a state that does not provide by law for the escheat or custodial taking of the property or its escheat or unclaimed property law is not applicable to the property, and (ii) the holder is a domiciliary of a state that does not provide by law for the escheat or custodial taking of the property or its escheat or unclaimed property law is not applicable to the property.

VA. CODE ANN. § 55-210.2:2 (Michie 2001 Supp.). Paragraph four of § 55-210.2:2 will not apply because every state other than Alaska provides for the escheat or custodial taking of intangible property, and the HOW Program was not active in Alaska.

34. The Virginia statute also includes a reciprocity provision whereby specific property otherwise deemed abandoned is not presumed abandoned in Virginia if it is payable to an owner whose last known address is in another state by a holder who is subject to the jurisdiction of that state and if:

(a) [The property] may be claimed as abandoned or escheated under the laws of such other state; and

(b) The laws of such other state make reciprocal provision that similar specific property is not presumed abandoned or escheatable by such other state when payable to an owner whose last known address is within this Commonwealth by a holder who is subject to the jurisdiction of this Commonwealth.

VA. CODE ANN. § 55-210.11 (Michie 2001 Supp.). Therefore, one must look to the state unclaimed property laws of the state of the last known address of each owner to whom unclaimed property is payable. For purposes of the statute, "last known address" is defined as "a description

of the location of the apparent owner sufficient to identify the state of residence of the apparent owner for the purpose of the delivery of mail.” VA. CODE ANN. § 55-210.2 (Michie 2001 Supp.).

35. The Virginia statute, as applied to this receivership, would be consistent with decisions of the United States Supreme Court regarding abandoned property, which have held, with regard to abandoned intangible property, that the state of the creditor’s last known address, as shown by the debtor’s books and records, is entitled to custody of the property owed him, except that if his address does not appear on the debtor’s books or is in a state that does not provide for escheat or custodial taking of intangibles, then the state of the debtor’s incorporation may take custody of the funds until some other state comes forward with proof that it has a superior right to custody or escheat. Pennsylvania v. New York, 407 U.S. 206, 210-11 (1972); Texas v. New Jersey, 379 U.S. 674, 681-82 (1965).

36. Therefore, as a general matter, the Deputy Receiver shall be required to apply, to a distribution of Residual Assets owed to any Builder Distributee whose last known address is invalid, the unclaimed property laws of the state of the last known address. The Deputy Receiver asserts that: (a) most states appear to have shortened waiting periods, ranging from six months to two years, *for determining abandonment in the case of corporations which have been dissolved*, (b) that in some states, this shortened period applies to either voluntary or involuntary dissolution, (c) that in other states, the shortened period applies only to voluntary dissolution, and (d) that absent an applicable shortened waiting period, property is not considered abandoned until after the expiration of three to seven years, depending upon the state. The Deputy Receiver therefore requests that he be authorized to create a trust to hold unclaimed distributions of Residual Assets (and unclaimed funds due to

creditors) which could not, under applicable law, be delivered to the custody of the relevant states prior to the date that HWC would cease to exist.

37. As an example of the process of the disposition of unclaimed property, the Commission looks to the applicable provisions of Virginia's UDUPA. For purposes of Virginia's UDUPA, "moneys" and "intangible ownership interests in business associations" are both considered intangible assets and the Deputy Receiver is the "holder" of such assets with respect to Builder Distributees' ownership interests in HWC. VA. CODE ANN. § 55-210.2 (definitions of "intangible property" and "holder"). All intangible property, less any lawful charges, that is held, issued, or owing in the ordinary course of the holder's business and has remained unclaimed by the owner for more than five years after it became payable is presumed abandoned, except as otherwise provided by statute. VA. CODE ANN. § 55-210.2:1 (Michie 2001 Supp.). However, all intangible property distributable in the course of a voluntary or involuntary dissolution of a business association which remains unclaimed by the owner for more than one year after the date for specified final distribution is presumed abandoned. VA. CODE ANN. § 55-210.7 (Michie 2001 Supp.). Therefore, the relevant period for determining when HWC liquidation distributions shall be presumed abandoned would be one year, rather than five years. In any event, any holder of tangible or intangible personal property, the owner of which cannot be located, may voluntarily report the property to the State Treasurer, prior to the statutory due dates, whereupon the property shall be presumed abandoned. VA. CODE ANN. § 55-210.10:2 (Michie 1995).⁶

⁶ Pursuant to reciprocity arrangements between Virginia and certain other states, the Deputy Receiver may voluntarily report to the Virginia State Treasurer, prior to the statutory due dates, unclaimed property whose owners' last known addresses were in those other states, whereupon the

