

statutory priorities). Most administrative expenses have been paid in the ordinary course but a small number of rehabilitation-related costs were submitted as proofs of claim (“POCs”). These POCs have now been finally determined and submitted for allowance pursuant to 8 V.S.A. § 7082. It is appropriate that distribution be made on these claims because doing so will satisfy the statutory priorities and further the expeditious completion of this proceeding without impairing the estate’s ability to pay its remaining priority class 1 obligations. See 8 V.S.A. 7083 (establishing the circumstances under which distributions may be ordered). The Liquidator therefore requests authority to make a 100% distribution on allowed priority class 1 claims.

2. Pursuant to the Plan of Liquidation approved by the Court on August 10, 2017, the Liquidator is required to “monitor DSNRRG’s financial condition, and as circumstances warrant, petition the Court to establish a distribution percentage for making interim payments on finally determined claims in priority class 3.” See *id.*, at ¶ 2.d. The Liquidator believes that the circumstances of the proceeding and DSNRRG’s financial condition warrant making an interim distribution on allowed priority class 3 claims. An interim distribution would further the expeditious completion of this proceeding because it will encourage the prompt resolution of certain policyholder-level claims. Further, because DSNRRG’s assets are known and its liabilities can be reasonably estimated, the Liquidator believes the interests of creditors with allowed claims (who prefer a prompt disbursement) can be balanced against the interests of creditors with unliquidated/undetermined claims (for whom sufficient assets must be reserved) by establishing a 20% distribution percentage. See 8 V.S.A. § 7083. The Liquidator therefore requests that a 20% distribution percentage be established for priority class 3 and that he be authorized to make an interim distribution at that rate on allowed priority class 3 claims after he has received a suitable federal priority act release from the United States. See Affidavit of J.

David Leslie, Special Deputy Liquidator, in Support of Motion for Interim Distributions on Allowed Priority Class 1 and Class 3 Claims filed herewith, at ¶ 3 (hereinafter, “Leslie Aff., ¶ __”).

Background

3. On September 15, 2016, the Commissioner filed an *ex parte* Petition for Seizure Order pursuant to 8 V.S.A. § 7042(b) seeking, among other things, authorization to take possession and control of DSNRRG. The Court granted the Commissioner’s petition by its Order entered on September 15, 2016. After gaining control of DSNRRG’s assets and operations, the Commissioner concluded that the company was insolvent but that liquidation would be premature. Accordingly, the Commissioner requested that the Court place the company in rehabilitation, appoint him as rehabilitator, and approve a proposed rehabilitation plan (“Rehabilitation Plan”). The Court granted these requests in its Order for Rehabilitation of Doctors and Surgeons National Risk Retention Group IC, Inc., entered on October 7, 2016 (“Order for Rehabilitation”).

4. The flexible structure of the Rehabilitation Plan was superior to liquidation in many ways. Most notably, the Rehabilitation Plan allowed third-party claimants and policyholders to continue resolving disputes in their home jurisdictions, it avoided the disruption and expense of establishing a claim determination procedure and moving such disputes to Vermont, and it permitted a partial payment to claimants in the ordinary course of business. The key to the Rehabilitation Plan was the partial payment arrangement under which all policyholder-level claimants were to receive payment (and bear losses) at an equal rate. So long as the distribution rate for those payments was set at an appropriate level, it was possible in a rehabilitation setting to balance the interest of claimants with liquidated/determined claims and

the interest of claimants with unliquidated/undetermined claims. Cf. 8 V.S.A. § 7083 (requiring such balancing in liquidation proceedings). The Rehabilitation Plan initially contemplated a 50% distribution rate that was reduced to 35% in December of 2016 when the company's third party administrator ("TPA") and actuarial consultants reported adverse loss development and uncertainty regarding the company's ultimate liabilities. See Rehabilitator's Second Status Report, filed December 20, 2016, ¶ 10. See also Order Approving Rehabilitator's Motion to Reduce Claim Distribution Level, entered December 27, 2016, ¶ 1.

5. In the spring of 2017, the TPA updated its claims analysis and recommended significant increases in case reserves. The actuarial consultant then advised that further increases to DSNRRG's overall reserves were necessary but that the conditions necessary for producing a credible reserve estimate (e.g. claim volume and stability in claim development) were not present such that the extent of the necessary reserve increases could not be estimated in an actuarially sound manner. This meant that the reserve study underlying the 35% distribution rate was likely to have been understated, that the 35% distribution percentage risked creating preferential transfers under 8 V.S.A. § 7067, and that there was no actuarially sound basis for establishing a revised (lower) distribution percentage. See Petition for Order of Liquidation for Doctors and Surgeons National Risk Retention Group IC, Inc., filed June 19, 2017 ("Liquidation Petition"), ¶¶ 7-9.

