

IN THE UNITED STATES TAX COURT

In the Matter of:)
)
RESERVE MECHANICAL CORP., f.k.a.)
RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
v.)
)
COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

Volume: 1
Pages: 1 through 86
Place: Houston, Texas
Date: April 27, 2017

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 Petitioner,) Docket No. 14545-16
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 v.)
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 COMMISSIONER OF INTERNAL REVENUE,)
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 Respondent.)

Room 7006
Casey U.S. Courthouse
515 Rusk Avenue
Houston, Texas

April 27, 2017

The above-entitled matter came on for
trial, pursuant to notice, at 9:30 a.m.

BEFORE: HONORABLE KATHLEEN KERRIGAN
Judge

APPEARANCES:

For the Petitioner:

VAL J. ALBRIGHT, Esquire
MICHELLE Y. KU, Esquire
Gardere Wynne
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Dallas, Texas 75201
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1 APPEARANCES: (continued)

2 For the Respondent:

3 G. ROGER MARKLEY, Esquire
4 THOMAS F. HARRIMAN, Esquire
5 NASEEM J. KHAN, Esquire
6 JUSTIN D. SCHEID, Esquire
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10 Chicago, Illinois 60606
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C O N T E N T S

WITNESSES:	DIRECT	CROSS	REDIRECT	RECROSS	VOIR DIRE
For Petitioner:					
Robert L. Snyder	18	39	76		
Robert L. Snyder	81	83			
For Respondent					
None					
OPENING STATEMENT ON BEHALF OF RESPONDENT:					13
OPENING STATEMENT ON BEHALF OF PETITIONER:					12

1

E X H I B I T S

2

EXHIBITS:

IDENTIFIED

RECEIVED

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1 through 27 and
31 through 95

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97-P

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1 P R O C E E D I N G S

2 (9:30 a.m.)

3 THE CLERK: Docket Number 14545-16, Reserve
4 Mechanical Corp., formerly known as Reserve Casualty
5 Corp.

6 Please state your appearances.

7 MR. MARKLEY: Good morning, Your Honor.
8 Roger Markley for Respondent.

9 MR. SCHEID: Justin Scheid for Respondent.

10 MR. HARRIMAN: Tom Harriman for Respondent.

11 MS. KHAN: Naseem Khan for Respondent, Your
12 Honor.

13 MR. ALBRIGHT: Val Albright for the
14 Petitioner. Good morning, Your Honor.

15 MS. KU: Good morning, Your Honor.
16 Michelle Ku for Petitioner.

17 MR. ZUMBAUM: Norm Zumbaum, representative.

18 MR. MARKLEY: And I also have Mr. James
19 Batory as our representative.

20 THE COURT: Thank you. You may be seated.

21 I believe the first preliminary matter was
22 the stipulation of facts, and I lodged it yesterday,
23 and the Court has a question about the stipulation,
24 it would be on page 13, and it starts on page 12,
25 paragraph 55, but the question I had pertains to page

1 13. On page 13 it mentions that Petitioner advised
2 Respondent that the attachment to each of 42-J and
3 44-J were incorrect and that Petitioner provided
4 correct copies of those documents and they would be
5 in 49 and 50-J, and the Court just wanted to be clear
6 that what was in 42 and 44, is that correct and just
7 had the wrong attachment, or is there something in 42
8 and 44? Because 49 and 50 are coverage forms and
9 they're still included in coverage forms in 42 and
10 43, and I just wanted to be clear, is the coverage
11 form incorrect and 42 and 44 and the others, and I
12 just wanted clarification.

13 MR. ALBRIGHT: Your Honor, there is an
14 attachment to 42-J and 44-J that has an incorrect
15 name in it, and Exhibits 42-J and 44-J are intended
16 to correct that. I'm not sure, I haven't looked
17 recently at what the Court has in front of it for 42-
18 J and 44-J -- I'm sorry -- 49-J and 50-J.

19 THE COURT: The Court has for 49-J and 50-J
20 it has documents that start with coverage form, and
21 I'm looking at the Bates number back on 42 it ends in
22 5972. I was wondering if that's where 49-J and 50-J
23 -- I just want a clarification of this.

24 MR. SCHEID: Yes, Your Honor. From
25 Respondent's perspective, you're correct. The

1 coverage form is the difference, and specifically, as
2 far as Respondent is aware, the only difference
3 between the coverage forms is the name of the
4 insured. As you'll see on the Bates number you
5 referenced in Exhibit 42-J at 5972, the insured is
6 Pacific Arts Entertainment, LLC and Pacific Arts
7 Presents, LLC, as well as in Exhibit 44-J at Bates
8 number 5847, again looking at the coverage form, the
9 name of the insured is Pacific Arts Entertainment,
10 LLC and Pacific Arts Presents, LLC. So as it relates
11 to Exhibits 49-J and 50-J, the only change is to the
12 name of the insured on the coverage form.

13 MR. ALBRIGHT: That's correct, Your Honor.

14 THE COURT: Okay. Thanks. I just wanted
15 to clarify the record and the Pacific Arts
16 Entertainment forms don't apply and it should have
17 been just switched out.

18 MR. SCHEID: There is a difference of
19 agreement as to whether they do or don't apply. The
20 parties have stipulated to both.

21 THE COURT: Okay. I just wanted to be
22 clear you were stipulating to both because the
23 wording in the stipulation was a little confusing in
24 having both in, so I just wanted to have it all clear
25 on the record so it's all part of it. So thank you,

1 the Court is clear on that now.

2 MR. SCHEID: Thank you, Your Honor.

3 THE COURT: And I believe yesterday we
4 discussed that there were six reservations,
5 Petitioner had three and Respondent had three
6 reservations in the stipulation. Mr. Albright, it
7 was my understanding that Respondent had reservations
8 on 28-P, 29-P and 30-P, and we're not going to
9 address this now because you'll have the opportunity
10 to authenticate these documents on the record.

11 MR. ALBRIGHT: Yes, Your Honor. We plan to
12 address these exhibits through witnesses.

13 THE COURT: Okay. And then, Mr. Albright,
14 you raised objections to I believe it was 5-R, 6-R
15 and 7-R, and I believe our discussion was yesterday
16 that we could address those now as a preliminary
17 matter.

18 MR. ALBRIGHT: Your Honor, if I may?

19 THE COURT: Yes.

20 MR. ALBRIGHT: Exhibits 5-R, 6-R and 7-R
21 are substitute for returns that were prepared by
22 Respondent, and Petitioner agrees that these exhibits
23 are authentic, however, to the extent there are
24 statements in these exhibits, Petitioner would object
25 to having those admitted for the truth or falsity of

1 the matters asserted in there. It may be some
2 opinions or observations of a revenue agent in those
3 6020-B forms, and that's Petitioner's concern. We
4 really don't have a problem with the exhibit coming
5 into evidence other than accepting what's in those
6 documents, the statements in there, for the truth or
7 falsity of the matters asserted.

8 MR. SCHEID: Your Honor, it appears as
9 though Petitioner is only objecting on grounds of
10 hearsay then as it relates to the document, and to
11 that extent, the document is a business record
12 prepared by the Internal Revenue Service in the
13 ordinary course of its operations, attached to it is
14 the 6020-B certification as well, and therefore, to
15 the extent there's any claim of hearsay, I think the
16 documents in each of these exhibits overcome that
17 hearsay objection.

18 THE COURT: All right. Do you have any
19 response before I rule, Mr. Albright?

20 MR. ALBRIGHT: Well, Your Honor, these
21 exhibits were prepared in the context of a dispute or
22 an examination where Respondent has taken certain
23 positions that Petitioner did not agree with, and so
24 that's the point, that there's really no -- the
25 statements in those exhibits shouldn't just be

1 accepted to prove the facts that are asserted in the
2 statements.

3 THE COURT: All right. Thank you.

4 Exhibits 5-R, 6-R and 7-R are admitted.

5 And Mr. Albright, to address your concern, the
6 purpose of these statements, I believe these returns
7 were prepared as preparing the notice of deficiency,
8 and that's what this trial is about to see if there
9 is agreement with what's in the notice of deficiency
10 or your position.

11 THE COURT: At this time the Court is going
12 to file the stipulation of facts, paragraphs 1
13 through 95, with accompanying exhibits, and
14 reservations remain on 28-P through 30-P.

15 (The documents referred to were
16 marked for identification as
17 Exhibits 1 through 27 and 31
18 through 95 and were received
19 in evidence.)

20 THE COURT: Are there any other preliminary
21 matters before we begin the opening statements?

22 MR. MARKLEY: Yes, Your Honor. The only
23 thing is I would have -- excuse me. This is Mr.
24 Zumbaum, he's the Petitioner, and we have our
25 representative Mr. Batory. We have an expert, we

1 have our own expert. Mr. Riggin, would you stand up
2 so that the Judge knows who you are. He's our
3 expert. I don't know who these two gentlemen are,
4 but I would just request, and I know Ms. Ku and this
5 lady, I believe, is also an employee, if you will,
6 but other than that, I would request that any person
7 who is a fact witness, regardless of whether they're
8 a potential expert witness, would leave the courtroom
9 at this time until such time as they testify.

10 THE COURT: Mr. Albright?

11 MR. ALBRIGHT: Your Honor, we have Mr.
12 Steve Cohen, who was the subject of a motion to quash
13 yesterday, and to my understanding, he is not a
14 witness in this case at this point, and so he should
15 be permitted to be in the courtroom. Also, we have
16 Mr. Brogan Vermillion [phonetic], and he's not listed
17 as a witness anywhere.

18 MR. MARKLEY: All right. I don't have any
19 problem with them being here as long as -- I know
20 that obviously rebuttal witnesses can't be determined
21 at this time, who knows, but I'll assume that they
22 will not be testifying as rebuttal witnesses. I
23 guess Mr. Cohen theoretically could, that would be
24 only my concern about Mr. Cohen. The other
25 gentleman, I don't even know who that person is. But

1 assuming Mr. Cohen is not going to be a rebuttal
2 witness, I wouldn't object.

3 THE COURT: I'll allow Mr. Albright to
4 answer that.

5 MR. ALBRIGHT: Petitioner has no intention
6 of calling Mr. Cohen as a rebuttal witness, nor Mr.
7 Vermillion.

8 MR. MARKLEY: So I withdraw any concern
9 about them.

10 THE COURT: All right. Any other
11 preliminary matters?

12 MR. MARKLEY: Not from us, Your Honor.

13 THE COURT: Mr. Albright, if you're ready
14 to begin with your opening statement.

15 OPENING STATEMENT ON BEHALF OF THE PETITIONER

16 Mr. ALBRIGHT: Yes, Your Honor. And
17 consistent with what the Court said yesterday or the
18 day before, I'm going to be very brief.

19 This case involves whether the Petitioner
20 has an insurance company for tax purposes. The
21 issues also concern whether the insurance
22 arrangements entered into by the Petitioner are
23 insurance contracts.

24 Petitioner will present evidence about the
25 formation of Petitioner which include evidence

1 including the evaluation and considerations that led
2 to the formation of the Petitioner. That evidence
3 includes a captive feasibility study that Petitioner
4 intends to present evidence concerning. Also, copies
5 of the insurance contracts are in the stipulated
6 exhibits. Petitioner will also present evidence
7 concerning how the premiums set forth in the policies
8 were set. Petitioner will also present evidence
9 concerning the operation of Petitioner, including the
10 payment of claims that Petitioner paid. And
11 Petitioner will also present expert testimony to
12 establish that Petitioner and its insurance
13 arrangements meet the test for insurance for tax
14 purposes.

15 That concludes my opening statement, Your
16 Honor.

17 THE COURT: Thank you.

18 OPENING STATEMENT ON BEHALF OF RESPONDENT

19 MR. HARRIMAN: Good morning, Your Honor.

20 Your Honor, this is about Petitioner's
21 owners, Norman Zumbaum and Corey Weikel, moving money
22 from one pocket to another for the sole purpose of
23 reducing their taxable income. The evidence will
24 show that each time Petitioner engaged in one of the
25 alleged insurance transactions at issue, there was no

1 purpose behind it but for the generation of tax-free
2 income by manipulating Section 501(c)(15) to create a
3 corresponding tax benefit for its owners.