THE PLANS OF LIQUIDATION

38. The Deputy Receiver has developed proposed Plans of Liquidation for the satisfaction of all the HOW Companies' liabilities and the subsequent wind down and liquidation of their affairs. Pursuant to the HOWIC Plan of Liquidation, HOWIC would be liquidated and its assets and any liabilities transferred to HWC. Pursuant to the HOW/HWC Plan of Liquidation, which would be contingent upon completion of the HOWIC Plan of Liquidation, first HOW and then HWC would be liquidated, and any assets remaining after the payment of all HOW Companies' liabilities would be transferred to the Builder Distributees. The Deputy Receiver describes the Plans of Liquidation in the Application and Exhibit "A" thereto.

39. The proposed Plans of Liquidation also make provision for the disposition of all claims against the HOW Companies' assets.

40. Essential conditions proposed by the Deputy Receiver to the HOWIC Plan of Liquidation include a determination that all of the HOW Companies' liabilities can first be satisfied and confirmation by the Internal Revenue Service that the HOWIC Plan of Liquidation would receive favorable federal income tax treatment in certain key respects.

41. Having considered the argument and evidence of counsel, and the elements of the Plans of Liquidation, the Commission now finds that the Plans of Liquidation are reasonable, lawful, and the best method of winding down the receivership under the circumstances. The Commission also finds that the other relief requested by the Application is reasonable, lawful, and appropriate in

property shall be presumed abandoned and may be distributed to the reciprocal states by the Virginia State Treasurer.

order to bring finality to the financial affairs of the HOW Companies in furtherance of their liquidation.

THEREFORE, BY THIS ORDER, THE COMMISSION:

1. Declares that further efforts to rehabilitate the HOW Companies would be useless and that the HOW Companies should be liquidated subject to the conditions and requirements provided by the Plans of Liquidation,

2. Declares that the rights, interests, and contingent claims of all builders, policyholders, certificate holders, and creditors of the HOW Companies are fixed as of the date of the entry of this order,

3. Declares that the only former members of HWC who are entitled to any refund of capital contributions pursuant to the Builder Agreements are those whose capital contributions vested pursuant to the terms of the Builder Agreements and who either: (a) after the inception of the receivership, had their Builder Agreements automatically terminated during 1994 and 1995 upon expiration of their Builder Agreements' one-year terms, or (b) voluntarily terminated their Builder Agreements either before inception of the receivership or prior to the date that such Builder Agreements would have terminated automatically during 1994 or 1995 upon expiration of their one-year terms, and who at the time of termination had been members in good standing for at least five consecutive years (collectively, "Eligible Builders")⁷,

⁷ There were Member-Builders who were in good standing as of October 14, 1994, but who had not been members in good standing for at least five continuous years as of the date their Builder Agreements were terminated automatically for non-renewal. The Commission agrees that such Member-Builders should be treated as if they meet the five year vesting requirement, because their Builder Agreements were terminated neither voluntarily nor for cause, but because of the

4. Declares that the HOW Companies' owners, who are entitled to any Residual Assets upon dissolution, are those persons who are HOWIC insureds as of the date of the Receivership Order, with each such Builder Distributee to receive a share of any Residual Assets which is proportionate to the Builder Distributee's respective contribution to HWC's treasury, pursuant to the methodology set forth in Exhibit "A-1" to the Application,

5. Authorizes the Deputy Receiver to adopt a directive implementing the HOWIC Plan of Liquidation if and when he files a written report with the Commission advising that he has received an actuarial projection that HOWIC has sufficient assets to satisfy its liabilities and to declare a dividend to HWC sufficient for HWC to satisfy its liabilities, including the refund of all vested capital contributions. Pursuant to the HOWIC Plan of Liquidation, the Deputy Receiver shall:

- a. Liquidate HOWIC and transfer its assets, along with any remaining liabilities, to HWC,
- b. Issue a directive establishing a period for the filing of proofs of claims against the HOW Companies, beginning on the date of issuance of the directive and ending on a specified deadline (the "Bar Date"), and mail and publish notices of such Bar Date to all interested parties, as described in greater detail below,

receivership. In addition, the Commission agrees with the Deputy Receiver that Member-Builders terminated only for filing bankruptcy prior to receivership should be treated as if they meet the five-year vesting requirement because their terminations were pursuant to so-called *ipso facto* clauses which federal bankruptcy courts have held are void as a matter of law. Other builders are not eligible for capital contribution refunds because they were terminated for cause other than bankruptcy, or terminated their Builder Agreements voluntarily prior to the vesting of capital contributions. The Commission agrees with the Deputy Receiver that those non-refundable capital contributions should be deemed to belong to HWC, for the benefit of its owners.