6. In light of this analysis, the Commissioner concluded that liquidation was necessary. He therefore filed the Liquidation Petition, requesting that the Court place DSNRRG in liquidation, appoint him as liquidator, and approve the Plan of Liquidation. Because it was not possible to establish an actuarially supported distribution percentage, the Liquidator did not seek authority to make an interim distribution on policyholder-level claims. Instead, the Plan of

Liquidation contemplated that DSNRRG would cease all payments of defense and indemnity to its policyholder-level creditors. The Commissioner advised, however, that as Liquidator he would “closely monitor DSNRRG’s financial condition, and as circumstances warrant, petition the Court to establish a distribution percentage for making interim payments on finally determined claims in priority class 3.” Liquidation Petition, ¶ 20; Plan of Liquidation, ¶ 2.d. The Court approved the Plan of Liquidation in its Order of Liquidation entered on August 10, 2017 (“Order of Liquidation”).

7. On January 31, 2019, the Liquidator filed his Status Report and First Report of Claims presenting fifty-two finally determined POCs. See 8 V.S.A. §§ 7078(a) (“Within 60 days from the mailing of the notice [of determination], the claimant may file objections with the liquidator” and “[i]f no such filing is made, the claimant may not object to the determination”) and 7082(a) (“[T]he liquidator shall present to the court a report... of the claims against the insurer with recommendations”). The Court entered its Order Approving Liquidator’s First Report of Claims on February 4, 2019. See 8 V.S.A. § 7082(b) (“The court may approve, disapprove, or modify the report of claims [filed] by the liquidator.”). The Liquidator’s Second Report of Claims presenting thirty finally determined POCs is submitted as Exhibit A to the Liquidator’s Status Report, Annual Accounting, and Second Report of Claims filed herewith. See 8 V.S.A. §§ 7078(a) and 7082(a). If the Second Report of Claims is approved, the Court will have allowed eight POCs in priority class 1 (total value: \$30,490.39) and fifty-one POCs in priority class 3 (total value: \$1,400,727.43). Leslie Aff. ¶ 2.

8. In addition to claims filed by private parties, the Liquidator has also received a POC filed by the United States Department of Justice (“USDOJ”). That POC asserts “all rights under [DSNRRG] policies” regarding “unknown” claims and in an “unknown” amount. The

United States describes this placeholder POC as being “entitled to first priority treatment pursuant to 31 U.S.C. § 3713 [the federal priority act]”. The USDOJ has taken the position that a liquidator is personally liable to the extent that a distribution from the estate of an insolvent insurer impairs the estate’s ability to make payment on a subsequently discovered federal claim. The Liquidator is not aware of any obligations owed to the United States that would fall within priority class 1 (administrative expense) or priority class 3 (policyholder-level claims). The USDOJ has asserted, however, that federal priority act liability is strict and attaches even when the liquidator is unaware of federal claims at the time of the distribution, the existence of federal claims could not have been ascertained or predicted, and the United States has not identified, specified, or quantified any claims. Leslie Aff., ¶ 3.

9. DSNRRG’s liquid assets (held in the form of cash, cash equivalents, and short-term investments) totaled \$3.5 million as of July 31, 2019. In addition to these liquid assets, the estate is entitled to credit (i.e. setoffs against distributions on priority class 3 claims) for the value of payments made to policyholder-level creditors under the Rehabilitation Plan.¹ The extent to which such credits can be applied in setoff depends upon the distributions made from the estate (i.e. as the distribution rate rises, so does the opportunity for setoff). The Liquidator estimates, however, that ultimate recovery on these claims will exceed \$275,000. Leslie Aff., ¶ 4.