4 The deficiencies in the statutory notice
5 are the result of several issues that boil down to
6 two key questions: one, whether the insurance and
7 re-insurance premiums lack economic substance; and
8 two, whether the insurance arrangement qualifies as
9 insurance for federal income tax purposes. The
10 evidence will show that the insurance transactions
11 lack economic substance, and further, Petitioner's
12 arrangement does not qualify as insurance for federal
13 income tax purposes.

14 In 2008, Mr. Zumbaum and Mr. Weikel, with
15 the assistance of Capstone Associated Services,
16 created Petitioner as an insurance company with
17 themselves as directors. Mr. Zumbaum and Mr. Weikel
18 were owners of several entities. One was Peak
19 Mechanical & Components, a mining equipment
20 manufacturer, along with ZW Enterprises, and
21 RocQuest, LLC, whose line of business has never been
22 truly clarified with Respondent. Mr. Zumbaum and Mr.
23 Weikel created Petitioner with the supposed intent of
24 issuing insurance policies to these three entities.

25 During the years at issue, Petitioner

1 issued alleged insurance contracts for insurance to
2 Peak Mechanical, ZW Enterprises, and RocQuest, LLC,
3 with thirteen contracts during 2008, eleven contracts
4 during 2009, an eleven contracts during 2010. The
5 evidence will show, however, that the contracts
6 issued were void of any economic substance. The
7 benchmarks of insurance simply aren't here. The
8 feasibility study Capstone and related associates
9 conducted at the request of Mr. Zumbaum and Mr.
10 Weikel, that was conducted in late 2008, is devoid of
11 any credible analysis concerning the insurance needs
12 of the three entities owned by Mr. Zumbaum and Mr.
13 Weikel.

14 In December 2008, Mr. Zumbaum and Mr.
15 Weikel quickly set up Petitioner in order to maximize
16 their deductions for the related businesses before
17 the end of the taxable year. This is clear as the
18 evidence will show that upon the formation of
19 Petitioner, the insurance expenses for Peak
20 Mechanical skyrocketed from its previous insurance
21 expenses in prior years.

22 In issuing the 2008 contracts, no documents
23 have been produced to show any support for the
24 premiums, including actuarial work papers,
25 underwriting questionnaires, or evidence of any

1 previous losses that the three entities owned by Mr.
2 Zumbaum and Mr. Weikel had incurred that would
3 necessitate such special risk for excess insurance.

4 The same void of information continues in
5 2009 and 2010, with the premium prices climbing each
6 year ever closer but never intentionally exceeding
7 the maximum amount allowed under 501(c)(15).

8 Respondent's expert, Don Riggin, has 35
9 years in the insurance industry in various roles, as
10 an underwriter, broker, agent and recently as a
11 captive insurance consultant. He will testify that
12 Petitioner's premiums lack the loss history and
13 underwriting documentation that is standard in the
14 insurance industry.

15 Respondent will also call a representative
16 of Atlas Insurance Services who will testify about
17 the services it provided to Petitioner.

18 Your Honor, no documents have been produced
19 that show any actuarial work or due diligence was
20 conducted prior to the contracts being issued.
21 Coming in after the fact and attempting to justify
22 the premium rates does not show the reasonableness
23 and care expected of the standards of the insurance
24 industry. It shows an attempt to retroactively
25 repair the missing gaps in their case to protect

1 their tax-free entity.

2 Your Honor, at the end of this trial,
3 Respondent will show that Petitioner is nothing more
4 than an entity that's only goal is the generation of
5 tax-free income by manipulating Section 501(c)(15).
6 Petitioner's claim of charging reasonable premium
7 rates for the 2008, 2009 and 2010 tax years cannot be
8 allowed to stand due to the lack of economic
9 substance behind it.

10 Thank you.

11 THE COURT: Mr. Albright.

12 MR. ALBRIGHT: Your Honor, we're going to
13 all the first witness. Petitioner calls Robert L.
14 Snyder, II.

15 THE COURT: We'll go off the record for a
16 moment.

17 (Off the record.)

18 THE COURT: Back on the record.

19 Whereupon,

20 ROBERT L. SNYDER

21 having been first duly sworn, was called as
22 a witness herein and was examined and testified as
23 follows:

24 THE CLERK: Can you please state your name
25 and address for the record?

1 THE WITNESS: Robert L. Snyder, 18315
2 Pamela Way, Spring, Texas 77379.

3 THE CLERK: Thank you. You may be seated.

4 DIRECT EXAMINATION

5 BY MR. ALBRIGHT:

6 Q Good morning, Mr. Snyder.

7 A Good morning.

8 Q Mr. Snyder, are you employed?

9 A Yes.

10 Q And where are you currently employed?

11 A I'm employed with a firm called Willis
12 Towers Watson.

13 Q And what is Willis Towers Watson?

14 A Willis Towers Watson is a global insurance
15 broker, risk management consultant and employee
16 benefits advisory firm.

17 Q And do you have a title?

18 A I do. I'm senior vice president.

19 Q And what are your duties at Willis Towers
20 Watson?

21 A Officially, I am part of our national
22 healthcare industry practice. Our firm is the third
23 largest firm globally that does the business that we
24 do, and we are organized around a group of industry
25 specialties, one of which happens to be the

1 healthcare provider industry, so I'm part of the team
2 nationally that basically leads our strategy and
3 business development for large healthcare providers
4 such as hospitals, multi-hospital systems, academic
5 medical centers, large physician groups, medical
6 schools, and so forth.

7 Q And are you involved in providing insurance
8 coverages for these clients?

9 A I am. I am involved with helping to
10 negotiate insurance contracts, as well as advising
11 clients and also working with clients to discuss
12 alternatives to insurance.

13 Q And when you say alternatives to insurance,
14 what do you mean?

15 A That would include alternative risk
16 financing mechanisms such as self-funded liability
17 trusts, captive insurance companies, risk retention
18 groups, risk purchasing groups.

19 Q And how long have you been employed by
20 Willis Towers Watson?

21 A Just coming up on ten years.

22 Q And prior to being employed --
23 incidentally, is Willis Towers Watson a law firm?

24 A No, absolutely not.

25 Q So prior to working at Willis Towers

1 Watson, where did you work?

2 A Immediately prior, I worked for six years
3 in Houston with a local firm, specialty insurance
4 brokerage firm called Myron F. Steves & Company. I
5 was there from 2001 to 2007. Prior to that, I had a
6 21-year start to my career with a firm called Johnson
7 & Higgins which at the time was the largest privately
8 held insurance broker in the world. We merged with
9 the Marsh & McLennan Companies in 1997, and as a
10 result of that merger and my having been designated
11 as a key employee, I was obligated to stay with Marsh
12 & McLennan for four years after the merger, which I
13 did, so I had 25 years in that combined organization.

14 Q And when you were at Myron F. Steves &
15 Company, did you have a title there?

16 A Yes. I was director of risk consulting.

17 Q And what did your duties entail in that
18 job?

19 A I had worked closely with Myron Steves &
20 Company before I went to work for them. We had
21 collaborated on a number of programs, self-insurance
22 programs, and several captives for healthcare
23 providers. Myron Steves & Company overall is a
24 brokerage firm that's referred to in the business as
25 a surplus lines broker or surplus lines intermediary,

1 which means they represent some specialty markets
2 that many agents and brokers cannot access directly
3 on their own, so the agents and brokers come to Myron
4 Steves to get access to those markets.

5 At one time, during my time with J&H and
6 Marsh and McLennan, I used Myron Steves to access the
7 market to put together some of the programs that we
8 had worked on. That worked pretty well over a period
9 of years, and when I decided to leave Marsh, I had
10 met with several principals from Myron Steves &
11 Company, they were very interested in more or less
12 replicating in-house some of the work that I had done
13 in my previous position, so I joined specifically to
14 help them develop some clientele agents and brokers
15 and potential insured entities who were interested in
16 designing alternative risk financing arrangements,
17 essentially the same kind of work I had been doing
18 for Myron Steves.

19 Q And so to summarize, you've been working in
20 the insurance industry for how long?

21 A I'm just coming up on 41 years.

22 Q Can you tell me a little bit about your
23 education?

24 A Yes. I have an undergraduate bachelor's
25 degree from Lycoming, a liberal arts school in

1 Williamsport, Pennsylvania. I have a doctorate of
2 jurisprudence from South Texas College of Law. I
3 hold the Associate of Risk Management, otherwise
4 known as ARM, professional designation, and of
5 course, various licenses.

6 Q Are you a member of a bar?

7 A I am. I'm a member of the State Bar of
8 Texas.

9 Q Have you ever practiced law?

10 A No, except for an internship during law
11 school. I actually came to Johnson & Higgins
12 initially to be a staff attorney in Houston basically
13 dealing with insurance agency matters, regulatory
14 matters with the State Department of Insurance and so
15 forth, and to be the interface with our general
16 counsel's office in New York. But very early in my
17 career I got involved with healthcare entities during
18 the time of a very, very distressed market for
19 medical malpractice coverage in the mid to late
20 1970s, and in fairly short order I was really working
21 full-time in the business, and so I basically moved
22 over from my brief tenure in the legal position and
23 assumed my duties working with outside clients.

24 Q Have you ever been a partner in a law firm?

25 A No, sir.

1 MR. ALBRIGHT: Your Honor, if I could, I
2 would like to provide Mr. Snyder with a copy of
3 Exhibit 16-J.

4 MR. MARKLEY: No objection.

5 THE COURT: You may.

6 MR. ALBRIGHT: May I approach the witness,
7 Your Honor?

8 THE COURT: You may.

9 BY MR. ALBRIGHT:

10 Q Mr. Snyder, I've handed you a copy of
11 Exhibit 16-J which the parties have stipulated is a
12 copy of the captive insurance company feasibility
13 study for Peak Mechanical & Components, Inc. Are you
14 familiar with Exhibit 16-J?

15 A Yes.

16 Q And can you turn to page 3?

17 A Yes.

18 Q Is that your signature on Exhibit 16-J on
19 page 3?

20 A Yes.

21 MR. ALBRIGHT: Your Honor, may I provide
22 Mr. Snyder with another exhibit?

23 THE COURT: Is this also another stipulated
24 exhibit?

25 MR. ALBRIGHT: Yes, ma'am.

1 THE COURT: Yes. And when you provide it
2 to him, if you could just identify it for the record.

3 MR. ALBRIGHT: Your Honor, may I have a
4 moment to confer with Mr. Markley? I understand
5 there might be an issue that we haven't resolved
6 concerning Exhibit 34-J.

7 THE COURT: Yes, you may.

8 We'll go off the record.

9 (Off the record.)

10 THE COURT: Back on the record.

11 MR. ALBRIGHT: Your Honor, may I provide a
12 copy of Exhibit 34-J, which is a stipulated exhibit,
13 to Mr. Snyder?

14 THE COURT: Yes.

15 MR. MARKLEY: No objection.

16 MR. ALBRIGHT: May I approach, Your Honor?

17 THE COURT: Yes.

18 BY MR. ALBRIGHT:

19 Q Mr. Snyder, are you familiar with Exhibit
20 34-J?

21 A Yes.

22 Q And do you recall how is it that you're
23 familiar with Exhibit 34-J?

24 A The exhibit contains the background
25 information that I would have been provided at the

1 time that we were originally working on the
2 feasibility study.

3 Q And when you say background information
4 when we were working on the feasibility study, are
5 you referring to Exhibit 16-J?

6 A Yes.

7 Q And you said we were working on the
8 feasibility study. Who is we?

9 A That would have been collaboratively
10 between me and staff from Capstone Associated
11 Services.

12 Q And do you recall who the person at
13 Capstone Associated Services that you worked with, do
14 you recall the name?

15 A Yes.

16 Q And what was the name?

17 A Lance McNeel.

18 Q Back to Exhibit 16-J, what was your role in
19 the preparation of Exhibit 16-J?

20 A In developing the feasibility studies,
21 there was a process that was undertaken that
22 initiated with Capstone, and that process led to the
23 creation of a draft feasibility study which was
24 submitted for my review. My role has been over a
25 period of time to review feasibility studies, the

1 associated background material and help to finalize
2 the study jointly between now with Willis Towers
3 Watson and Capstone.

4 Q And do you have an understanding of what
5 Mr. McNeel's role was in the preparation of Exhibit
6 16-J?

7 A Yes. He would have been the principal
8 author of the draft feasibility study and also
9 directly involved in gathering together and working
10 with me to analyze the background material. I
11 believe Mr. McNeel also would have conducted the
12 initial site visit to the client's business location.