ORDER APPROVING PLANS OF LIQUIDATION FOR HOW INSURANCE COMPANY, A RISK RETENTION GROUP, HOME OWNERS WARRANTY CORPORATION, AND HOME WARRANTY CORPORATION, APPROVING CLAIMS BAR DATE, AND RELATED MATTERS

- c. Pay the costs and expenses of the HOW Companies' administration, pursuant to VA. CODE ANN. §§ 38.2-1509(B)(1) and 38.2-1510,
- d. Pay the claims of the HOW Companies' secured creditors, pursuant to VA. CODE ANN. § 38.2-1509.B.1(I),
- e. Adjudicate, and pay in full, the claims of policyholders arising out of the HOW Companies' insurance contracts, pursuant to VA. CODE ANN. § 38.2-1509.B.1(ii),
- f. Pay the HOW Companies' taxes, pursuant to VA. CODE ANN. § 38.2-1509.B.1(iii),
- g. Pay wages of the HOW Companies' employees entitled to priority, pursuant to VA. CODE ANN. § 38.2-1509.B.1(iv),
- h. Adjudicate, and pay in full, general creditor claims against the HOW Companies, pursuant to VA. CODE ANN. § 38.2-1509.B.1(v), and
- i. Begin the liquidation of HOWIC in the year in which HOWIC makes its first distribution of assets to HWC (the "Distribution Year") and, under applicable tax rules, complete the liquidation of HOWIC by the end of the third calendar year following the Distribution Year (the "Liquidation Period").

6. Requires the Deputy Receiver, if he does not issue a directive adopting the HOWIC Plan of Liquidation within three years of this order, to return to the Commission for further instruction,

7. Contingent upon the Deputy Receiver adopting the HOWIC Plan of Liquidation and completing the actual liquidating distributions from HOWIC to HWC pursuant thereto, authorizes

him to issue a second directive adopting the HOW/HWC Plan of Liquidation, pursuant to which he shall:

- a. Continue managing the affairs of the HOW Companies until such time as they are liquidated and dissolved,
- b. Pay the costs and expenses of the HOW Companies' administration, pursuant to VA. CODE ANN. §§ 38.2-1509(B)(1) and 38.2-1510,
- c. Adjudicate, and pay in full, the claims of policyholders arising out of the HOW Companies' insurance contracts, pursuant to VA. CODE ANN. § 38.2-1509.B.1(ii),
- d. Pay the HOW Companies' taxes, pursuant to VA. CODE ANN. § 38.2-1509.B.1(iii),
- e. Pay wages of the HOW Companies' employees entitled to priority, pursuant to VA. CODE ANN. § 38.2-1509.B.1(iv),
- f. Adjudicate, and pay in full, general creditor claims against the HOW Companies, including the refund of all vested capital contributions to Eligible Builders, pursuant to VA. CODE ANN. § 38.2-1509.B.1(v),
- g. Take all steps necessary and appropriate to liquidate and dissolve HOW as soon as reasonably practicable,
- h. Be authorized to cause any third party or contractor of the HOW Companies to assume remaining obligations and contingencies of HOWIC, HOW, or HWC, in exchange for reasonable consideration, to complete the liquidation and dissolution of such entities, and be authorized to obtain an independent opinion from an actuarial or accounting firm regarding the

reasonableness of consideration paid for the assumption of HOWIC, HOW, or HWC obligations or contingencies,

i. Be authorized to maintain a \$10 million reserve for claims, costs, expenses, unknown claims, and contingencies, over and above any existing reserves for insurance/warranty claims, until final liquidation of HWC,

j. Return to the Commission for further instruction if the amount of Residual Assets were to be so small as to make a distribution to Builder Distributees impracticable,

k. After the final wind down of HOWIC is completed, be authorized to cause HWC to distribute any Residual Assets to those builders who were HOWIC insureds as of the date of the Receivership Order, with each such Builder Distributee receiving a share of any Residual Assets which is proportionate to the Builder Distributee's respective contribution to HWC's treasury, under the following conditions: (i) the Deputy Receiver adopts a directive implementing the HOWIC Plan of Liquidation, (ii) the Deputy Receiver completes the HOWIC Plan of Liquidation and distributes HOWIC's assets and remaining liabilities to HWC during the Liquidation Period, and (iii) after receipt of HOWIC's assets and remaining liabilities, HWC first satisfies all liabilities of itself, HOW, and HOWIC before distributing any Residual Assets to the Builder Distributees.⁸

l. In the event that he cannot find any person owed funds by the HOW Companies, including any Builder Distributee owed a distribution of Residual Assets, deliver such unclaimed funds to the custody of the state of that person's last known address, as shown by the

⁸ The Commission approves the methodology for allocating Residual Assets among Builder Distributees described in Exhibit "A-1" to the Application.

