

P & P CAPTIVE NEWSLETTER

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FAREWELL TO LISA VENTRISS

The history of captives in Vermont is replete with the contributions of extraordinary people. Some made their mark then moved on to another phase in their career or life. Others remained to continue Vermont's tradition of excellence. We have been truly favored by these people and that, perhaps above all, explains Vermont's success as a captive domicile. On June 1, 2002 another of these transitions occurred as Lisa Ventriss left her position as President of the VCIA to lead the Vermont Business Roundtable.

Lisa first appeared on the captive scene five years ago to head the VCIA. She came into an organization which, at that time, was admittedly at a crossroads. What began as a predominately Vermont institution developed an increasingly important out-of-state constituency – namely those who formed captives in the state of Vermont. Could the VCIA maintain its vitality and provide real value to a remarkably diverse group of people, companies and associations spread throughout the

country? Those who perhaps doubted the VCIA's chances then had little notion of the talented, energetic person about to take its helm.

It is difficult to describe Lisa's five years of contributions in a few words. Foremost among her accomplishments was the successful integration of many new faces into the VCIA. The Committees of the VCIA, typically comprised of people from every corner of the United States, diligently pursued a wide range of issues designed to ensure Vermont's stature as "the domestic domicile of choice." During Lisa's tenure, the VCIA developed the Captive Reciprocal bill, Sponsored Captive legislation, and numerous "technical" bills designed to make life more rational for captives and their lawyers (for this we truly thank her). Her track record in the legislative arena is unblemished: What Lisa wanted, Lisa got.

Fortunately, Lisa's legislative prowess did not begin or end at Vermont's borders. Several years ago the U.S. Treasury Department got the idea that policyholders should only be permitted to deduct

premiums paid to insurers which had at least 51% unrelated business. In other words, most corporate owners would be unable to deduct premiums paid to affiliated captives. Lisa immediately contacted staff members of Vermont's U.S. Senate delegation and met with other industry trade groups to rally opposition to the Treasury's proposal. With Lisa's assistance, the proposal ultimately died.

Nevertheless, there were some "miscalculations" along the way (the Puff the Magic Dragon evening at one VCIA Conference readily comes to mind). Such moments, however, merely serve to remind us of the very special personal qualities Lisa brought to her job: a self-effacing sense of humor, the willingness to take a chance, and a broad intellectual curiosity. On behalf of our clients, we thank Lisa for a job well done and wish her continued success in all of her endeavors.

PROGRESS ON EXPANSION OF LIABILITY RISK RETENTION ACT

Advocates for expansion of the federal Liability Risk Retention Act ("LRRRA") have had recent successes, and one setback, in seeking to allow broader coverages to be written by Risk Retention and Purchasing Groups. After diligently building a broad coalition, including several RRGs and national trade and service organizations (including the NRRRA, VCIA and The Consumer Federation of America), an attempt was made to link LRRRA expansion to the Senate's version of the Terrorism Insurance Bill.

Sponsors of the measure, Wyden of Oregon and Burns of Montana, agreed on language and sought to add it as an

amendment. Parliamentary rulings prohibited the linkage, and the Senate passed its Terrorism bill without the Wyden/Burns amendment. Coalition leaders in Washington, D.C. and elsewhere are evaluating whether to push the measure in stand-alone form, or to seek its inclusion with other pending legislation.

In addition to obtaining important sponsorship, the coalition has solidified support in other influential quarters, including insurance trade associations, regulatory departments, and state legislators. Both the Alliance of Insurers and the National Association of Independent Insurers support the coalition. Vermont – the domicile with the greatest number of RRGs – has also been a driving force. Vermont's Director of Captive Insurance, Leonard Crouse, wrote a letter to Congress strongly supporting expansion, and Commissioner Costle has been lobbying her counterparts in other states and the NAIC to take a favorable, or at least neutral, position. Two Vermont legislators, Kathleen Keenan and Mark Young, both of whom have consistently and enthusiastically supported captives, and who hold leadership positions in the National Conference of Insurance Legislators ("NCOIL"), introduced a resolution at NCOIL urging Congress to accept the proposed expansion. On July 11, NCOIL adopted the favorable resolution and it has now been furnished to Congress.