13 Q What was the purpose for Exhibit 16-J?
14 What is the purpose of Exhibit 16-J, from your
15 perspective?

16 A Typically when a company is considering
17 creating a captive insurance company, there is front-
18 end feasibility work that is done to determine, first
19 of all, the appropriateness of the client making that
20 decision to form a captive insurance company, and
21 then further, to explore what types of coverages
22 might be suitable for being written through the
23 captive.

24 Q Did you know Mr. McNeel prior to your
25 working on Exhibit 16-J with him?

1 A I did.

2 Q How did you know him?

3 A Lance McNeel and I happened to be
4 colleagues, not in the same division but we worked
5 together for a number of years at Johnson & Higgins,
6 the original firm where I started my career, and so
7 we knew each other in passing and through company
8 functions and so forth.

9 Q Just exactly what was Johnson & Higgins?

10 A Johnson & Higgins was an insurance
11 brokerage firm, privately held, at the time the
12 largest privately held insurance broker in the world.

13 Q Now, if you look at the first page of
14 Exhibit 16-J or the second page, there's a reference
15 to initial site visit, August 13, 2008. Do you see
16 that?

17 A Yes.

18 Q What does that mean?

19 A That would have been the date when a
20 Capstone representative -- and I believe in this
21 instance Mr. McNeel was the Capstone representative -
22 - would have visited the main operating location of
23 the potential captive owner of the underlying
24 business and would have met with owners and managers
25 and physically seen the site, typically taking

1 photographs and so forth, to try and gain an
2 understanding of what the operation looked like.

3 Q Did you yourself ever visit Peak Mechanical
4 & Components, Inc.?

5 A I didn't.

6 Q The cover page on Exhibit 16-J has a logo.
7 Do you see the logo there of Willis HRH?

8 A I do.

9 Q Do you know what that stands for?

10 A Yes. I should back up a little bit on the
11 history of Willis Towers Watson. Willis by itself
12 actually was one of the oldest insurance broker
13 groups in the world that was originally formed in
14 1828 in London, and Willis operated that way for
15 many, many years. Back in 2007, Willis merged with -
16 - actually acquired a firm called Hilb -- I'll spell
17 that -- H-I-L-B, Rogal, R-O-G-A-L, and Hamilton,
18 otherwise known as HRH. HRH was a smaller competitor
19 of Willis. Willis merged with that company and for a
20 period of time operated under the name, the trade
21 name and logo that you see here Willis HRH. The HRH
22 name was subsequently dropped from the corporate name
23 and the company operated as Willis until the
24 beginning of 2016 when the merger with Towers Watson,
25 the large international consulting firm, was

1 completed, and that created Willis Towers Watson, the
2 company that exists today.

3 Q Now, Mr. Snyder, if Respondent in this case
4 -- Respondent being the Commissioner of Internal
5 Revenue -- alleged that Willis HRH is law firm, would
6 that be correct?

7 A No, not at all.

8 Q Mr. Snyder, I see also there's another logo
9 on the front of this exhibit 16-J. Do you see that?

10 A I do.

11 Q And what is that logo?

12 A That's the Capstone Associated logo.

13 Q Mr. Snyder, had you participated in the
14 preparation of other captive insurance feasibility
15 studies prior to your work on 16-J?

16 A Yes.

17 Q Can you sort of in an order of magnitude
18 can you tell me how many captive feasibility studies
19 or efforts you've been involved in?

20 A As far as captive insurance company
21 efforts, I would place that number in between 175 and
22 200. I would not have been directly involved in
23 feasibility studies with all of those because in the
24 prior company and the company I work for now we have
25 a wholly separate group of people who work on those

1 studies.

2 Q Mr. Snyder, if you'd turn to page 7 of
3 Exhibit 16-J, please. There is a discussion of
4 various types of captive insurance arrangements. Do
5 you see that?

6 A I do.

7 Q At the time you were working on Exhibit 16-
8 J, had you had experience with these various types of
9 captive insurance arrangements?

10 A Most of them, yes. I'm certainly familiar
11 with all of them and I had worked a number of these
12 structures, yes.

13 Q And Mr. Snyder, if you'll turn to page 19
14 of Exhibit 16-J, I believe you'll see a discussion of
15 various types of insurance coverages. Do you see
16 that?

17 A I do.

18 Q Do you see the column on page 19 of Exhibit
19 16-J that is headed "Limitations that can be covered
20 by one or more captives."

21 A Yes.

22 Q What is the point of the information in
23 that column?

24 A The point of that information would be to
25 point up a number of areas of exposure for a business

1 for which insurance could be provided via a captive
2 insurance company.

3 Q And can you turn to pages 19, 20 and 21,
4 and there appears to be a discussion of various
5 risks. Do you see that?

6 A I do.

7 Q Do you know whether these are the types of
8 risks that insurance companies issue insurance
9 policies to cover?

10 A Yes, they are. Not all of these would have
11 -- I would say most of these coverages have an active
12 market on the commercial side of the insurance
13 industry, a couple of them not so much, but all of
14 them potentially would have treatment in the
15 commercial insurance industry.

16 Q Now, Mr. Snyder, if you take a look at
17 pages 24, 25 and 26, there appears to be a discussion
18 of different coverages.

19 A Yes.

20 Q And again, why would this discussion be
21 included in Exhibit 16-J?

22 A Well, one of the things that is done as
23 part of the feasibility study is to review insurance
24 coverages that are already in place for the
25 underlying business.

1 Q And if you would turn to page 2 of Exhibit
2 16-J, there is a reference to a manuscripted policy
3 forms insured through a captive. Do you see that at
4 the bottom of the page there?

5 MR. MARKLEY: Excuse me. I'm not
6 objecting. Page 2?

7 MR. ALBRIGHT: Page 2.

8 MR. MARKLEY: Page 2. Thank you.

9 THE WITNESS: Yes, I see the reference to
10 manuscripted policy form.

11 BY MR. ALBRIGHT:

12 Q What is a manuscripted policy form?

13 A A manuscripted form is a customized form,
14 the wording for which would be designed for a
15 particular insured. That is sometimes done on the
16 commercial side of the insurance business. Many of
17 the coverages that all of us would be familiar with,
18 such as worker's compensation or automobile or
19 property insurance, are written normally by companies
20 that are referred to as licensed and admitted
21 companies in states around the country, in some cases
22 all states, but there's another set of the commercial
23 insurance industry that is referred to as non-
24 admitted or surplus lines insurance. Those coverages
25 are written by companies that may be and they are

1 licensed and admitted and capitalized in one or two
2 states but they operate on a national basis as
3 approved non-admitted companies whereby they can
4 issue policies that are customized, not regulated by
5 the state insurance requirements for which
6 policyholders would pay an additional tax to the
7 state.

8 So manuscripted forms represent that set of
9 customized non-standard type forms that would also be
10 very technical with respect to captive insurance
11 companies.

12 Q Now, back to Exhibit 16-J for a moment,
13 does Exhibit 16-J reach a conclusion and make a
14 recommendation?

15 A It did reach a conclusion that the
16 formation of a captive insurance for Peak and its
17 affiliated companies would be feasible and
18 appropriate.

19 MR. ALBRIGHT: Your Honor, may I provide
20 Mr. Snyder with a copy of another stipulated exhibit,
21 Exhibit 96-J?

22 THE COURT: Yes.

23 MR. MARKLEY: Again, this is not an
24 objection, but I believe that he said it reached a
25 conclusion and I think I found the page. Is that on

1 page 3 of the report?

2 BY MR. ALBRIGHT:

3 Q Do you know where the conclusion is in the
4 report, Mr. Snyder?

5 A I believe the conclusion actually appears
6 in two places: one would be in the executive summary
7 which probably is page 3 -- yes, I see it there --
8 and it would also appear again at the end of the
9 report, in this particular instance it would be I
10 want to say 50-something.

11 MR. MARKLEY: May I suggest 46?

12 THE WITNESS: I would be happy to look at
13 46. Yes, that's it.

14 MR. ALBRIGHT: Your Honor, may I provide
15 Mr. Snyder the copy of Exhibit 96-J?

16 THE COURT: Yes.

17 BY MR. ALBRIGHT:

18 Q Mr. Snyder, have you see Exhibit 96-J
19 before?

20 A Yes.

21 Q And there's a signature on page 3.

22 A That is my signature.

23 Q On page 3?

24 A Yes.

25 Q At the time you executed this letter, can

1 you identify who your employer was?

2 A Myron Steves & Company.

3 Q And is this the same Myron Steves that you
4 talked about before?

5 A It is.

6 Q I notice that Exhibit 96-J has references
7 to Houston, Dallas, San Antonio and Austin at the
8 bottom of page 1.

9 A Yes. Those are locations of Myron Steves &
10 Company. Myron Steves & Company is a long-
11 established firm in Houston over a 60-plus year
12 history in the surplus lines insurance business,
13 they're a very well regarded firm. The firm employs,
14 I think, between 200 and 220 people. Houston is the
15 home base and there are satellite offices, branch
16 offices in Dallas, San Antonio and Austin.

17 Q Do you notice that Exhibit 96-J makes
18 reference to quota share reinsurance policies?

19 A Yes.

20 Q What is a quota share reinsurance policy?

21 A A quota share reinsurance policy is a
22 policy that would typically be used by a reinsurance
23 pool where a portion of the risks that are
24 underwritten by other insurance companies -- in this
25 case it would be captive insurance companies, and I'm

1 using an insurance term now -- that are ceded --
2 that's C-E-D-E-D -- ceded to the quota share
3 reinsurer proportionately, and the reinsurer then
4 basically will cede back to the captive insurance
5 company a small portion for that pool of risk. So
6 the quota share refers to the proportionate percent,
7 whatever it happened to be.

8 Q Exhibit 96-J also makes reference to a stop
9 loss reinsurance agreement.

10 A Yes.

11 Q What is a stop loss reinsurance agreement?

12 A In this instance the stop loss reinsurance
13 agreement represented a specific proportion of risk
14 that was underwritten by a captive insurance company
15 that was ceded directly to the reinsurer. It
16 actually was not -- let me correct myself -- it
17 wasn't ceded by the captive insurance company, it was
18 provided directly by the reinsurer to the underlying
19 insured. So a percentage of the business was placed
20 directly with the joint stop loss reinsurer, and this
21 terminology refers to that.

22 Q Exhibit 96-J is addressed to -- oh, I'm
23 sorry -- it's addressed to the officers and directors
24 of PoolRe Insurance Corporation, care of their
25 insurance company manager. And so at the time you

1 signed the letter dated May 31, 2005, Exhibit 96-J,
2 were you employed by PoolRe Insurance Corporation?

3 A No.

4 Q Were you a director of PoolRe Insurance
5 Corporation at that time?

6 A No, not at that time.

7 Q Were you an officer of Pool Re Insurance
8 Corporation at that time?

9 A No.

10 Q Is it fair to say that you didn't have any
11 kind of employment relationship with Pool Re
12 Insurance Corporation at that time?

13 MR. MARKLEY: I have to object. I haven't
14 really objected to anything being leading, but I
15 think that's a little bit different. He can just say
16 what his relationship was, Your Honor. I object.

17 THE COURT: You can rephrase the question.

18 BY MR. ALBRIGHT:

19 Q Mr. Snyder, at the time you signed the
20 letter dated May 31, 2005, did you have any
21 relationship with Pool Re Insurance Corporation?

22 A No.

23 MR. ALBRIGHT: Your Honor, at this time I'd
24 ask to mark this document as Petitioner's exhibit
25 next in order for identification.

1 THE COURT: Okay. And does Respondent's
2 counsel have a copy of this document?

3 MR. ALBRIGHT: Your Honor, this is Mr.
4 Snyder's report.

5 THE COURT: Okay. And I believe, Mr.
6 Albright, yesterday when we discussed this that we
7 were going to segregate the fact testimony from the
8 expert testimony so we would also have the cross as
9 the fact witness before we got into the expert
10 testimony.

11 MR. ALBRIGHT: That's fine with Petitioner,
12 Your Honor.

13 THE COURT: And also, the Court was
14 slightly unclear yesterday on some of your witnesses
15 if they were going to still be an expert, so it's my
16 understanding you still want Mr. Snyder to be an
17 expert.

