

08/30/2001

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HONORABLE MARK R. SANTANA

D. Glab
Deputy

CV 1992-005232

FILED: _____

JOHN GREENE, et al.

NICHOLAS C GUTTILLA

v.

AMS LIFE INSURANCE COMPANY, et al. MICHAEL R GLOVER

ROBERT G BESHEARS
PATRICK M MURPHY
RYAN J TALAMANTE
MARK J DEPASQUALE
MICHAEL HASSAN
LORD BISSELL & BROOK
115 S LASALLE ST
CHICAGO IL 60603-3801

MINUTE ENTRY

The court having heard the testimony in this case, having considered the evidence and oral argument of counsel, finds as follows:

I. INTRODUCTION

The evidence in this case establishes that J. Huell Briscoe & Associates, Inc. and respondents Jerome S. Comm and Bruce Jackson (collectively referred to as Briscoe) had a long and close working relationship with AMS Life Insurance Company (AMS). As the sole actuaries for AMS, Briscoe provided virtually all of the actuarial services for AMS from 1983 to 1990, including performing quarterly reserves for AMS from 1983 to 1990, year end certification of reserves from 1983 to 1990,

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and supplying AMS with annual statements information. Briscoe updated its in-force and transaction records on a quarterly basis from AMS's records. Briscoe met with AMS personnel at AMS office each quarter to reconcile AMS records with Briscoe's documents.

Briscoe knew that AMS had no internal expertise or capacity to calculate its reserves or appreciate what an actuary would need to calculate reserves. Moreover, because of the constant turnover in AMS treasurers, Briscoe knew or should have known that AMS was in a particularly vulnerable position with respect to the accuracy of its financial position. Briscoe also knew, or should have known, as part of the professional responsibility, that AMS was totally dependant on Briscoe for timely, accurate, actuarial services. AMS, its officers, directors and stockholders relied upon Briscoe to provide timely, accurate actuarial services. State regulators and at least current policyholders were also relying on Briscoe for actuarial services that met professional standards.

Among the most critical of those professional obligations was to accurately calculate the AMS reserves so that there was "good and sufficient provisions for all unmatured obligations of the company guaranteed under the terms of its policies." The evidence presented at trial establishes that Briscoe repeatedly failed to properly make those reserve calculations and violated its professional obligations to AMS, the state regulators and policyholders.

II. 1988 ACTUARIAL CERTIFICATION

Excess Interest

The evidence establishes that Briscoe did receive the excess interest calculations. Both trial testimony and exhibits establish that Briscoe received the CFO information that contained the excess interest calculations. It is simply not

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credible for Briscoe to argue that, despite serving as the sole actuary for AMS, and meeting with AMS on a quarterly basis to reconcile Briscoe's internal numbers with AMS, Briscoe had no knowledge of the AMS excess interest calculations. Despite Briscoe protestations to the contrary, there is no persuasive evidence that AMS systematically withheld the excess interest information from its actuary. To the contrary, the evidence indicates that AMS provided Briscoe with whatever information AMS possessed concerning the excess interest. Moreover, the evidence demonstrates that there were Falconer reports in the Briscoe quarterly reserve files that showed hundreds of excess interest guarantees which were simply ignored.

AMS/AmFed Treaty

The evidence establishes that Amfed was not authorized to transact business in Arizona. As required by A.R.S. § 20-261, the treaty was not valid until it was approved in writing by the Director of the Arizona Department of Insurance (ADOI). The approval never occurred. Briscoe failed to determine that Amfed was not an authorized insurer or that the custodial account called for in the agreement had never been established. More significantly, Briscoe failed to recognize that there was no transfer of risk associated with the Amfed treaty and AMS was therefore not entitled to take a corresponding reserve credit.

The evidence is overwhelming that Briscoe made virtually no effort to review this treaty and similar treaties in 1989 and 1990. The Briscoe actuary did not even bother to obtain a copy of these agreements, apparently believing that a phone call to determine that the treaties existed was a sufficient review. To put it mildly, the court believes that these actions demonstrate something less than professional diligence.

Nevertheless, Briscoe vigorously argues that for the 1988 and 1989, there was no specific professional guidance concerning what constituted a risk transfer. Until the promulgation of Actuarial Standard of Practice 11 (effective 1990), there was no

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formal guidance on what constituted a transfer of risk in 1988 and 1989. But the testimony and evidence at trial established that the standard of practice in those years was such that (1) a substantial or actual risk had to be transferred and (2) state regulators would not permit a risk transfer that was disproportionate to reserve credit. Moreover, Briscoe had been repeatedly warned by the Illinois Department of Insurance (IDOI), one of its state regulators, that there must be a legitimate transfer of primary risk.