Statutory Structure

10. The liquidation statutes permit distributions “[u]nder the direction of the Court... in a manner that will assure the proper recognition of priorities and a reasonable balance between

¹ For example, POC 60 sought payment under the terms of a 2017 settlement agreement resolving a claim against a DSNRRG insured. That agreement established a \$500,000 obligation on which DSNRRG made a \$175,000 (35%) payment pursuant to the Rehabilitation Plan. POC 60 was allowed in this proceeding in the amount of DSNRRG’s total obligation (\$500,000) subject to DSNRRG’s prior payment of \$175,000. This means that the creditor will receive further funds from DSNRRG only if (and to the extent) that a distribution exceeding \$175,000 (i.e. 35%) is ordered in this proceeding.

the expeditious completion of the liquidation and the protection of unliquidated and undetermined claims, including third party claims.” 8 V.S.A. § 7083. In the case of an interim distribution, “assur[ing] the proper recognition of priorities” means establishing reserves sufficient to ensure that higher priority claims are paid in full. See 8 V.S.A. §§ 7081 (“Every claim in each class shall be paid in full or adequate funds retained for such payment before the members of the next class receive any payment”) and 7083. Similarly, “protect[ing] unliquidated and undetermined claims” means ensuring that sufficient funds are retained to ensure that all claims in a particular priority class will ultimately receive the same distribution percentage regardless of the time at which they are determined/liquidated. See 8 V.S.A. §§ 7081 and 7083.

11. Practically, the distribution statute requires that estate liabilities be projected for each priority class. Recognition of priorities for higher classes can then be assured by making distribution on the allowed claims and establishing reserves sufficient to ensure that all remaining claims expected to fall in that priority class can be paid in full. See 8 V.S.A. § 7081. If estimated liabilities in a priority class exceed the assets expected to be available, an interim distribution may be made on allowed claims so long as it is at a level (i.e. a distribution percentage) that is conservative and ensures there will be sufficient funds available to make similar payment on undetermined/unliquidated claims when they are eventually resolved. See 8 V.S.A. § 7083.

12. When considering the feasibility of a distribution, the Liquidator must also consider the potential application of the federal priority act. That act provides that “[a] claim of the United States Government shall be paid first when... a person indebted to the Government is insolvent and... the estate of the deceased debtor, in the custody of the... administrator, is not

enough to pay all debts of the debtor.” 31 U.S.C. § 3713(a). To incentivize strict compliance and thus protect the federal fisc, the act provides that “[a] representative of... an estate [excluding bankruptcy trustees] paying any part of a debt... before paying a claim of the Government is laible to the extent of the payment for unpaid claims of the Government.” 31 U.S.C. § 3713(b).

13. On its own, the federal priority act would create an absolute priority for federal claims. The effects of the federal priority act are constrained, however, by the the McCarran-Ferguson Act (15 U.S.C. § 1011 *et seq.*) which creates a form of reverse preemption, letting State laws regulating the business of insurance prevail over general federal rules that do not “specifically relate[] to the business of insurance.” See Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25, 38-41 (1996). The United States Supreme Court has applied the McCarran-Ferguson Act to address tensions between the federal priority act and State insurer insolvency statutes and concluded that State laws control to the extent they privilege administrative expenses and policyholder-level claims. See United States Dep’t of the Treasury v. Fabe, 508 U.S. 491, 493 and 508-09 (1993). Federal courts have also held, however, that claim filing deadlines established under State law are ineffective as against the United States. See Antonio Garcia v. Island Program Designer, Inc., 4 F.3d 57, 62 (1st Cir. 1993). This means that the United States might assert a new claim at any time and attempt to hold a liquidator personally liable in the event that a distribution was previously made and the estate no longer has sufficient assets to pay the late-filed federal claim. See Ruthardt v. United States, 303 F.3d 375, 385 (1st Cir. 2002) *cert. denied*, 538 U.S. 1031 (2003). The spectre of retroactive personal liability means that liquidators of insolvent insurers “cannot ever pay off creditors with lower priorities” -- i.e. those below priority class 1 -- “unless [they] can wrangle a waiver from the

United States.” Ruthardt, 303 F.3d at 385 (Observing that this is “simply terrible public policy and was almost certainly not the result of any considered judgment by Congress”).