HOW Companies' books and records, pursuant to the procedures established by that state's unclaimed property laws (or, if permitted by reciprocity arrangements, to the Virginia State Treasurer on behalf of such other state),

m. Be authorized to create a trust to hold any unclaimed funds if the applicable state unclaimed property laws did not permit him to deliver any such unclaimed funds to the relevant states prior to the date that HWC would cease to exist and the receivership would terminate (and if no reciprocity arrangement allows him to deliver the unclaimed funds to the Virginia State Treasurer on such other states' behalf), and

n. Dissolve HWC upon: (i) payment of its liabilities with all available assets, or (ii) distribution of all Residual Assets.

8. Authorizes the Deputy Receiver, in his reasonable discretion, to select a Bar Date 180 days after notice thereof. All Claims (including contingent claims, claims of Eligible Builders for refunds of capital contributions, and claims for increased percentage payments on previously approved claims) against the HOW Companies must be filed before the Bar Date, or be subordinated in payment to all timely filed claims, except that the following claims are not subject to the Bar Date:

a. Claims of any kind that have already been submitted properly to the Deputy Receiver, whether general creditor claims, claims for repairs of Major Structural Defects, claims for payment of builder defense costs, claims for breach of warranty, or any other claims, except that, to the extent that a claimant has not submitted the affidavit required to perfect a claim for an increased percentage payment of an approved claim pursuant to a Distribution Notification, such claim for an increased percentage payment of a previously approved claim shall be subject to the Bar Date,

b. Proper administrative expense claims (*i.e.*, claims for payment of services rendered, or goods supplied, to the HOW Companies at the request of the Deputy Receiver after October 14, 1994),

c. Claims covered by HOW Companies' policies and certificates, which are now in effect, for the repair of covered Major Structural Defects that have not yet manifested themselves as of the Bar Date,

d. Claims by builders for refund of Loss Reserve Deposits, or release of letters of credit, and

e. Claims by Builder Distributees to a share of the Residual Assets.

Claims submitted after the Bar Date, if approved, shall be subordinated in payment to all timely filed claims, with the exception of the claims described in categories "a" through "e" above, which shall not be subject to the Bar Date. All claims of whatsoever nature shall be permanently barred from sharing in the assets of the HOW Companies if such claims are not submitted to the Deputy Receiver before closure of the receivership, with the exception of claims described in category "e" above, which shall be governed by the unclaimed property laws,

9. Orders that disputes concerning any claims against the assets of the HOW Companies shall be resolved in accordance with the Receivership Appeal Procedure adopted by the Circuit Court in the Receivership Order,

10. Authorizes the Deputy Receiver, in his reasonable discretion as part of the Plans of Liquidation, to extend the initial Bar Date by directive to a date no more than 365 days following

the date of the directive establishing the initial Bar Date, if the initial Bar Date results in a filing period of less than 365 days,

11. Authorizes the Deputy Receiver to provide written notice of the Bar Date (and any extension thereof) and proof of claim instructions, by first-class United States mail to all known claimants, creditors, and former Member-Builders at their last known address disclosed in the books and records of the HOW Companies, in a form reasonably calculated to provide interested persons with notice of the proposed Bar Date (and any extension thereof) and the consequences of failing to timely file claims against the HOW Companies, except that the Deputy Receiver shall not be required to mail a notice if he reasonably believes that the last known address is no longer valid,

12. Authorizes the Deputy Receiver to publish notice of the Bar Date (and any extension thereof) and proof of claim instructions for one day each week for two consecutive weeks in the Richmond Times-Dispatch, The Wall Street Journal, and USA Today. The publication notice shall be of a form reasonably calculated to provide sufficient notice to any claimant, creditor, or former Member-Builder who does not receive direct notice by first-class United States mail of the Bar Date (and any extension thereof) and proof of claim instructions, and

13. Approves the termination and closure of these receivership proceedings without the necessity for further order of the Commission upon completion of the liquidation and dissolution of HOW, HOWIC, and HWC pursuant to the Plans of Liquidation, unless the Deputy Receiver determines that he should seek a specific order of discharge or some other order from the Commission.

All of the foregoing shall be subject to the further orders of the Commission.

AN ATTESTED COPY hereof, shall be sent by the Clerk of the Commission to [LIST RECIPIENTS].