The court rejects the suggestion that a sufficient "risk" is transferred if the treaty creates liability to the reinsurer in the event of a national economic collapse or sudden nationwide "run" on Briscoe's reserves. No significant risk was transferred by the AMFed treaty. The AMFed treaty, like later risk transfer treaties, was a sham treaty to allow AMS to increase its reserves when there had been no meaningful transfer of risk. Briscoe fully participated in these sham treaties by failing to identify these agreements as improper transfers of risk and certifying reserves based on these hollow agreements.

UHL

Although the evidence establishes that Briscoe failed to include the liabilities from the UHL merger in the 1988 certification, the evidence is inconclusive as to whether Briscoe actually received the information relating to these policies.

Minimum Nonforfeiture

The 1988 Briscoe certification clearly states that the calculations of reserves "meets the requirements of the insurance laws of Arizona". But the evidence establishes that the calculations do not meet the requirements of A.R.S. § 20-1232, the Arizona minimum nonforfeiture statute. The evidence clearly establishes that Briscoe, at least by 1987, was familiar with the application of state minimum nonforfeiture laws and

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that these statutes, including Arizona's, required a prospective and retrospective test.

Briscoe does not seriously dispute that it was familiar with these tests or that A.R.S. § 20-1232 required application of a prospective and retrospective test. Rather, it argues that the ADOI did not require compliance with A.R.S. § 20-1232 because of the unworkability of these statutory standards. But Briscoe produced no persuasive evidence at trial to support this position. Bruce Jackson, the responsible actuary, admitted that he had never consulted with the ADOI on whether that agency was enforcing A.R.S. § 20-1232. Moreover, the court finds the testimony of Robert Wilcox, Briscoe's expert witness, that ADOI was not enforcing the minimum nonforfeiture law, unpersuasive and unsupported.

Briscoe breached its professional duties and obligations when it certified that the AMS 1988 reserves complied with A.R.S. § 20-1232. Briscoe knew or should have known that its reserve calculations did not comply with that statute and it had never received a waiver from ADOI concerning the statute's enforceability.

Negligence

The evidence establishes that Briscoe was negligent in its 1988 actuarial certification of the AMS reserves with respect to excess interest, the AMS/AMFed Treaty and the minimum nonforfeiture statute, A.R.S. § 20-1232.

Negligent Misrepresentation

Briscoe's 1988 certification constitutes negligent misrepresentation as to excess interest, the AMS/AMFed Treaty and the minimum nonforfeiture law. The negligent misrepresentation was made to and relied upon by AMS, its officers, directors, stockholders, and policyholders as well as the relevant regulatory agencies, particularly ADOI and the

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IDOI. All of these individuals and entities were entitled to rely upon the 1988 certification.

The court rejects Briscoe's argument that the Receiver must demonstrate actual reliance by the regulatory agencies. Rather the Receiver must only demonstrate that Briscoe knew that AMS intended to supply the information for state regulators and that ADOI was in that group. Standard Chartered PLC v. Price Waterhouse, 190 Ariz. 6, 32, 945 P.2d 317, 343 (Ct. App. 1997). It is undisputed that Briscoe knew that the 1988 certification would be supplied to ADOI.

Moreover, even if actual reliance had to be shown, the Receiver has met that burden. Evidence of actual reliance exists in the trial testimony. The court does not believe that ADOI has to provide testimony that a *specific ADOI employee* can recall actually reviewing or relying on the 1988 certification. Requiring the Receiver to meet such a standard, would render the tort of negligent misrepresentation meaningless in regulatory cases. ADOI employees, like other state insurance regulators, review many certifications every year and cannot possibly recall all the certifications that indicate that an insurance company is solvent. The court presumes that the certification was reviewed because *no regulatory action was taken*. If Briscoe, as it should have, certified in 1988 that AMS was insolvent, ADOI would have acted upon that information. In this situation, the lack of regulatory action indicates reliance.

III. 1989 ACTUARIAL CERTIFICATION

Certification Errors

Briscoe attempts to avoid some of the insurance problems in 1989 by arguing that the 1989 certification did not cover any reinsurance. The difficulty with that argument is that the 1989 certification is uncertain, at best, on the issue of what life insurance is covered by the certification. Briscoe was professionally obligated to provide a clear, unambiguous

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certification, therefore, the certification's ambiguity, which Briscoe could have prevented, must be construed against Briscoe. Additionally, had Briscoe intended that certain reinsurance not be covered by the certification, not only should it have made that fact clear, it should have specifically relied on another actuarial certification with respect to that reinsurance. The court finds that the applicable professional standards required such a result. It is undisputed that Briscoe did not obtain such a certification. Finally, Briscoe's net number matched the "net" number found in Exhibit 8 of the 1989 AMS Statement. If Briscoe believed that the 1989 certification did not cover certain reinsurance it should have clearly stated its' belief in a qualification to Exhibit 8. It is undisputed that Briscoe supplied the Exhibit 8 "net" number; there is no qualification to that number. The court finds that Briscoe was negligent in its preparation of the 1989 certification.