Not surprisingly, this effort is costly, and the brunt is being borne by a handful of RRGs. As always, legislative or regulatory victories usually flow from the willingness of a few interested RRGs to step up to the plate. Passage of the LRRRA expansion measure, however, will greatly benefit any RRG

desiring alternatives to property, auto, physical damage, marine and aircraft hull, and other specialized casualty coverages outside liability areas already permitted.

There are at least two mechanisms for providing financial assistance to this mutual effort, namely the NRRRA's ongoing fundraising support from members, and a separate funding mechanism put together by a group of RRGs and administered independently by Dan Labrie, CEO of the Housing Authority RRG. If you would like to discuss these options, or contact the RRGs already involved, please contact Jeff Johnson, Jim Clemons or John Primmer.

THE ROLE OF A CAPTIVE BOARD MEMBER POST-ENRON, WORLDCOM, ETC.

While recent financial debacles have involved a variety of means of hiding expenses or exaggerating revenues, they all seem to have a common denominator: Someone was asleep at the switch. Obviously auditors and law firms can be faulted in many cases, but where were the boards or the crucial committees? Usually when grave troubles result from gross violations or avoidance of existing rules, sweeping new rules follow. Right now the focus is on the auditors. But it is a near certainty that a result of this will be to raise the standards of conduct for corporate fiduciaries. Directors and committee members can expect to be required to work harder, be more skeptical, pay closer attention, and see more clearly. At the same time they can expect to face greater risks in serving on boards.

In a recent conversation with Len Crouse, Vermont's Captive Director, he said:

“Service on a corporate board of directors can no longer be considered simply as an honorarium. The time has long gone when a director could expect to merely attend a monthly board meeting and collect a fee without actively participating in the governance of the corporation on whose board they served. The increasing complexity of the marketplace and the currently challenging economic environment in which companies are operating has brought this fact sharply into focus.

Here in Vermont I cannot emphasize enough the ever-increasing importance of the director's active role in corporate oversight at the captive company level as well as at the parent company. It is very sobering when you view the disastrous effect that manipulation of corporate financial results has had not only on the corporations involved, but also on both the individual investor and the economy as a whole. As a result, we are placing even more reliance than ever on Vermont's first line of defense, the captive attorneys, managers, auditors, and actuaries involved with these companies, to keep us apprised on a timely basis of the development of potential problems impacting a captive company or parent. We expect that the directors of these regulated captive entities will be on top of things as well. As for our in-house activities, we have in this past year stepped up our offsite surveillance of parent companies by putting in place several systems and procedures both for monitoring parent company financial health and for minimizing any adverse impact the parent's finances may have on its Vermont captive.”

Two years ago P&P began to organize the

collective experience of its Corporate/Commercial lawyers into a specialty called the Governance Project. This has recently been expanded to include the firm's Litigation/Employment Practices group. In our ongoing representation of corporate and other boards our new emphasis is to help them strengthen their standards of professionalism and accountability to meet emerging standards. As Len Crouse puts it, "The days of the 'Good Old Boys' Club' are over."

RRG FEE ISSUES: BUILDING ON THE MICHIGAN MOMENTUM

We have recently learned that the Oklahoma Insurance Department will no longer apply its annual anti-fraud fee to foreign-domiciled risk retention groups registered to do business in that state. The fee, currently \$600 paid in quarterly installments, originated in 1999 to fund the Department's then-new Anti-Fraud Unit. On behalf of various clients, Primmer & Piper has carried on an active dialogue with the Department pointing out that the fee is preempted by the federal Liability Risk Retention Act (LRRRA) and that it is unreasonable as applied to insurers like risk retention groups whose insureds are also its owners.

Though no reason has been given for the Department's reversal, the recent federal court decision overturning a Michigan fee charged to risk retention groups substantially strengthened the preemption argument. We are now working with companies registered in Nevada to file suit challenging that state's \$2,450 annual fee, and will keep you posted on developments. We remain committed to challenging the various illegal fees states impose, and

continuing the process of educating state regulators on their important but limited role under the LRRRA.