18 MR. ALBRIGHT: Yes, Your Honor.

19 THE COURT: So for now, I would like you to
20 complete any questions for him as a fact witness and
21 then we'll proceed into the cross.

22 MR. ALBRIGHT: I believe I have completed
23 the factual portion of his testimony, Your Honor.

24 THE COURT: All right.

25 MR. MARKLEY: May we take five minutes,

1 Your Honor?

2 THE COURT: Okay. The Court will take a
3 five-minute recess. Thank you.

4 (Whereupon, a brief recess was taken.)

5 CROSS-EXAMINATION

6 BY MR. MARKLEY:

7 Q Good morning, Mr. Snyder.

8 A Good morning.

9 Q I'm one of the attorneys for the IRS on
10 this case, and even though we met in the men's room
11 earlier and talked about Texas was formed and things
12 like that, neither one of us knew each other. Is
13 that right?

14 A That is correct.

15 Q And now you know that I'm on this side.

16 A Yes, sir.

17 Q So you went to college in at Lycoming, I
18 the same town where they have they the Little League
19 World Series. Correct?

20 A That is correct.

21 Q And then pretty much after that you were
22 down in Texas. Would that be correct?

23 A Yes. I've been in Texas most of my life.

24 Q And would it be correct, I think you said
25 like an internship at one point in law school towards

1 the end of your -- I won't say career, from your term
2 in law school, you have been an insurance person, and
3 insurance broker, in the insurance business for 41
4 years. Is that right?

5 A That is correct.

6 Q Now, prior to you coming in here today, did
7 you have an opportunity to look at any books and
8 records or any documents or anything of that nature
9 to prepare yourself for your testimony today?

10 A Yes. I have looked at all the accumulated
11 documents that we had and that have been offered to
12 me at the Capstone office and I've been reading them.

13 Q So when you said Capstone office, is that
14 here locally in Houston?

15 A Yes, it is.

16 Q And do you know what type of business that
17 Capstone is involved in?

18 A Yes. Capstone -- this is my description, I
19 often referred to it as a business within a business.
20 Capstone itself is a turnkey captive management and
21 captive formation company that's staffed by insurance
22 and financial professionals. It's a subset of the
23 Feldman Law Firm, and of course, the law firm is
24 where the attorneys reside who work with the staff
25 from Capstone. Capstone's business is directed at

1 captive insurance company formation.

2 Q In reading your report over -- of course,
3 I've been involved in this thing for a couple of
4 months, and reading your report over the months, the
5 feasibility study and your report, I saw that word
6 turnkey. Can you tell us what that means?

7 A My understanding of turnkey is that when a
8 client or prospective client chooses to work with
9 Capstone that Capstone will essentially undertake all
10 of the services with respect to captive formation
11 management for that client -- that is, Capstone will
12 work on the feasibility study, Capstone will assist
13 the client in identifying a domicile where the captive
14 insurance company can be formed and licensed, will
15 assist with all necessary regulatory filings, on an
16 ongoing business will provide all the accounting and
17 legal infrastructure necessary for the ongoing
18 operation of that company.

19 Q So you had mentioned, I think, in the
20 Houston office you had the lawyer part and you had
21 the non-layer part of Capstone -- I'm sorry, that's
22 really not correct. You have Capstone non-lawyers
23 and then you have the Feldman lawyers. Is that fair?

24 A That's fair in my understanding.

25 Q Are they on the same floor, different

1 floor, do you know?

2 A Same floor.

3 Q Have you ever been there?

4 A Been there many times.

5 Q I'm not asking you what you talked to the
6 lawyers about but you talked to the lawyers about
7 captive type matters?

8 A Not ordinarily. Occasionally a question
9 will come up where we will have on the lawyers, we'll
10 have someone from Capstone and maybe myself, but on a
11 routine ongoing basis, I am working with the
12 insurance and financial managers at Capstone.

13 Q People, for example, like Mr. McNeel?

14 A Yes.

15 Q And did you ever work with anyone else
16 during this time period we're talking about, late
17 2000s, from Capstone other than Mr. McNeel?

18 A There was a predecessor to Mr. McNeel doing
19 effectively the same work, and I am going to confess
20 I've forgotten part of his name, his first name is
21 Scott, that's what I remember. I also have worked
22 with Charles Earles, who I believe is the president
23 of Capstone; with Megan Brooks, who is the financial
24 and operations manager. And so the insurance
25 operations manager is a gentleman, David Overbeck,

1 and several of his core staff who work with him,
2 probably six people, something along that line.

3 Q Do you know a lady by the name of Helen
4 Nguyen? It's a Vietnamese name, N-G-U-Y-E-N.

5 A I do know Helen, or I knew of Helen.

6 Q Did you work with her?

7 A I did.

8 Q Did the folks that you worked with at
9 Capstone, such that you just mentioned, were they
10 doing basically the same type of work in regard to
11 captives?

12 A With regard to Capstone, yes.

13 Q Right. I mean, I know you didn't see their
14 timecards, I understand that, but with regard to
15 captives, did they do that type of work?

16 A Yes.

17 Q How would you describe the relationship
18 between the Feldman Law Firm and the Capstone company
19 in regard to the formation and the administration of
20 captives?

21 A It's a close relationship. Stewart Feldman,
22 the head of the law firm, is also involved with
23 oversight of Capstone, the whole enterprise
24 ultimately rolls up to him, and so there is
25 involvement there, although I can say from my own

1 experience -- though I know Mr. Feldman, from my own
2 experience I only very occasionally run into him.
3 When I'm in the office, I work almost exclusively
4 with Capstone.

5 Q Do you know if he ever goes out on the
6 feasibility studies?

7 A I believe he goes out on a site visit, yes.
8 I don't know if that's routine but I think it has
9 happened.

10 Q But he didn't go out on this one, if you
11 know.

12 A I don't happen to know that.

13 Q But you do know that Mr. McNeel went.
14 Right?

15 A That is my understanding.

16 Q And I say this when I really should say
17 going out in the field is what I should have said.

18 A That's my understanding.

19 Q Peak is located in Idaho?

20 A Yes, sir.

21 Q And you did not go on that one?

22 A No, I did not.

23 Q So prior to today -- I'm not interested in
24 any conversation that you've had with Mr. Albright --
25 D but prior to today did you have any conversations

1 with Mr. Feldman about this matter about which you're
2 testifying?

3 A Yes, briefly. We've had several meetings
4 in preparation for the trial and Mr. Feldman sat in
5 on one or two of those.

6 Q Okay. Did you ever have any conversations
7 with Mr. Feldman about regarding what potential
8 testimony you might be giving, questions you might be
9 asked?

10 A I think in general, again, as part of trial
11 preparation we've gone over areas that I was likely
12 to be questioned about, either direct or on cross-
13 examination, and so that's been a group discussion.

14 Q Now, we talked about your employment.
15 During the time period of your employment, wherever
16 it might be in the insurance business, how much of
17 that time period would you say is involved with
18 captive type insurance companies?

19 A I would say -- I would say there would be
20 some connection with captive insurance companies in
21 at least half of my work, maybe more than that.

22 Q So would that be like 20 out of 40 years?

23 A Well, in terms of years, I'm looking over
24 the whole sweep of all years and I'm actually
25 thinking of clients who I've worked with, but my own

1 experience working with captive insurance companies
2 dates back 30 years.

3 Q So at the present time that you're dealing
4 with captive insurance companies, among other things,
5 and the health insurance industry. Is that correct?

6 A I should clarify that because I know
7 there's sometimes confusion, not related to health
8 insurance but insurance for healthcare providers --
9 in other words, the property and liability and other
10 insurance that a healthcare provider, such a
11 hospital, needs to purchase for itself, but I do not
12 work in the health insurance field at all.

13 Q Now, you're familiar with the type of
14 business that is involved with Peak. Are you
15 familiar with that?

16 A Yes.

17 Q Prior to your working on this matter
18 involving Peak captive insurance issues and the
19 Reserve company, did you ever work with any entities
20 that involve like mining or things of that nature
21 before?

22 A I would say certainly the energy business
23 or could have been oil and gas exploration and
24 pipeline construction, that sort of thing, so I guess
25 that all kind of generally falls into the category of

1 mineral development, whether it's mining specifically
2 or not, but industrial type businesses.

3 Q So industrial type business -- I mean, I
4 don't even know the big oil companies anymore, the
5 names have changed all the time and some of them are
6 Russian or whatever, but can you give us examples of
7 your normal type of business that you work with in
8 regard to doing feasibility studies?

9 A Most of the I would say industrial or other
10 types of general business that I've worked with,
11 that's in connection with Capstone. In my own
12 organization, because of our industry specialization,
13 I am assigned to the healthcare industry part of the
14 company, so I normally wouldn't work directly, let's
15 say, with an energy company, although peripherally
16 I've been involved over the years. And this could be
17 with respect to my own company, this could be in
18 areas like construction, energy and environmental
19 resources, aviation, real estate, a wide sweep of
20 businesses. I'm known to be available as an advisor
21 sometimes when people have questions about contracts
22 or something along those lines.

23 Q So were you aware of the type of business
24 that Peak -- I'll call it Peak just as a general term
25 -- were you aware of the specific type of business

1 that they were engaged in?

2 A I was.

3 Q And that involved not in mining per se but
4 I'll call it assisting in the mining business and
5 providing various services and actually equipment.
6 Is that right?

7 A Correct. My understanding is mainly
8 manufacturing and fabrication of certain devices used
9 in the mining industry.

10 Q So prior to your feasibility study
11 involving in this case Peak and subsequent to that,
12 have you ever dealt with that type of business in
13 terms of a feasibility study before or after,
14 specifically that kind?

15 A Specifically that kind, I can't recall that
16 right now.

17 Q Now, you also have, as well as the work
18 that you described, what exactly is your relationship
19 with Pool Re? I know that at one point in time you
20 were not in Pool Re but you happened to be involved
21 with writing a letter on behalf of Myron Steves
22 Company in '05 to Pool Re. What's your involvement
23 with Pool Re now, if anything?

24 A Now I am one of the two directors of Pool
25 Re.

1 Q And as a director is your office here in
2 Houston or some other place in Texas?

3 A Well, as a director I don't have an office
4 dedicated to that per se. The regulatory management
5 for Pool Re is in the domicile of the company's
6 license which happens to be in
7 Anguilla, and so there's an office there. There's
8 nothing that I do here that requires me to have a
9 physical office for Pool Re.

10 Q You had said the regulatory. What do you
11 mean by that?

12 A Obviously, we interface with the regulators
13 in the domicile of the company's license.

14 Q As one of the directors of Pool Re, I know
15 you don't have an office here, but I assume you have
16 an email and equipment, telephone.

17 A No. It's a very lean infrastructure. There
18 are two appointed directors, there's one individual
19 who holds one of the officer positions. Most of my
20 communication related to Pool Re happens when I'm
21 actually in the Capstone office or in the office and
22 occasionally I'm sent some papers and the financial
23 reports.

24 Q So when you're in the Capstone office that
25 you mentioned ten seconds ago, what kind of

1 communications go back and forth that you hear or
2 know of regarding Capstone and Pool Re?

3 A The day-to-day operation management of Pool
4 Re is delegated to Capstone, so Capstone will
5 occasionally have me sign off on documents such as
6 notices in lieu of meetings because physical meetings
7 in the domicile aren't actually required, claim
8 reports if Pool Re is paying out claims, and some
9 reports with regard to financial exposures under the
10 reinsurance program. I do not have any authorization
11 to sign checks, however.

12 Q So how would you describe -- from what you
13 know, not guessing or anything like that but from
14 what you actually know, how would you describe the
15 interrelationship between Pool Re and Capstone?

16 A It is a contractual relationship and I
17 would say a close day-to-day working relationship.

18 Q Do you know if Pool Re is a captive of any
19 entity?

20 A Yes.

21 Q And do know what entity Pool Re is a
22 captive insurance company of, or reinsurance perhaps?

23 A I'm not quite sure I understand the
24 question.

25 Q Okay. When I asked you first do you know

1 if Pool Re is a captive. Do you understand that
2 question?

3 A Yes, sir.

4 Q So what's the answer to that question.

5 A I know that Pool Re is a captive because
6 it's domiciled and licensed in Anguilla and is
7 registered as a captive insurance company.