Excess Interest

The court finds, (as more fully discussed in the 1988 excess interest section) that the preponderance of the evidence establishes that Briscoe had the necessary information concerning the excess interest. However, Briscoe failed to include that excess interest in its calculation of reserves.

CLICO and NRG Treaties

For the reasons stated the discussion of the AMS/AmFed treaty, the court finds that Briscoe failed to meet its professional responsibilities when it did not identify that these treaties did not transfer meaningful risk and that AMS was improperly taking a disproportionate reserve.

Minimum Nonforfeiture

For the reasons set forth in its discussion of the minimum nonforfeiture calculations in the 1988 certification, the court finds that Briscoe certified to compliance with A.R.S. § 20-1232

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when its reserve calculations did not conform to that statute's requirements.

Single Premium Whole Life Insurance (SWPL)

The preponderance of the evidence establishes that Briscoe simply failed to include the SWPL in its 1989 reserve calculation and certification.

Negligence

The evidence establishes that Briscoe was negligent in its 1989 actuarial certification of the AMS reserves with respect to the issues of reinsurance, excess interest, the CLICO and NRG Treaties, the minimum nonforfeiture statute and the calculation of the SWPL reserves.

Negligent Misrepresentation

Briscoe's 1988 certification constitutes negligent misrepresentation as to reinsurance, excess interest, the AMS/AMFed Treaty, the minimum nonforfeiture law and the SWPL. The negligent misrepresentation was made to and relied upon by AMS, its officers, directors, stockholders and policyholders as well as the relevant regulatory agencies, particularly ADOI and IDOI. All of these individuals and entities were entitled to rely upon the 1988 certification.

IV. 1990 ACTUARIAL CERTIFICATION

Non-Reserve Items

The court finds that Briscoe's conduct with respect to the 1990 certification was negligent and inexcusable. Although Briscoe argues that its inclusion of the three "non-reserve" items in the 1990 certification was merely "unorthodox", the

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court finds that the inclusion of these items in the certification clearly breached applicable professional standards. This error was compounded by Briscoe's untimely provision of the certification and its signing of the May 29, 1991 letter to the regulators (prepared by AMS). That letter was clearly designed to buy AMS more time with respect to its failure to file a timely annual statement. The letter suggests that the delay in filing the AMS certification is caused by technological and logistical issues. But Briscoe knew or should have known that significant data problems and a deteriorating financial situation were the main reasons for AMS' inability to file the 1990 annual statement. The evidence also indicates that Briscoe made no effort to determine whether the AMS data was accurate but instead prepared a certification that did not meet professional standards.

The evidence establishes that Briscoe's main focus during this time period was ensuring that it was paid for its services, and that it was prepared to go to extraordinary lengths to obtain that payment. Briscoe was professionally obligated to certify in 1991 what it knew or should have known about AMS: that as of December 31, 1990, AMS (as it had been in 1988 and 1989) was insolvent. In failing to so certify, Briscoe breached its professional duties to AMS, its officers, directors and stockholders.

Briscoe argues that by providing an "unorthodox" certification that AMS never filed, it absolved itself of all responsibility for the 1991 debacle. But if Briscoe had provided AMS with a certification of insolvency, Buchanan & Associates (Buchanan) would have had no basis, for providing a false certification. Rather than assisting AMS recognizing that a receivership was necessary, as it was professionally required to do, the evidence indicates that Briscoe's 1990 "certification" exacerbated the AMS collapse.

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FSL/Westchester

The court finds that the evidence is inconclusive on the issue of Briscoe's knowledge of the FSL/Westchester agreement. The preponderance of the evidence does not establish that Briscoe was aware that the FSL sale of the universal book of business had collapsed.

Excess Interest

The court finds, as more fully discussed in the 1988 excess interest section above that the preponderance of the evidence establishes that in 1989, Briscoe had the necessary information concerning the excess interest. However, Briscoe failed to include that excess interest in its calculation of reserves.

Minimum Nonforfeiture

For the reasons set forth in its discussion of the minimum nonforfeiture calculations in the 1988 certification, the court finds that Briscoe certified to compliance with A.R.S. § 20-1232 when its reserve calculations did not conform to that statute's requirements.

Negligence

The evidence establishes that Briscoe was negligent in its 1989 actuarial certification of the AMS reserves with respect to non-reserve items, excess interest, and the minimum nonforfeiture requirements.

Negligent Misrepresentation

The court finds that negligent misrepresentation has not been proven with respect to the 1990 certification. It is undisputed that AMS did not file the 1990 Briscoe certification. Although the 1990 Briscoe certification was used as the basis

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for the false 1990 Buchanan certification, it was certainly not foreseeable to Briscoe that AMS or that Buchanan would breach its professional obligations by providing a false certification.