Projection of DSNRRG’s Liabilities by Priority Class

14. **Priority Class 1 Liabilities.** The first priority class is reserved for “[t]he costs and expenses of administration, during conservation, rehabilitation and liquidation.” 8 V.S.A. § 7081(1). Most expenses of conducting the rehabilitation of DSNRRG were paid in the ordinary course of business and all liquidation expenses incurred to-date have been similarly paid. See Order for Rehabilitation, ¶ (d); Order of Liquidation, ¶ 5.A.iv. Unpaid priority class 1 claims are therefore limited to two categories: i) expenses of rehabilitation that were submitted as POCs in the liquidation and thus handled outside the ordinary course; and, ii) future expenses of administering the liquidation proceeding to its conclusion. With regard to the first category, all POCs presenting priority class 1 exposures have been allowed or presented for allowance in the total amount of \$30,490.39. See, *supra*, ¶ 7. With regard to prospective administrative expense, there is significant potential for variability due to the fact that disputed claim proceedings may prove necessary and could require that the Liquidator litigate substantive questions of medical malpractice in Vermont. See 8 V.S.A. § 7078(b) (Liquidator to request hearings to resolve disputed claims). The Liquidator has adopted a claim resolution strategy that is designed to reduce the likelihood of such litigation. See, e.g., Liquidator’s Status Report and First Report of Claims filed January 31, 2019 at ¶ 10 (“[T]he Liquidator has preferred to await developments in the underlying proceedings and pursue negotiated resolutions” rather than “issu[ing] notices of determination assigning a value to a controverted tort claim.”). In the interest of prudence and conservatism, however, the Liquidator has established a large reserve for priority class 1 claims – \$750,000 – that would be sufficient to fund both ordinary administrative expenses and any

necessary claims litigation. It should be recognized that much of this reserve can be released for the benefit of estate creditors if substantive disputed claim litigation proves unnecessary. Leslie Aff., ¶ 6.

15. **Priority Class 2 Liabilities.** Priority class 2 includes the administrative expenses of guaranty associations. See 8 V.S.A. § 7081(2). Because DSNRRG is a risk retention group and thus prohibited by law from participating in the guaranty fund systems, there are no guaranty association expenses associated with this proceeding and no possibility of any class 2 claim. See 15 U.S. Code Ann. § 3902(a); 8 V.S.A. § 6054(a).

16. **Priority Class 3 Liabilities.** Priority class 3 includes “all claims under policies”. 8 V.S.A. § 7081(3). Upon preliminary review of all claims filed in this proceeding, the Liquidator counted 123 POCs asserting claims under policies and therefore having the potential to constitute priority class 3 claims.² Of these POCs, ten have been denied or withdrawn and fifty-one have been allowed (or presented for allowance) in the total amount of \$1,400,727.43. See, supra, ¶ 7. This leaves sixty-two unliquidated/undetermined POCs potentially falling in priority class 3. It remains impossible to establish reserves for these claims using actuarial techniques. See, supra, ¶ 5. The application of the claim filing deadline, however, means that the universe of claims is largely fixed (see, infra, note 2) and the sixty-two remaining POCs actually relate to only thirty-three separate incidents of alleged medical malpractice.³ The Liquidator has investigated these incidents with the assistance of the claims adjudicator, Patrick

² Though the Liquidator is not aware that such claims exist, it should be noted that the United States is not subject to claim filing deadlines and could theoretically submit a new priority class 3 claim at any point. See, supra, ¶ 13.

³ A single incident of alleged malpractice can produce multiple POCs because claims may be asserted not only by the insured but also by patients, employers at risk of vicarious liability, and other third parties entitled to assert claims against the insured. See 8 V.S.A. § 7077(a).

McGrath. See Plan of Liquidation, ¶ 2.c (“The adjudicator will be engaged by the Liquidator for the purpose of reviewing medical malpractice claims, conducting such investigation as may be necessary, identifying a fair value for the claim, and assisting in settlement discussions.”) This process has permitted the claims adjudicator to form a judgment as to the range of potential DSNRRG exposures presented by each incident. Specifically, for each incident, Mr. McGrath has offered his opinion both as to a “best estimate” of the exposure presented as well as a “pessimistic scenario” reflecting the adverse end of the expected range of potential exposure.⁴ The total of Mr. McGrath’s “best estimate” projections for undetermined potential class 3 claims is approximately \$6.5 million while the total in a “pessimistic scenario” is approximately \$9.1 million. In light of Mr. McGrath’s analysis, the Liquidator believes it is reasonable and conservative to estimate that priority class 3 claims will ultimately total approximately \$10.5 million -- \$1.4 million in claims that have been allowed or presented for allowance plus \$9.1 million in undetermined claims under the “pessimistic scenario”. Leslie Aff., ¶ 10.