8 Q And who is it a captive of, of what entity,
9 if you know.

10 A Well, it would be a captive of the owner of
11 Pool Re. There's one single owner.

12 Q And who is that?

13 A That is Stephen Friedman.

14 Q Stephen Friedman?

15 A Yes, sir.

16 Q Do you know if Pool Re is a captive of
17 Capstone, do you have any idea?

18 A To the best of my knowledge, no.

19 Q To the best of your knowledge.

20 A Yes, sir.

21 Q We're going to spend a lot more time with
22 me asking you questions than with Mr. Albright, so
23 just to let you know, because we're going to go
24 through the feasibility study and things of that
25 nature. Okay? Just giving you a heads up.

1 Now, in terms of the Myron Steves letter,
2 going back to the 2005, what is it, 96-J? Do you
3 have 96-J up there?

4 A I do.

5 Q I notice on that letter at the top, dated
6 May 31, the letter was going to Pool Re with a carbon
7 copy, I guess -- or I'm not really sure what this is
8 -- to Atlas Insurance Management. Do you see that?

9 A I do.

10 Q Can you tell us what the point of that was?

11 A At the time I believe that Pool Re was
12 actually domiciled in the British Virgin Islands,
13 BVI, and Atlas Insurance Management was the
14 management company in the domicile, and so they would
15 have received a copy of this letter. Any
16 communication that was meant for the company would
17 have been copied to the captive manager.

18 Q And so Atlas was the captive manager at
19 that time?

20 A At that time.

21 Q Do you know did that ever change?

22 A Yes. Pool Re was ultimately re-domiciled
23 in Anguilla and Capstone actually now has its own
24 management presence in Anguilla.

25 Q 16-J, do you have that? 16-J is the

1 feasibility study -- 34-J. I apologize, we have so
2 many big books of stuff here. 34-J, would you call
3 it the raw materials that were used in part by you
4 and perhaps Mr. McNeel to put together the
5 feasibility study?

6 A I think that's a fair description.

7 Q So do you recall -- we'll call 34-J the raw
8 materials -- other than that, did you have anything
9 else to put together the feasibility study that you
10 recall? I think you mentioned this in your report, I
11 think you mentioned it on page 3.

12 A I don't actually have my report.

13 Q Okay. Well, then we'll deal with that
14 later.

15 THE COURT: I just want to clarify we're
16 still on the fact witness, and his expert report has
17 not been offered nor has he been offered as an
18 expert.

19 MR. MARKLEY: You're right, and I
20 apologize. I'll go to the feasibility study and ask
21 him from that. I'm sorry.

22 BY MR. MARKLEY:

23 Q Now, in terms of the feasibility study,
24 that was conducted initially by Mr. McNeel, he went
25 actually out there to Idaho to the Peak company?

1 A That's my understanding.

2 Q And that was in 2008?

3 A Yes, sir.

4 Q Do you know when Peak first got insurance
5 from Reserve company, when they first started paying
6 premiums when they got their insurance?

7 A That would have been in December of 2008.

8 Q So do you know more or less what the premium
9 amount was?

10 A I believe it was something on the order of
11 \$400,000 offhand.

12 Q I was going to ask you if it was around
13 \$400,000-plus, something like that. So they were
14 paying -- would it be correct to say that they were
15 paying, more or less, \$4,000 more, perhaps, for one
16 month of coverage in 2008. Would that be correct?

17 A Not precisely correct. It would be correct
18 if the policies were issued at that time, but the way
19 a number of the policies are written -- and I can't
20 tell you specifically which ones right now -- but a
21 number of the policies are for claims made, policies
22 that had retroactive dates that go back for a number
23 of years prior to the original inception date. So in
24 effect, it's taking coverage back retroactively for a
25 number of years, even though the policy was issued as

1 of a certain date.

2 Q Do you know if it actually says that in the
3 policy?

4 A The policies that have retroactive dates
5 have that clearly specified, yes.

6 Q So without getting into what this one says,
7 it either has it or it doesn't have it, you really
8 don't know. Is that correct?

9 A That's correct.

10 Q And the document speaks for itself anyway.
11 Right?

12 A Yes, sir.

13 Q So let's see, we've got Mr. McNeel putting
14 together -- well, he's out in Idaho and he puts
15 together a rough draft for you?

16 A He would have put together a rough draft
17 for me upon his return and sending all the
18 information. There's usually some dialogue back and
19 forth with the client and their financial managers to
20 pull together all of the information that's part of
21 the review.

22 Q And you had indicated when Mr. Albright had
23 asked you earlier on page 1 of your feasibility study
24 -- which is 16-J, I believe, if you want to just take
25 a look in there -- that you had said in there that

1 Capstone had already met on site with the proposed
2 insurer. Is that correct?

3 A Yes.

4 Q So when you said Capstone, did you mean Mr.
5 McNeel?

6 A Again, to the best of my knowledge. I
7 don't know if anyone else was involved in the site
8 visit.

9 Q Do you have any knowledge of how it was
10 that Capstone and Peak connected up with each other?

11 A I don't.

12 Q Do you know if Capstone advertises in any
13 manner regarding the type of policies or type of
14 captive programs they might be able to help people
15 with?

16 A I know that Capstone is fairly active in
17 the captive insurance industry, as are a number of
18 other companies, and I know they do some advertising
19 around the possibility of forming a captive insurance
20 company.

21 Q Do you have any personal knowledge of
22 whether -- well, Mr. Zumbaum is here but he's not --
23 there's the Peak company and then Mr. Zumbaum -- but
24 do you know if either Mr. Zumbaum and/or just the
25 entity Peak ever reached out to Capstone with the

1 effect of I would like to participate in your
2 program?

3 A I don't know that specifically, no, how
4 they got connected.

5 Q So the draft materials come back to you and
6 you review them in terms of the feasibility study.
7 Is that correct?

8 A That is correct.

9 Q And I believe you signed, I think it's on
10 page 3 on 16-J that's your signature, and that other
11 page I don't know that you signed it but that's all
12 your conclusion. Is that true?

13 A Yes.

14 Q Okay. But on page 3 is where you signed
15 it. Is that right?

16 A That is correct.

17 Q And if you to go -- do you know when you
18 actually signed it? Do you know offhand?

19 A I do not know a specific date.

20 Q Well, do you have any -- what's the best of
21 your ability to reconstruct how long after the
22 initial visit you would have signed it?

23 A It would have been a matter of months,
24 certainly. It takes that long before I'm involved in
25 the normal course of things.

1 Q So the initial visit, according to the
2 feasibility study, if you look at that cover page,
3 was August 13, 2008. Is that right?

4 A To the best of my knowledge.

5 Q I'm just reading off of this.

6 And you would have signed it in 2009, do
7 you know?

8 A It could have been in the calendar year by
9 virtue of the fact that the company was formed right
10 near the end of 2008, and there's sometimes a lag
11 time from when the feasibility work is completed
12 until the final report is actually put in front of me
13 to sign. That happens fairly consistently.

14 Q So are you saying that an insurance policy
15 could have been signed and put into effect prior to
16 your completion of the feasibility study?

17 A I would say the work would have been
18 completed, what might have been a final signature on
19 the final report.

20 Q Did you ever talk to any of the folks at
21 Peak, for example, Mr. Zumbaum who is here, or
22 anybody else directly involved?

23 A Not directly.

24 Q When Mr. McNeel went out there to Idaho to
25 do the first line work on the feasibility study, did

1 you ever question him or second-guess him on any of
2 his conclusions or any of his work?

3 A No, not second-guess. We would have
4 discussed at a point in time all of the assembled
5 material that was gathered. He would have given me a
6 briefing, an oral briefing on what the company's
7 business was about, who the owners were, what the
8 scope of the operations were, general discussion
9 about the business, and I would have had an
10 opportunity to ask him questions to get a finer
11 understanding.

12 Q So based on your knowledge of him in the
13 past, your relationship in the past, work-wise or
14 friend-wise, whatever, you relied upon what he said
15 to do your final version.

16 A Yes. I should say, based on I've known
17 Lance for a long time, Lance has been a very well
18 regarded insurance professional his entire career
19 that I'm aware of, and I would have a high level of
20 confidence in the information that he would bring to
21 me.

22 Q As far as the captive type of programs that
23 you're familiar with, for example, the one in this
24 particular case involving Reserve insurance of Peak
25 and its other entities, is there anything that -- and

1 I don't want to say that's necessarily negative --
2 pro forma about the kind of policies that are
3 involved in this? Is there something that's
4 prototypical? Maybe that's a better word.

5 A Prototypical is probably fair. There's a
6 consistency to it because with respect to businesses
7 of this type, there's either a need for coverage or a
8 need for additional coverage or sometimes gaps in
9 insurance and a risk financing program that would be
10 more or less typical. So yes, I would say you might
11 see a prototypical set of policies but they would not
12 be the same for every client.

13 Q Sure. They would be different for every
14 client, for example, if you're a bakery or a mining
15 company, as an example?

16 A Yes.

17 Q So would any of the be the same or the type
18 of insurance risks or insurance policies be the same
19 that across the board?

20 A Yes, some of them would be.

21 Q In terms of the type of insurance policies
22 that were being offered in the regard that you had
23 just mentioned, some are similar and some are
24 different, do you recall who would have determined
25 what type of policies would be considered? Was it

1 the person who was the insured company or would it be
2 Capstone?

3 A It would be Capstone, and I'm going to
4 probably say in some role of consultation with the
5 captive owner, the underlying business, and then I
6 would see a representative listing of potential
7 coverages.

8 Q Okay. So again going back to your
9 feasibility study on that -- I'm not sure how many
10 cover pages there are to that, but the one that has
11 Willis HRH and Capstone, the little logos -- do you
12 see that?

13 A Yes, sir.

14 Q Does that to you represent, because they're
15 both on there, that this is a joint collaboration
16 between you -- or your entity, your company, and
17 Capstone?

18 A Yes.

19 Q So in terms of the feasibility study, this
20 was a joint opinion, so to speak?

21 A Yes.

22 Q So when you were signing off on this, you
23 were signing off in a sense as a representative of
24 both those entities?

25 A I would have been signing off on behalf of

1 my own entity.

2 Q You would be signing off on behalf of your
3 own entity, but since Capstone was part and parcel of
4 the cover sheet, would you believe that -- or was it
5 the position that you were taking that you were
6 affirming whatever it was that Capstone had done in
7 the feasibility -- I'm sorry -- in its program, would
8 be affirming that, saying that was the correct way to
9 do things?

10 A That might be overly broad from the
11 standpoint that at that point in time I wouldn't have
12 necessarily seen all the policies that were going to
13 be issued or the premiums that had been developed.
14 It would have been jointly our view that I was
15 affirming that formation of a captive insurance
16 company made business and financial sense for this
17 particular client.

18 Q So in other words, at the time that you
19 signed off on this, you would have thought maybe a
20 captive program made sense but you wouldn't
21 necessarily have known whether the particular
22 policies within the program, let's say ten, eleven,
23 thirteen, or the premiums for those policies would
24 have made sense or not made sense.

25 A That's correct.

1 Q Okay. So then would it be fair to say that
2 when you did your feasibility study, you were not
3 really looking at what kind of policies Peak needed?

4 A It would be fair to say that I would have
5 looked at generally, that's always part of the
6 discussion I have with a Capstone representative, but
7 as for final determination about policies, I
8 wouldn't.

9 Q Did you have any involvement at all in the
10 determination of the premium amounts?

11 A I did not.

12 Q So you don't know anything about that.

13 A I mean, I know, as we discussed earlier,
14 roughly the total amount of premium that was involved
15 but not the specific policy premiums.

16 Q In terms of this program, the captive
17 insurance program that was being offered by Capstone
18 -- and I'm not asking you as a tax lawyer or anything
19 like that -- were you aware if Capstone was saying:
20 Oh, this would be a good program, companies, because
21 of tax incentives involved in this?

22 A I think what's fair to say -- and this
23 would be true with respect to the formation of any
24 captive for any company, large or small, would be
25 some assessment commentary with respect to the tax

1 considerations. The tax considerations certainly
2 require that all those are talked about.

3 Q And I'm not asking you as a tax expert or
4 anything like that, but do you know what the tax
5 considerations were?

6 A Well, the tax considerations at this point
7 in time would have been centered around the formation
8 of a 501(c)(15) company as opposed to possibly an
9 831(b) company.