V. CAUSATION

The evidence establishes that Briscoe's negligence and negligent misrepresentations were a cause in fact and proximate cause of the AMS insolvency.

VI. SUPERSEDING CAUSES AND APPORTIONMENT OF FAULT TO OTHERS

AMS Management - Briscoe argues that AMS management deceit and looting of AMS was a superseding cause of the insolvency. The court finds that there is evidence in the record that both Michael Krneta (Krneta) and Michael Brdecka (Brdecka) attempted to deceive the state regulators concerning AMS financial condition and that Krneta misappropriated AMS assets. But the evidence does not establish that Krneta, Brdecka or anyone else in the AMS management deceived Briscoe with respect to the reserves. To the contrary, the evidence indicates that AMS management either directly provided or was ready to provide Briscoe with any information it needed to accurately calculate the AMS reserves.

The court finds that the actions of AMS management, no matter how deplorable, were not a superseding cause of the insolvency. The evidence simply does not support the conclusion that the AMS management deceived Briscoe.

However, the court finds that the Receiver has underestimated the responsibility of the Briscoe management in this matter. The preponderance of the evidence indicates that at least by late 1990, and certainly by early 1991, AMS management was aware that AMS was in financial difficulty. During that time period, the evidence indicates that Krneta, Brdecka, and others were focusing on delaying or avoiding the pending insolvency, rather than forthrightly addressing it with

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the regulators. The court finds that, with respect to the 1991 annual statement and certification, the Receiver's suggested damage allocation to Briscoe unfairly saddles Briscoe with liability that should have been apportioned to AMS management.

Buchanan Respondents and McGladery & Pullen - The court finds that the Receiver has already fairly apportioned fault with respect to the Buchanan Respondents and McGladery and Pullen.

Michael Clark - The court has not been presented with any evidence that would support apportioning liability to Michael Clark.

IDOI - Although Briscoe asserts that IDOI is a party at fault in this matter, there is simply no substantial evidence in the record that supports this claim.

ADOI - Briscoe argues that ADOI failed to timely act against AMS pursuant to A.R.S. § 20-219 either because of political pressure and/or bureaucratic inaction. The court finds that evidence indicating that ADOI bowed to political pressure and forestalled taking enforcement action is scant to nonexistent. While ADOI may have given some attention to the lobbying of AMS former counsel and others, this hardly establishes that ADOI deliberately disregarded its statutory obligations.

While the evidence does suggest that ADOI did not act with alacrity with respect to the AMS insolvency, Briscoe must prove that ADOI was grossly negligent for this court to find that ADOI to be a party at fault. The evidence must show that ADOI acted with reckless disregard of its statutory duties and that it should have realized that its actions or inactions with respect to A.R.S. § 20-219 created an unreasonable risk of harm to AMS and others. The evidence does not support the conclusion that ADOI was grossly negligent in its handling of the AMS insolvency or its delay in taking action pursuant to A.R.S. §20-219.

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VII. CONCLUSION

The preponderance of the evidence establishes that the responsibility of Briscoe for the AMS debacle is substantial. The one constant in the history of AMS, from its rise to collapse was the consistent and intense involvement of Briscoe. The evidence demonstrates that Briscoe was intimately involved in the preparation of the calculation of the AMS reserves and the annual statement. The trial testimony and exhibits establish that AMS was totally dependent on Briscoe for advice on its financial solvency, particularly during the critical years of 1988-1991. Briscoe's complete failure to properly calculate the AMS reserves and advise both AMS (including its officers, directors, stockholders and policy holders) and the regulators that the company was insolvent beginning in 1988 is truly egregious.

Briscoe, although it had the information that demonstrated the continuing insolvency, either missed or ignored that vital information. In 1991, when it was clear that AMS was having substantial financial problems, Briscoe's focus was on taking whatever actions were necessary to accommodate its client and obtain payment. At no time did Briscoe step forward to do the right thing. For Briscoe to now assert that it was misled by its client and it has no responsibility for the AMS insolvency is simply not credible. Briscoe bears significant professional responsibility for the AMS insolvency.

VIII. DAMAGES

Based on the evidence presented, the court determines that Briscoe's liability in this matter is: \$17.5 million dollars.

IT IS ORDERED:

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- (1) The Receiver shall prepare proposed findings of fact and conclusions of law that are not inconsistent with this minute entry;
- (2) The Receiver shall prepare a proposed form of judgment that is consistent with this minute entry;
- (3) The proposed findings of fact, conclusions of law and proposed form of judgment shall be filed by Friday, October 5, 2001;
- (4) The Respondents shall have until Friday, November 2, 2001 to file a any Objections to the proposed findings of fact, conclusions of law and form of judgment.
- (5) The Receiver shall file any reply by Friday, November 16, 2001.