17. **Priority Classes 4-10 Liabilities.** Priority classes through 10 include all other claims filed with the Liquidator. 8 V.S.A. § 7081. Because the Liquidator anticipates that estate assets will be insufficient to pay all claims falling in priority class 3, no distribution on claims falling in priority classes 4-10 will be possible. It is therefore unnecessary to either evaluate the amount in which such claims might be allowed (see Plan of Liquidation, ¶ 2.b) or to establish reserves regarding these classes. See 8 V.S.A. §§ 7081 and 7083.

⁴ Mr. McGrath advises that his “best estimate” for each incident is equivalent to the reserve he would recommend DSNRRG carry if it were operating as a going concern while his “pessimistic scenario” is a conservative figure that, if used for purposes of evaluating ultimate priority class 3 exposures, would tend to protect the interest of creditors with undetermined and unliquidated claims. Mr. McGrath also notes that estimates of defense expense for any particular policyholder are subject to significant variability because idiosyncratic events (e.g. settlement occurring before trial vs. settlement after trial) can have material effects while outliers (e.g. matters involving trial, appeal, and retrial) can have very large impacts where defense expenses are in addition to policy limits. Mr. McGrath does not believe, however, that this potential for volatility prevents reasonable estimation of class 3 exposures.

Proposed Distributions

18. **Proposed Priority Class 1 Distribution.** As discussed above (see, supra, ¶ 10), unpaid liabilities in priority class 1 include POCs allowed or presented for allowance in the total amount of \$30,490.39 together with remaining administrative expenses for which the Liquidator has established a \$750,000 reserve. Liquid estate assets (\$3.5 million as of July 31, 2019) are clearly sufficient to pay all of these liabilities so the Liquidator requests authority to make a 100% distribution on the allowed priority class 1 claims. Leslie Aff., ¶¶ 4, 6; see 8 V.S.A. § 7083.

19. **Proposed Priority Class 3 Interim Distribution.** The Plan of Liquidation contemplates that, as circumstances and DSNRRG's financial condition warrant, the Liquidator will "petition the Court to establish a distribution percentage for making interim payments on finally determined claims in priority class 3." *Id.*, ¶ 2.d; see 8 V.S.A. § 7083. The Liquidator believes that the circumstances warrant an interim distribution because it may help to accelerate progress in the resolution of claims while protecting the interest of creditors with undetermined claims. Specifically, one reason that claim resolution has proceeded more slowly than had been hoped is that some claimants are hesitant to agree to a less-than-limits settlement when the Liquidator cannot "guarantee" the eventual estate distribution rate or a date by which payment will be made. Authorization to make an interim distribution on priority class 3 claims may reduce some of this creditor hesitation because the claimant would be guaranteed a sum certain (the amount of the allowed claim multiplied by the interim distribution percentage) as well as prompt payment. The Liquidator believes that, through the establishment of a conservative interim distribution percentage, this benefit can be achieved while still protecting the interests of creditors with unliquidated/undetermined claims. Leslie Aff., ¶ 9; see 8 V.S.A. § 7083

(Distributions must be made “in a manner that will assure... a reasonable balance between the expeditious completion of the liquidation and protection of unliquidated and undetermined claims.”)

20. For purposes of establishing an interim distribution percentage, the Liquidator compared estimated liabilities to available assets. As discussed in ¶ 16 above, the Liquidator estimates that the ultimate value of all priority class 3 claims will be \$10.5 million – \$1.4 million in POCs that have already been allowed or presented for allowance plus the claims adjudicator’s \$9.1 million “pessimistic scenario” projection of undetermined/unliquidated priority class 3 POCs. After making distribution on the priority class 1 claims and setting aside funds sufficient to ensure that the statutory priorities are recognized (i.e. the \$750,000 reserve for administrative expense), the Liquidator projects that liquid assets available to pay priority class 3 claims will total approximately \$2.48 million. See 8 V.S.A. §§ 7081 and 7083. Using the \$10.5 million exposure figure (which incorporates Mr. McGrath’s “pessimistic scenario” for priority class 3 exposures), these liquid assets -- together with the available setoffs described in ¶ 7 -- would be sufficient to support an ultimate distribution on priority class 3 claims of more than 25%. For purposes of an interim distribution, however, a “cushion” in the form of a lower distribution percentage would be appropriate to “assure... the protection of unliquidated and undetermined claims.”⁵ See 8 V.S.A. § 7083. The Liquidator therefore requests that the Court establish an interim distribution rate of 20% on priority class 3 claims. Such a distribution would result in the immediate payment of \$66,396.45 and the application of \$219,495.51 in credits for payments