NEWS FROM THE VERMONT STATE HOUSE: LEGISLATURE ADJOURNS AFTER LENGTHY SESSION

The 2001-2002 Vermont General Assembly finally adjourned in late June, concluding one of the longest sessions in recent history. The major obstacle to final adjournment was legislative redistricting; a decennial exercise in which the boundaries for legislative districts are redrawn to reflect



population shifts identified by the recent census. Faced with either compromising on the politically-charged issue or allowing the courts to decide the legislative boundaries, lawmakers chose compromise. The Legislature will not reconvene until next January to begin a new biennium. All bills not passed into law this year are now dead. Initiatives will need to be reintroduced in January for reconsideration.

The year was generally quiet for captives in the State House, although one unexpected and unwelcome initiative surfaced in the waning days of the session. Currently, a portion of the overall captive premium tax paid by insurers and collected by the state helps fund captive-related marketing services conducted by the Vermont Agency of Commerce and Community Development. Late this session, the Senate passed its version of the annual budget bill containing a proposal to increase the percentage going to the Agency from two to three percent. While the proposal did not attempt to increase the captive premium tax paid by insurers, concerns were raised by the captive

insurance industry when it became evident that funds generated from the increase may not have been intended for the Agency's promotion of captive insurance. In the end, lawmakers decided to refrain from this proposal and allocate additional revenue to the Agency of Commerce and Community Development from another source.

Overall, this General Assembly will be remembered for many things, though not for passage of landmark legislation. This session marked the first time in well over a decade that opposing parties controlled the House and Senate. Partisanship was rife, particularly in the waning days and hours, as evidenced by the battle over legislative redistricting. That issue, combined with a difficult budget year due to declining revenues, helped to push the session almost two months past its targeted adjournment date. Many other high-profile issues fell victim to philosophical differences, including revisions to the state's education financing law, repeal of the state's civil unions law, comprehensive renewable energy initiatives and mandates, Medicaid reform (health care delivery), and regulations intended to eradicate mercury-added products. Among the bills enacted into law (and sure to be touted by lawmakers) were late compromises related to the management of collected stormwater runoff (an issue that has stalled commercial development in parts of the state), on-site septic systems and new authority for landowners to install alternative septic systems, and a measure designed to increase public accountability of physicians.

Particularly troubling for legislators is a continued decline in revenues. Recent budget figures show revenues approximately \$25 million below forecast.

This effectively renders the '03 budget just approved by the Legislature obsolete. Faced with either further extending the session to revise the budget, call a special session to readdress the budget, or grant expanded authority to the executive branch to make the necessary cuts, the Legislature chose the latter. Look for the Governor to not only make cuts in the months ahead but also dip into the "rainy day" reserves to cover shortfalls.

Declining revenues are expected to continue and force the next Legislature to face another tough budget. Above all, however, looms change in Vermont's political landscape. Governor Howard Dean (D) is leaving office after serving in that capacity for over a decade - to run for President. A close race for the next Governor is expected between Lieutenant Governor Doug Racine (D) and Treasurer Jim Douglas (R), whose resultant departures from their respective offices will leave them wide open to hotly contested races. Several Representatives and Senators have already announced their retirement from public office. This, combined with the historical 30-35% legislative turnover, promises many new faces in the next General Assembly. Lastly, election of a new Governor portends significant changes at the agency and department levels of the executive branch.

We will continue to report on election results and anticipated legislative initiatives in the coming months.

UPDATES

- On July 1, 2002 Molly Lambert became President of the VCIA. She previously served as Vermont's Secretary of

Economic Development. We wish her the best of luck in her new position.

- In June, the U.S. Senate passed a terror insurance bill. If ultimately enacted, the legislation will provide a federal backstop for insurers in the event of a catastrophic loss caused by terrorism. The bill is markedly different than a terror insurance bill passed in late 2001 by the House of Representatives. At this time, a Conference Committee to resolve the differences in the respective approaches has not been appointed.

- VCIA efforts to evaluate possible revisions to Vermont's captive statute continue. The Legislative Committee is presently considering a variety of adjustments which would clarify operation of the statute.

Changes would not occur until the Vermont Legislature convenes in 2003.

E-MAIL OPTION

If you would prefer to save a tree and receive your copy of the P&P Captive Newsletter by e-mail, please contact Cara Griswold at (802)223-2102 or by e-mail at cgriswold@primmer.com.

Primmer & Piper's captive team is comprised of: John L. Primmer, Jeffrey P. Johnson, James E. Clemons, Russell A. Young, James F. Feehan, Cara Griswold, Laura Daudelin and Kurt Lutes.