10 Q So would it be correct, as you understood
11 it, that a 501(c)(15) company could not have more
12 money coming into a place like Anguilla, for example,
13 than \$600,000 a year in premiums?

14 A At that point in time the 501(c)(15)s were
15 subject to what is called the gross receipts test
16 which is can be construed a little differently than a
17 premium per se, that aggregate number was \$600,000.

18 Q And I don't want to belabor this, but do
19 you know if there's any relationship between the
20 amount of money, for example, that Peak was taking in
21 in gross receipts as opposed to how the premium was
22 determined?

23 A Not directly.

24 Q Okay. Do you know if there was any history
25 that the Peak company had as to potential losses in

1 the past prior to the formation of the policies that
2 it signed on with Reserve in late 2008?

3 A Not directly. I knew that Peak bought an
4 array of commercial insurance policies, and like any
5 business, I would assume they would have had some
6 claims under those policies.

7 Q Sure. Do you know if they had any claims
8 that were of the type that would be covered by the
9 type of insurances set up under the policy that is
10 involved in this case with Reserve Company?

11 A I don't know that specifically.

12 Q Okay. Do you know if anybody else, maybe
13 Mr. McNeel or anybody else, was aware of what the
14 loss history -- potential loss history was of Peak?

15 A Again, I don't know that specifically, but
16 I would assume he would have had some understanding
17 of that.

18 Q Now, if you know -- and again, this is just
19 based on what you understood from how the program is
20 supposed to be -- if the calculation for gross
21 receipts, vis-a-vis the premiums and that nature, if
22 it was -- if whatever the accurate figure was was
23 more than \$600,000 going into the Anguillan entity,
24 was that a viable setup, if you know that?

25 A I don't know that.

1 Q But was it part of the program as you
2 understand it to establish an insurance company
3 receiving monies from an insured where it was never
4 more than 600,000 going into Anguilla, if you know?

5 A Yes, I do. I know that the intention would
6 have -- and then this would apply to any type of
7 captive that we're talking, specifically a 501(c)(15)
8 -- not to exceed the allowable threshold.

9 Q Was there anything that you know about --
10 and again, a lot of this is you knowing from working
11 with Capstone folks. Is that true?

12 A That's true.

13 Q And Mr. Feldman?

14 A Yes.

15 Q Okay. If you know, was there any
16 particular reason that you're aware of why Anguilla
17 was established?

18 A Not a particular reason. I think that the
19 reason that Anguilla and several of the other British
20 Commonwealth territories are selected is because, for
21 one reason, for smaller businesses they have lower
22 capitalization requirements than some of the other
23 domiciles, so it could have been Anguilla or several
24 others, but generally related to capitalization and
25 the regulatory infrastructure in the domicile.

1 Q So I'd like for you to turn to page 8 of
2 your feasibility study, if you don't mind, and it's
3 in that section, do you see that bullet point small
4 and intermediate captives. Do you see that?

5 A I do.

6 Q And going down, what, five maybe lines, it
7 talks about these types of captives require domicile
8 favorable to small and intermediate captives and a
9 turnkey type of administration to overcome the
10 transaction costs associated with such a captive.

11 A Yes, I see that.

12 Q What do you understand that to mean and
13 what influence would that have if I'm a businessman
14 and want to become part of a captive operation?

15 A Well, I can tell you that domicile
16 favorable, what that means is probably a lower
17 minimum capitalization requirement in that domicile
18 and also a fair amount of flexibility with respect to
19 the regulations promulgated by that domicile.

20 Q Would it be fair to say that the type
21 domicile that would be selected in these type of
22 captive arrangements in regard to Capstone setting
23 them up would be a domicile where there was the least
24 amount of regulation involved?

25 A I don't know if least would be exactly

1 accurate, but I would say flexibility in terms of
2 making filings and reports and that sort of thing.
3 I'll interject that the domiciles such as Anguilla --
4 and I've worked with clients that worked in a number
5 of I would say the offshore or island domiciles that
6 are all British protectorates and they're all subject
7 to UK financial and legal standards.

8 Q And as far as you know, at least what's
9 been explained to you, those standards are
10 significantly less than in the United States, if you
11 know?

12 A I do know, and they can be. It really
13 depends on an individual state and there is a
14 grouping of states that have captive formation
15 friendly legislation so a fair number of captives are
16 formed there. But in several of those states,
17 especially with respect to a small company, the
18 regulation might be stricter in some sense but it
19 wouldn't be uniformly true.

20 Q Do you have any knowledge of whether it
21 would be more difficult to get the type of insurance
22 that Peak got in this instance through an insurance
23 company regulated by the State of Idaho or any other
24 state, Montana, up in that are?

25 A Again, I would say not necessarily.

1 Montana happens to be a state that has captive
2 legislation and so one could possibly form a company
3 there. The regulators in the states that permit
4 captive formation are usually fairly flexible in
5 terms of the types of coverage that would be included
6 as part of the business plan, so it's a different
7 regulatory scheme than for a commercial insurance
8 company.

9 Q Okay. So you mentioned about Montana but
10 this company, Peak, is actually in Idaho. Do you
11 know if it's more flexible there or not?

12 A Actually, I don't even know if Idaho has
13 captive legislation.

14 Q I said Montana because it's not too far
15 away.

16 Now, in your feasibility study, going to
17 page 19 through I think it's 21, that's where you
18 talk about the risk management issues. Can you turn
19 to that, please?

20 A Yes. I'm there.

21 Q Now, as to each of those type of policies,
22 were those the ones that you recommended that be
23 enacted in this particular case?

24 A Yes. Jointly with Capstone we would have
25 run through all of these and I would have agreed with

1 Mr. McNeel that these were the potential coverages
2 that would make sense for this company. Yes.

3 Q So they were coverages that would have made
4 sense. Would they have made sense based upon
5 problems that Peak had had in the past with having a
6 loss as a result of the lack of the coverage of one
7 of these policies?

8 A Not necessarily as a result of having a
9 loss, but as a result of having a known potential
10 exposure, and it's not uncommon for a business to
11 have exposures that aren't fully addressed by its
12 existing commercial insurance program.

13 Q As to the items that are listed, the types
14 of risk matter issues from 19 to 21, do you have any
15 personal knowledge -- do you have personal knowledge
16 of each and every one of those type of policies that
17 would be available to cover a company such as Peak?

18 A Possibly with one or two exceptions in that
19 whole array.

20 Q Okay. Well, can you pick out one that you
21 have particular knowledge of and explain why you
22 would have knowledge of that?

23 A Sure. As to most of them the answer is
24 yes, but I'll take employment practices, and any
25 employer with multiple employees and properties is

1 subject to potential employee claims arising out of
2 local place situations. That coverage, you'll note
3 that it happens to be listed right after the
4 directors and officers liability coverage -- in the
5 commercial insurance world it's fairly common to
6 connect the D&O, directors and officers, and
7 employment practices liability coverage.

8 Q Okay. In this particular situation are you
9 aware that the same two gentlemen that were
10 essentially the main participants in the Peak company
11 were also the same main participants in the Reserve
12 insurance company?

13 A Yes.

14 Q All right. Are you aware of any directors
15 and officers liability that would be applicable to
16 that situation where a claim would be made against
17 Peak directors against the Peak company when the
18 directors of the Peak company were the same as in the
19 insurance company, that is Reserve?

20 A Would you be referring to claims by the
21 directors of one company against another company?

22 Q Yes. Well, for example, the directors
23 liability, how would you understand that to be?

24 A Well, the directors and officers liability
25 coverage what are generally termed as wrongful acts

1 that have been alleged to have been committed by a
2 director or an office. The claims with publicly
3 traded companies is claims made from shareholders as
4 in a shareholder derivative suit. Many private
5 companies buy directors and officers liability
6 coverage, though, because of potential claims from
7 customers or suppliers. Normally there is --
8 directors or officers who are also directors or
9 officers of another company, there is sometimes an
10 exclusion in one policy that prevents a claim by or
11 on behalf of them from the other company. That's
12 fairly common.

13 Q And how would that apply in this instance
14 in this case with Peak getting a policy that would
15 cover directors and officers liability?

16 A As far as I know, the coverage that would
17 have been written would have been written on behalf
18 of the directors or officers of Peak as directors or
19 officers of Peak, not as directors or officers of
20 Reserve.

21 Q There's also on page 19 one about
22 legislative and regulatory changes. Do you see that?

23 A I do.

24 Q Were you aware that there had been any
25 legislative or regulatory changes by EPA or anybody

1 else that had had a negative effect on Peak?

2 A I was not specifically aware of that.

3 Q Now, I notice that there's one about
4 pollution liability and that's kind of a big one. Is
5 that correct, that would be big issue?

6 A I would say so.

7 Q And there were two other entities that are
8 associated with Peak. Are you aware of that, that
9 they were also being insured?

10 A Yes.

11 Q Do you know what they did at all?

12 A I think one of them designed emissions
13 controls and one was, I think, an ancillary business
14 of the owners, and not terribly uncommon but it would
15 have been something related.

16 Q Okay. So was one involved in real estate
17 and one involved in the sale of alcohol, as far as
18 you knew?

19 A I believe I had heard that along the way.

20 Q Would the types of policies that you
21 mentioned on 19, 20 or 21, would they be the types of
22 businesses, or those other two businesses, would they
23 be the types of businesses that you believe would
24 have needed this type of insurance as 19, 20 and 21?

25 A Not necessarily. The focus of the proposed

1 insurances would always be with regard to the main
2 operating entity.

3 Q Now let's go to 21, that's the last one I'm
4 going to go, tax liability. Were you aware of
5 whether there was any issues that Peak had with
6 potential -- strike that -- were you aware of any
7 issues that Peak had where they had been determined
8 to have liability in prior years, tax liability?

9 A No, I was not.

10 Q Okay. And one of the things I noticed on
11 the tax liability, the middle line for number 21 was
12 one of the potential risks as a tax liability was as
13 to adverse decisions regarding captive planning.

14 A Yes.

15 Q So in other words, a liability against the
16 type of planning that actually reached fruition in
17 this matter with what policies they got. Right?

18 A That's what I understand.

19 MR. MARKLEY: Bear with me a second, Your
20 Honor. May I have a moment?

21 (Pause.)

22 MR. MARKLEY: I'm back and I hope to over
23 pretty quickly, but I have a lot of helpers here.

24 BY MR. MARKLEY:

25 Q Do you know if Pool Re has any employees in

1 Anguilla offhand?

2 A No employees.

3 Q No employees. And I think you already said
4 they're not in the United States either. Right?

5 A That's correct.

6 Q Do you know if Capstone has any employees
7 in Anguilla?

8 A Yes.

9 Q And do you know what their names are
10 offhand?

11 A The one person who I do know who would be the
12 manager in Anguilla is a woman called Fiona Curtis.

13 Q Do you know what she does?

14 A Yes. She would be referred to as the
15 domicile captive manager, so she would be the local
16 presence of the company and would interface with the
17 regulators in Anguilla on behalf of Reserve and other
18 companies, other captive programs.

19 Q You've worked on a lot of captive
20 feasibility studies over the years. Is that right?

21 A That's correct.

22 Q Has there ever been an instance where you
23 concluded in your work with Capstone, jointly with
24 Capstone, not just off in the wild blue, where there
25 was not a good reason or a good basis to have a

1 captive program set up?

2 A I believe there have been several instances
3 where I will say that the discussion on feasibility
4 was basically abandoned for one reason or another,
5 and that could have been for business purposes or
6 because just a determination that the company wasn't
7 feasible.

8 MR. MARKLEY: Thank you. I have nothing
9 else, Your Honor.

10 THE COURT: Mr. Albright, do you have any
11 redirect as a fact witness?

12 MR. ALBRIGHT: I'm sorry, Your Honor?

13 THE COURT: Do you have any redirect as a
14 fact witness.

15 MR. ALBRIGHT: As a fact witness at this
16 time?

17 THE COURT: Yes, just as a fact witness.

18 MR. ALBRIGHT: Yes, Your Honor.

19 REDIRECT EXAMINATION

20 BY MR. ALBRIGHT:

21 Q Mr. Snyder, Mr. Markley asked you whether
22 Pool Re had employees.

23 A Yes, he asked me that.

24 Q Do you know whether it's common in the
25 insurance industry for an insurance to have

1 employees?