⁵ Estate assets would be sufficient to pay a 20% distribution on all known priority class 3 claims even in the unlikely event that the ultimate value of undetermined/unliquidated claims is \$2.9 million (32%) higher than Mr. McGrath’s “pessimistic scenario” projection. The 20% interim distribution percentage therefore creates a significant “cushion” to ensure equivalent treatment of all priority class 3 claims. See 8 V.S.A. § 7083. It should be noted that the Liquidator does not expect such adverse development and that, if claims develop in line with Mr. McGrath’s “best estimate”, the ultimate distribution on priority class 3 claims will exceed 35%.

made in rehabilitation. See, supra, ¶ 7. Nearly \$2.4 million would remain available to pay distributions at the 20% rate as POCs are finally determined and to pay a higher distribution percentage at the close of the proceeding. See, supra, note 5. In light of these figures, the Liquidator believes a 20% distribution percentage strikes a reasonable balance between the expeditious completion of the liquidation and the protection of unliquidated/undetermined claims and that an interim distribution on allowed priority class 3 claims is therefore appropriate. Leslie Aff., ¶ 10; see 8 V.S.A. § 7083.

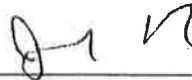
21. For the reasons discussed above, the Liquidator believes that the proposed interim distribution on allowed priority class 3 claims is appropriate and in conformity with the Vermont liquidation statutes. See 8 V.S.A. § 7083. To avoid potential personal liability under the federal priority act, the Liquidator requests that authority to make an interim distribution be contingent upon his receipt of a suitable federal priority act waiver from the United States. See 31 U.S.C. § 3713; Ruthardt, 303 F.3d at 385 (noting the need for such waivers).

WHEREFORE, the Liquidator requests that the Court enter an order:

- (a) Granting this Motion for an Order Authorizing Distributions on Allowed Priority Class 1 Claims and an Interim Distribution on Allowed Class 3 Claims;
- (b) Authorizing a 100% distribution on allowed priority class 1 claims;
- (c) Establishing a 20% interim distribution rate on priority class 3 claims;
- (d) Authorizing the Liquidator to make an interim distribution at the 20% rate on all allowed priority class 3 claims (contingent upon receiving a suitable federal priority act release from the United States); and,
- (e) Granting such other and further relief as justice may require.

Dated in Montpelier, Vermont, this 29th day of August, 2019.

MICHAEL S. PIECIAK, COMMISSIONER
DEPARTMENT OF FINANCIAL REGULATION
AS LIQUIDATOR OF DOCTORS AND
SURGEONS NATIONAL RISK RETENTION
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If the Second Report of Claims is approved, the Court will have allowed eight POCs in priority class 1 (total value: \$30,490.39) and fifty-one POCs in priority class 3 (total value: \$1,400,727.43).

3. In addition to claims filed by private parties, the Liquidator has also received a POC filed by the United States Department of Justice (“USDOJ”). That POC asserts “all rights under [DSNRRG] policies” regarding “unknown” claims and in an “unknown” amount. The United States describes this placeholder POC as being “entitled to first priority treatment pursuant to 31 U.S.C. § 3713 [the federal priority act]”. The USDOJ has taken the position that a liquidator is personally liable to the extent that a distribution from the estate of an insolvent insurer impairs the estate’s ability to make payment on a subsequently discovered federal claim. The Liquidator is not aware of any obligations owed to the United States that would fall within priority class 1 (administrative expense) or priority class 3 (policyholder-level claims). The USDOJ has asserted, however, that federal priority act liability is strict and attaches even when the liquidator is unaware of federal claims at the time of the distribution, the existence of federal claims could not have been ascertained or predicted, and the United States has not identified, specified, or quantified any claims.

4. DSNRRG’s liquid assets (held in the form of cash, cash equivalents, and short-term investments) totaled \$3.5 million as of July 31, 2019. In addition to these liquid assets, the estate is entitled to credit (i.e. setoffs against distributions on priority class 3 claims) for the value of payments made to policyholder-level creditors under the Rehabilitation Plan.¹ The extent to

¹ For example, POC 60 sought payment under the terms of a 2017 settlement agreement resolving a claim against a DSNRRG insured. That agreement established a \$500,000 obligation on which DSNRRG made a \$175,000 (35%) payment pursuant to the Rehabilitation Plan. POC 60 was allowed in this proceeding in the amount of DSNRRG’s total obligation (\$500,000) subject to DSNRRG’s prior payment of \$175,000. This means that the creditor will receive further funds from DSNRRG only if (and to the extent) that a distribution exceeding \$175,000 (i.e. 35%) is ordered in this proceeding.

which such credits can be applied in setoff depends upon the distributions made from the estate (i.e. as the distribution rate rises, so does the opportunity for setoff). The Liquidator estimates, however, that ultimate recovery on these claims will exceed \$275,000.

5. Most of the expenses of administering DSNRRG's rehabilitation and liquidation have been paid in the ordinary course but a small number of rehabilitation-related costs were submitted as proofs of claim ("POCs"). These POCs have now been finally determined and submitted for allowance pursuant to 8 V.S.A. § 7082.

6. Unpaid priority class 1 claims are limited to two categories: i) expenses of rehabilitation that were submitted as POCs in the liquidation and thus handled outside the ordinary course; and, ii) future expenses of administering the liquidation proceeding to its conclusion. With regard to the first category, all POCs presenting priority class 1 exposures have been allowed or presented for allowance in the total amount of \$30,490.39. In the interest of prudence and conservatism, however, the Liquidator has established a large reserve for priority class 1 claims – \$750,000 – that would be sufficient to fund both ordinary administrative expenses and any necessary claims litigation. It should be recognized that much of this reserve can be released for the benefit of estate creditors if substantive disputed claim litigation proves unnecessary.

7. Priority class 2 includes the administrative expenses of guaranty associations. Because DSNRRG is a risk retention group and thus prohibited by law from participating in the guaranty fund systems, there are no guaranty association expenses associated with this proceeding and no possibility of any class 2 claim.

8. Priority class 3 includes "all claims under policies". Upon preliminary review of all claims filed in this proceeding, the Liquidator counted 123 POCs asserting claims under

policies and therefore having the potential to constitute priority class 3 claims. Of these POCs, ten have been denied or withdrawn and fifty-one have been allowed (or presented for allowance) in the total amount of \$1,400,727.43. This leaves sixty-two unliquidated/undetermined POCs potentially falling in priority class 3. It remains impossible to establish reserves for these claims using actuarial techniques. The application of the claim filing deadline, however, means that the universe of claims is largely fixed and the sixty-two remaining POCs actually relate to only thirty-three separate incidents of alleged medical malpractice. The Liquidator has investigated these incidents with the assistance of the claims adjudicator, Patrick McGrath. This process has permitted the claims adjudicator to form a judgment as to the range of potential DSNRRG exposures presented by each incident. Specifically, for each incident, Mr. McGrath has offered his opinion both as to a “best estimate” of the exposure presented as well as a “pessimistic scenario” reflecting the adverse end of the expected range of potential exposure.² The total of Mr. McGrath’s “best estimate” projections for undetermined potential class 3 claims is approximately \$6.5 million while the total in a “pessimistic scenario” is approximately \$9.1 million. In light of Mr. McGrath’s analysis, the Liquidator believes it is reasonable and conservative to estimate that priority class 3 claims will ultimately total approximately \$10.5 million -- \$1.4 million in claims that have been allowed or presented for allowance plus \$9.1 million in undetermined claims under the “pessimistic scenario”.

² Mr. McGrath advises that his “best estimate” for each incident is equivalent to the reserve he would recommend DSNRRG carry if it were operating as a going concern while his “pessimistic scenario” is a conservative figure that, if used for purposes of evaluating ultimate priority class 3 exposures, would tend to protect the interest of creditors with undetermined and unliquidated claims. Mr. McGrath also notes that estimates of defense expense for any particular policyholder are subject to significant variability because idiosyncratic events (e.g. settlement occurring before trial vs. settlement after trial) can have material effects while outliers (e.g. matters involving trial, appeal, and retrial) can have very large impacts where defense expenses are in addition to policy limits. Mr. McGrath does not believe, however, that this potential for volatility prevents reasonable estimation of class 3 exposures.

9. The Liquidator believes that one reason that claim resolution has proceeded more slowly than had been hoped is that some claimants are hesitant to agree to a less-than-limits settlement when the Liquidator cannot “guarantee” the eventual estate distribution rate or a date by which payment will be made. Establishment of an interim distribution on priority class 3 claims may reduce some of this creditor hesitation because the claimant would be guaranteed a sum certain (the amount of the allowed claim multiplied by the interim distribution percentage) as well as prompt payment.