2 A Well, it's common generally a company would
3 have employees. It's also common that captive
4 insurance companies don't have direct employees.

5 Q But how are they managing their affairs?

6 A Well, they would manage their affairs
7 through a contracted manager.

8 Q Is that also -- does that happen with
9 larger captive insurance companies as well?

10 A Absolutely. The vast majority -- I can say
11 in my experience with all the captives that I've ever
12 worked with, large and small, I could probably on
13 less than the fingers of one hand the number of those
14 captives that have employees.

15 Q I wanted to be clear. Mr. Markley seemed
16 to suggest that you're a tax lawyer. I just want to
17 be clear, you're not a tax lawyer, are you?

18 A No, sir, I'm not.

19 Q And you're not a tax expert either, are
20 you?

21 A I am not a tax expert.

22 Q And Mr. Markley asked you about consistency
23 regarding policies. What about homeowners policies
24 that are available to consumers generally, is there
25 consistency in those policies?

1 A There is, but again, I should distinguish
2 between the regulated, or what is referred to as the
3 admitted insurance market in any state where policies
4 and rates are required to be filed with the
5 department of insurance, so if you take a common
6 coverage like homeowners or automobile, yes, there's
7 a great deal of consistency, but even with respect to
8 those policies -- I'll use homeowners as the example
9 since you mentioned it -- if the property has a high
10 enough value, the insurance underwriter will
11 occasionally customize coverage, there could be
12 special endorsements or that sort of thing, and even
13 file those with the state if necessary to customize
14 that policy.

15 But to go on and finish that, that would be
16 the regulated admitted insurance market. The surplus
17 lines market or the alternative risk market, as we
18 might call it, which would include captives and other
19 structures like that, would be highly customized and
20 there would not be consistency with all such policies
21 from one insured entity to another.

22 Q Mr. Markley also asked you about D&O
23 coverage.

24 A Yes.

25 Q D&O coverage, again, is what kind of

1 coverage?

2 A Directors and officers.

3 Q And so if Peak had a D&O policy, can you
4 think of any scenario under which that policy might
5 respond to a lawsuit?

6 A Yes. For a private company the most likely
7 scenario for a D&O policy to respond would be if a
8 customer or a supplier alleged that the insured
9 company had done something wrong and specifically
10 named one of the directors or officers as part of
11 that. Additionally, I think I mentioned that it's
12 common for employment practices liability to be
13 coupled with directors and officers coverage, and so
14 any sort of claim for an employee, say a
15 discrimination that was claimed, would be covered
16 under a policy like that.

17 MR. ALBRIGHT: Your Honor, that concludes
18 my redirect with regards to the factual portion of
19 his testimony.

20 THE COURT: Okay. Do you need a break, or
21 are you good to go?

22 THE WITNESS: Do you want me to step down?

23 THE COURT: No. Do you need a break?

24 THE WITNESS: Oh, am I good to go. Yes,
25 ma'am. Yes, Your Honor.

1 MR. ALBRIGHT: Your Honor, I would ask
2 permission for the clerk to mark this as Petitioner's
3 exhibit next in order for identification.

4 THE COURT: Okay. And I have just a
5 clarifying question about the supplemental
6 stipulation because I don't know how far in progress
7 you are on that and if you already have exhibits
8 numbered so we would not be duplicating numbers.

9 MR. HARRIMAN: Your Honor, at this time
10 we're still negotiating the supplemental, so we
11 wouldn't have any conflict with new numbers being
12 next in line with the stipulation that's been filed.

13 THE COURT: Thank you.

14 MR. ALBRIGHT: And Your Honor, I believe we
15 submitted a copy to the Court but I have copies here.

16 THE COURT: Okay. Thank you.

17 THE CLERK: Marked that as Exhibit 97-P.

18 (The document referred to was
19 marked for identification as
20 Petitioner Exhibit 97-P.)

21 MR. ALBRIGHT: And Your Honor, I also
22 provided a copy to Respondent's counsel and have an
23 extra copy for the court if the Court needs one.

24 THE COURT: I think we're good.

25 MR. MARKLEY: Your Honor, may I say

1 something? I'll stipulate to his qualifications.

2 THE COURT: Okay. All right.

3 MR. ALBRIGHT: Your Honor, may I provide
4 Mr. Snyder with a copy of the report?

5 THE COURT: Yes. And just to have the
6 record reflect, you're offering him as an expert
7 witness and Mr. Markley just stipulated to his
8 qualifications?

9 MR. MARKLEY: Yes, Your Honor, I will
10 stipulate to his qualifications.

11 THE COURT: All right. So he's admitted as
12 an expert.

13 MR. ALBRIGHT: Thank you, Your Honor.

14 Your Honor, may approach and provide a copy
15 to Mr. Snyder?

16 THE COURT: Yes.

17 DIRECT EXAMINATION

18 BY MR. ALBRIGHT:

19 Q Mr. Snyder, do you have a document that's
20 been marked for identification as Petitioner's
21 Exhibit 97-P for identification? Do you have that in
22 front of you?

23 A Yes.

24 Q Can you tell me what Exhibit 97-P is?

25 A It is my expert report with regard to this

1 matter.

2 MR. ALBRIGHT: Your Honor, I'd move the
3 exhibit into evidence.

4 THE COURT: Mr. Markley?

5 MR. MARKLEY: May I do a brief -- you're
6 moving it into evidence, and I do not object to that,
7 but I would still like to do some cross-examination.

8 THE COURT: Correct. I'm first going to
9 admit the expert report while Mr. Albright has five
10 minutes, and then it's turned over to you for your
11 cross.

12 MR. MARKLEY: Thank you.

13 THE COURT: So at this time the Court has
14 admitted 97-P.

15 (The document referred to,
16 having been previously
17 marked for identification as
18 Petitioner Exhibit 97-P,
19 was received in evidence.)

20 MR. ALBRIGHT: That is it, Your Honor. Pass
21 the witness for cross-examination.

22 THE COURT: Okay. Thank you.

23 MR. MARKLEY: Your Honor, I think it's
24 pretty obvious that a lot of questions that I would
25 ask now I've kind of asked before, so I'm not going

1 to duplicate that in this part of the record, so I
2 don't want to keep you here for the rest of your
3 life. Let's see if there's anything I can really ask
4 that I didn't ask before.

5 CROSS-EXAMINATION

6 BY MR. MARKLEY:

7 Q Just so I can clarify this, the work that
8 you do in your daily work is for more than just
9 Capstone. Is that correct?

10 A Absolutely.

11 Q And what percentage would you say would be
12 for Capstone?

13 A I would say something on the order of 10
14 percent of my professional time is allocated to
15 Capstone.

16 Q I'd like you to look at page 4 of your
17 report -- let me make sure I'm not on the feasibility
18 study now by accident, no -- page 4 of your report,
19 and you mentioned something in a footnote about
20 letters you had looked at, tax-exempt determination
21 letters. Do you see that in your footnote number 1?

22 A Yes, sir.

23 Q Okay. I'm not asking you about those
24 letters, but is it clear that you're saying whatever
25 is in those letters, those 39 letters, didn't have

1 anything to do with your determination that you made
2 -- your opinion in this case. Is that correct?

3 A That's correct.

4 Q Okay. That's not my question. I'm not
5 trying to be rude, but it's just yes or no.

6 Did you and -- and I'm not saying that this
7 is improper, but did you and Mr. McNeel kind of get
8 together in the way you wrote your reports in any
9 way?

10 A Mr. McNeel and I, no, I don't think he and
11 I had any discussion regarding our reports.

12 Q Okay. So if there's any similarity between
13 what's in your report and what's in Mr. McNeel's
14 report, that's just accidental.

15 A Perhaps. We -- I had -- we've had some
16 discussions generally about the -- and I say we, not
17 Mr. McNeel, because I don't think Mr. McNeel and I
18 had any discussion about it at all -- but simply with
19 Capstone staff, the material that needed to be
20 gathered together, how the report should be
21 organized, that sort of thing.

22 MR. MARKLEY: Since my questions of Mr.
23 Snyder as a fact witness are already in, I don't
24 think I really need to repeat that, they would be
25 kind of along the same lines, so I really don't have

1 any other questions.

2 THE COURT: All right.

3 MR. ALBRIGHT: I have no further questions,
4 Your Honor.

5 THE COURT: All right. You may step down.
6 Thank you.

7 THE WITNESS: Thank you.

8 (Whereupon, the witness was excused.)

9 MR. ALBRIGHT: And Your Honor, may I
10 retrieve the exhibits before I call my next witness?

11 THE COURT: Yes, you may.

12 (Whereupon, the above-entitled matter was
13 continued to Volume 2.)

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1 CERTIFICATE OF TRANSCRIBER AND PROOFREADER

2 CASE NAME: Reserve Mechanical Corp, f.k.a. as

3 Reserve Casualty Corp. v. Commissioner

4 DOCKET NO.: 14545-16

5 We, the undersigned, do hereby certify that the
6 foregoing pages, numbers 1 through 86, inclusive, are
7 the true, accurate and complete transcript prepared
8 from the recording made by electronic recording by
9 Leslie Berridge, on April 27, 2017, before the United
10 States Tax Court at its session in Houston, Texas, in
11 accordance with the applicable provisions of the
12 current verbatim reporting contract of the Court, and
13 have verified the accuracy of the transcript by
14 comparing the typewritten transcript against the
15 verbal recording.

16

17 _____

18 Nancy H. King 05/18/2017

19 (Transcriber) (Date)

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21 _____

22 Laurel H. Stoddard 05/19/2017

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25

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IN THE UNITED STATES TAX COURT

In the Matter of:)
)
RESERVE MECHANICAL CORP., f.k.a.)
RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
v.)
)
COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

Volume: 2
Pages: 87 through 186
Place: Houston, Texas
Date: April 27, 2017

1 IN THE UNITED STATES TAX COURT

2

In the Matter of:)

3

RESERVE MECHANICAL CORP., f.k.a.)

4

RESERVE CASUALTY CORP.,)

5

Petitioner,) Docket No. 14545-16

6

v.)

7

COMMISSIONER OF INTERNAL REVENUE,)

8

Respondent.)

9

Room 7006
Casey U.S. Courthouse
515 Rusk Avenue
Houston, Texas

10

11

12

April 27, 2017

13

The above-entitled matter came on for
trial, pursuant to notice, at 9:30 a.m.

14

15

BEFORE: HONORABLE KATHLEEN KERRIGAN
Judge

16

APPEARANCES:

17

For the Petitioner:

18

VAL J. ALBRIGHT, Esquire
MICHELLE Y. KU, Esquire
Gardere Wynne
2021 McKinney Avenue, Ste. 1600
Dallas, Texas 75201
214-999-3000

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1 APPEARANCES: (continued)

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C O N T E N T S

WITNESSES:	DIRECT	CROSS	REDIRECT	RECROSS	VOIR DIRE
For Petitioner:					
Norman Zumbaum	91	152	175	183	
For Respondent					
None					

1

E X H I B I T S

2

EXHIBITS:

IDENTIFIED

RECEIVED

3

98-R

174

not offered

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99-P

182

183

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100-R

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1 P R O C E E D I N G S

2 MR. ALBRIGHT: The Petitioner calls Norm
3 Zumbaum.

4 Whereupon,

5 NORMAN ZUMBAUM

6 having been first duly sworn, was called as
7 a witness herein and was examined and testified as
8 follows:

9 THE CLERK: Can you please state your name
10 and address for the record?

11 THE WITNESS: Norman Zumbaum, 122 Mullan
12 Avenue, Coeur D'Alene, Idaho.

13 DIRECT EXAMINATION

14 BY MR. ALBRIGHT:

15 Q And, Mr. Zumbaum, I'm a little hard of
16 hearing, so if you would speak up a little bit to
17 make sure that I'm hearing what you're saying. The
18 microphone is not for amplification purposes; it's
19 for recording purposes.