10. For purposes of establishing an interim distribution percentage, the Liquidator compared estimated liabilities to available assets. As discussed above, the Liquidator estimates that the ultimate value of all priority class 3 claims will be \$10.5 million – \$1.4 million in POCs that have already been allowed or presented for allowance plus the claims adjudicator’s \$9.1 million “pessimistic scenario” projection of undetermined/unliquidated priority class 3 POCs. After making distribution on the priority class 1 claims and setting aside funds sufficient to ensure that the statutory priorities are recognized (i.e. the \$750,000 reserve for administrative expense), the Liquidator projects that liquid assets available to pay priority class 3 claims will total approximately \$2.48 million. Using the \$10.5 million exposure figure (which incorporates Mr. McGrath’s “pessimistic scenario” for priority class 3 exposures), these liquid assets -- together with the available setoffs described in ¶ 4 -- would be sufficient to support an ultimate distribution on priority class 3 claims of more than 25%. For purposes of an interim distribution, however, a “cushion” in the form of a lower distribution percentage would be appropriate to “assure... the protection of unliquidated and undetermined claims.”³ If the Liquidator’s request

³ Estate assets would be sufficient to pay a 20% distribution on all known priority class 3 claims even in the unlikely event that the ultimate value of undetermined/unliquidated claims is \$2.9 million (32%) higher than Mr. McGrath’s “pessimistic scenario” projection. The 20% interim distribution percentage therefore creates a significant “cushion” to ensure equivalent treatment of all priority class 3 claims. It should be noted that the Liquidator does not expect

to establish a 20% interim distribution rate were granted and an interim distribution made on the allowed class 3 claims, nearly \$2.4 million would remain available to pay distributions at the 20% rate as POCs are finally determined and to pay a higher distribution percentage at the close of the proceeding.

Dated this 26th day of August, 2019.

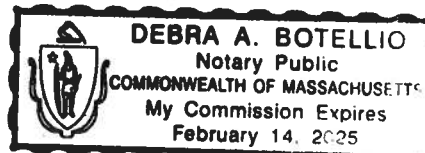

J. David Leslie, Special Deputy Liquidator

Subscribed and sworn to before me
this 26th day of August, 2019



Notary Public

My commission expires:



such adverse development and that, if claims develop in line with Mr. McGrath's "best estimate", the ultimate distribution on priority class 3 claims will exceed 35%.

STATE OF VERMONT
WASHINGTON COUNTY, SS

_____)
COMMISSIONER OF THE)
DEPARTMENT OF FINANCIAL)
REGULATION)
PLAINTIFF,)
)
v.)
)
DOCTORS AND SURGEONS)
NATIONAL RISK RETENTION GROUP)
IC, INC.)
RESPONDENT.)
_____)

SUPERIOR COURT
DOCKET NO. 559-916 Wncv

[PROPOSED]
ORDER AUTHORIZING DISTRIBUTIONS ON ALLOWED
PRIORITY CLASS 1 CLAIMS AND AN INTERIM
DISTRIBUTION ON ALLOWED CLASS 3 CLAIMS

This matter having come before the Court, by motion of the Commissioner of the Vermont Department of Financial Regulation (“Commissioner”) in his capacity as Liquidator (“Liquidator”) of Doctors and Surgeons National Risk Retention Group IC, Inc. (“DSNRRG”), for an order authorizing a 100% distribution on allowed priority class 1 claims, establishing a 20% interim distribution rate on priority class 3 claims, and authorizing an interim distribution at the 20% rate on all allowed priority class 3 claims, it is ORDERED that:

- i. The Liquidator’s Motion for an Order Authorizing Distributions on Allowed Priority Class 1 Claims and an Interim Distribution on Allowed Class 3 Claims is GRANTED;
- ii. The Liquidator is authorized, pursuant to 8 V.S.A. § 7082, to make a 100% distribution on allowed priority class 1 claims;
- iii. A 20% interim distribution percentage is established on priority class 3 claims; and,

- iv. Contingent upon having first received a federal priority act release from the United States that he deems suitable, the Liquidator is authorized, pursuant to 8 V.S.A. § 7082, to make a 20% interim distribution on allowed priority class 3 claims.

Dated in Montpelier, Vermont, _____, 2019.

Superior Court Judge