20 So good morning, or I should say -- it's
21 still good morning.

22 Mr. Zumbaum, are you employed?

23 A Yes.

24 Q And where are you employed?

25 A Peak Mechanical.

1 Q And the full name of the company is?

2 A Peak Mechanical & Components.

3 Q Peak Mechanical & Components, Incorporated?

4 A Incorporated. Yes.

5 Q And are you familiar with RocQuest, LLC?

6 A Yes, I am.

7 Q Are you familiar with ZW Enterprises, LLC?

8 A Yes, sir.

9 Q And how is that you're familiar with those
10 two companies?

11 A Owner.

12 Q Can you tell me a little bit about your
13 career?

14 A Yes. I started in the mining industry
15 right out of high school, worked in deep underground
16 mines, very hot, very dangerous working environment.
17 Spent probably ten years in the underground
18 environment as a laborer. Started out in a grizzly
19 mine which is basically where they're bringing the
20 large rock out and they're classified through a large
21 screen, classifying it and if the rocks don't fit you
22 start with basically taking a double jack and break
23 them up so they go down through the holes, and
24 eventually that gets right up to the surface.

25 I did that for a few years and then moved

1 my way up into what you would call a nipper position
2 which is kind of support for the mining crew. We
3 supported them with all the equipment that they
4 needed to do their projects for the day, handling
5 explosives, timber, whatever supplies they needed.

6 Then after that I kind of worked my way up
7 into the mechanical department, and then through the
8 years there I've worked my way up through management
9 in the mining industry.

10 Q And the family that you came from, was your
11 father in the mining industry as well?

12 A Yes. My dad worked in the mines for all of
13 his career which spanned about 45 years.

14 Q And when you say -- where did you grow up?

15 A I grew up in Wallis, Idaho.

16 Q Wallis, Idaho?

17 A Yes.

18 Q And what's the mining industry do in that
19 area?

20 A A lot of the silver industry and lead and
21 zinc industry, all deep underground mines, now down
22 about 8,500 feet is probably one of the deepest ones
23 that's there now.

24 Q And so I don't know if you said Silver
25 Valley. Are you familiar with Silver Valley, Idaho?

1 A That's what they call the valley we live
2 in. It was predominantly back in probably late
3 history, a lot of silver mining there, so it was just
4 kind of tagged that name Silver Valley.

5 Q Does the name ASARCO mean anything to you?

6 A Yes. I worked for ASARCO from the
7 beginning of my career until when I finished there
8 before I moved on in my career.

9 Q ASARCO, would you spell that, please?

10 A A-S-A-R-C-O.

11 Q Does that stand for a longer name?

12 A Yes. I believe it American Smelting and
13 Refining Company.

14 Q Can you tell me a little bit about what
15 ASARCO did? And I believe you said they did mining.

16 A They were the operators of our local mine.
17 They were, I believe, based out of New York at that
18 time, so they owned a number of mines and smelting
19 operations through the U.S.

20 Q And I believe you said you worked on a
21 grizzly when you started?

22 A Yes.

23 Q Is that spelled like grizzly bear?

24 A Just like grizzly bear, yes. That is what
25 they called that and it was kind of a mean place to

1 work, tough environment.

2 Q And you also used the term nipper.

3 A And that's just another mining term for
4 support staff for the mining crew would be more of a
5 term this day and age but back then it was you were
6 the nipper.

7 Q But you said that the nipper carries
8 explosives in the mine?

9 A Yes. We had to handle explosives, get it
10 up to the workers so we would transport it, handle
11 it, get it to where it needed to be.

12 Q And so did you ever have a management job
13 at ASARCO?

14 A Yes. I worked my way up into management.

15 Q And was that all in Idaho?

16 A Yes, that was all in Idaho. I finished
17 right there with them.

18 Q After you worked for ASARCO, did you work
19 for another company?

20 A Yes. I moved down and I worked for Mining
21 Equipment, MEI.

22 Q And do you know what years you worked for
23 that company?

24 A I believe I went down there in '96, I
25 believe.

1 Q How many years did you work for Mining
2 Equipment?

3 A I had 3-1/2 to 4 years there, I believe.

4 Q And what was the nature of Mining
5 Equipment's business?

6 A We ran a business of supporting the mining
7 and tunnel industry through equipment. We
8 manufactured equipment, refurbished equipment, so we
9 supplied a lot of it to the underground mining
10 industry and the tunneling industry, which you guys
11 are probably familiar with sewer, subway, things like
12 that.

13 Q And can you give examples of the mining
14 equipment that Mining Equipment company sold?

15 A Yes. We did of rail gear which would be
16 locomotives or transportation cars, cement mixer
17 stuff, and we also did a fair amount of rubber tire
18 stuff which would be LHD, load hauling dump trucks,
19 scoop trams which would be uploaders, loaders that
20 load rock on rubber tires, support gear for rubber
21 tire, did a fair amount of ventilation fan rehab and
22 repair work and supplied ventilation equipment in
23 mining. And there as another company there that they
24 owned and we supplied stage winches and hoisting.

25 Q What?

1 A Stage winches and hoisting equipment.

2 Q What is a stage winch?

3 A A stage winch is used more probably when
4 you're working like in the city here, say if Houston
5 was putting down a shaft to go down 1,000 feet to
6 intersect something or something like that, you would
7 use a series of stage winches around the outside of
8 the shaft, probably three to four, that would carry
9 your man working environment which is called a
10 galloway. That's what all the guys work off of and
11 gets your equipment down to the bottom of the shaft
12 and up. And then also used for mucking out, the
13 cleaning of the hole, I guess you would say.

14 Q You said mucking?

15 A Just a term, it's a mining term.

16 Q Do you spell that M-U-C-K-I-N-G?

17 A Yes.

18 Q Mucking out?

19 A Mucking out it's called.

20 Q And what is that?

21 A So let's say if you're doing a shaft, a
22 tunnel, going vertical is a shaft so you have to
23 blast if you're in rock, so the term mucking is when
24 you're taking out the rock. And the stage winches
25 will handle whatever pieces of equipment you have on

1 the end of it to do that function.

2 Q What jobs did you perform for Mining
3 Equipment?

4 A I was management, shop superintendent.

5 Q Do you recall whether Corey Weikel worked
6 for Mining Equipment?

7 A Corey Weikel worked with me there and he
8 also worked with me at ASARCO too.

9 Q And Corey Weikel today is?

10 A He's my partner.

11 Q Your partner.

12 A Yes.

13 Q Do you recall the name of the owner of
14 Mining Equipment?

15 A It was Bob Pope.

16 Q Bob?

17 A Pope, P-O-P-E.

18 Q And can you describe your relationship with
19 Bob Pope?

20 A Yes. We had a very good relationship when
21 I worked there, and after I left his company he kind
22 of mentored us. He's a very good business guy, very
23 good operator, and when we left the company and went
24 out on our own, he supported us very, very well, and
25 he was a good mentor for us.

1 Q Was he your competitor also?

2 A Not directly but indirectly, yes, but we
3 still in a very good relationship.

4 Q Now, if you don't mind, I would like to
5 refer to your company as Peak, if that's okay.

6 A Yes.

7 Q And I'm actually referring to Peak
8 Mechanical & Components, Inc., but it's easier to
9 talk if I just say Peak.

10 A Yes.

11 Q Did Peak ever do business with Mining
12 Equipment?

13 A We have done some business with them, yes.

14 Q What kind of business?

15 A We've purchased some used equipment from
16 them and supplied to the mines, and maybe something
17 we wouldn't have, they would have, we'd purchase it
18 from them.

19 Q Do you recall whether Mining Equipment was
20 ever involved in a lawsuit?

21 A Yes. When I was there, I don't remember
22 the exact date, I believe it was my second year
23 there, we were on -- actually, I remember the day, it
24 was Thanksgiving, they invited me over to dinner and
25 we were sitting there and we got a phone call from I

1 believe it was Scansa which was a construction
2 company doing a deep vertical shaft in New York City
3 and one of the stage winches had fell down and killed
4 a gentleman that morning -- afternoon, actually.

5 Q And who had supplied the stage winch?

6 A MEI did, Mining Equipment.

7 Q Mining Equipment, your employer.

8 A Yes.

9 Q And so was there ever a lawsuit that was
10 filed as a result of that?

11 A Yes. It was part of a lengthy lawsuit,
12 yes.

13 Q And do you recall what the claim in the
14 lawsuit was? What was your understanding of the
15 claim?

16 A I believe it was settled on Mining
17 Equipment's end between \$1- to \$2 million.

18 Q So was it your understanding that Mining
19 Equipment was at fault in that?

20 A Mining Equipment had no fault at it. When
21 the winch went down, from my understanding -- I was
22 there at the proceedings -- we just rented the winch
23 to the construction company, they had hired an
24 outside engineer to design the facility that would
25 hold the winch and the winch was made to roll out

1 over the shaft and go down so it could down his cable
2 when he was running the conveyance, and that had
3 given way which caused the winch to fall down the
4 shaft and killed a gentleman.

5 Q Do you know what -- are you familiar with
6 the specific winch that was involved in the case?

7 A No. Large.

8 Q Large. These winches are large?

9 A Yes. They are probably physically the size
10 of that one, probably 20 feet long, 15 feet tall and
11 could weigh tens of thousands of pounds. So when
12 that comes down and you're in the bottom of a shaft,
13 you're in a 35-foot diameter hole, you don't have a
14 whole lot of run room when you're sitting at the
15 bottom of it.

16 Q And I don't recall, did you say how much
17 Mining Equipment had to pay in that lawsuit?

18 A I believe, in just conversation because I
19 think it was probably settled after I left, I don't
20 really recall but I think it was between \$1- and \$2
21 million.

22 Q Now, you left Mining Equipment in 1997 or
23 1998. Is that right?

24 A Around there, yes.

25 Q Why did you leave?

1 A I went to work for a company called ARESCO.
2 We were wanting to get back, the family wanted to get
3 back to Idaho, we were located down in New Mexico.
4 My wife's twin sister is a heart-lung transplant
5 recipient and at that time she was having a lot of
6 medical issues, so it was best that we go back home,
7 and so we left the employment of Mining Equipment at
8 that time.

9 Q So I'd like to go back and talk to you a
10 little bit about -- well, first of all, do you recall
11 when Peak was formed?

12 A Right around '95, '96. We weren't very
13 active in it but Corey and I formed it just kind of
14 on the idea that we were going to work for ourselves.

15 Q But you don't remember the exact year it
16 was formed?

17 A No, not exactly.

18 Q So the mines in Silver Valley, you're
19 familiar with the mines in Silver Valley. Right?

20 A Yes, and we're still located there.

21 Q And are these mines open pit mines?

22 A No. We're all deep underground mines.

23 Q And so these mines, how deep can these
24 mines get?

25 A Right now the deepest they are, which is

1 the Hecla Lucky Friday mine, I believe is down about
2 8,200 feet.

3 Q And would you say not uncommon to have a
4 mine that's 5,000 feet deep?

5 A That's fairly common, yes.

6 Q And what happens as you go down into the
7 ground, the temperature, what happens?

8 A It gets very, very warm. You can have rock
9 temperatures up to 140 to 150 degrees.

10 Q At 5,000 feet?

11 A Yes. And you could have that in a 3,000-
12 foot mine too, so kind of a geological thing, how the
13 heat and the water -- predominantly Nevada's mines
14 aren't as deep and they have a lot of water, water is
15 very common, and we find that in copper mining too.

16 Q And there are human beings working in these
17 mines?

18 A Yes.

19 Q And it's 140 degrees?

20 A Well, we do ventilation work and that's
21 where the large ventilation fans come in. They run
22 through cooler systems, like a building here, you're
23 running very large air conditioning system for the
24 mine to get the cool air to the workers.

25 Q Is that a product that Peak sells?

1 A We have in the past, yes, sold large
2 ventilation systems. We haven't done air
3 conditioning systems but we have done the fans that
4 have supplemented the air conditioning systems.

5 Q And fans for use in underground mines?

6 A Yes. You've got to bring fresh air down
7 and exhaust air out, so you'll have a large
8 ventilation fan. It depends on the structure of the
9 mine and how it's done, you'll either have them on
10 the intake side or the exhaust side of the mine.

11 Q And how big are these fans?

12 A They can go up to 10 foot diameter, 1,500
13 horsepower, 2,000 horsepower, just depends on what
14 direction they're put in, so very large.

15 Q Fifteen hundred horsepower?

16 A Yes. It's not uncommon to see, you can see
17 some centrifugal fans up to 3,000 horsepower at
18 times.

19 Q But the fans at Peak sells or sold in 2008,
20 '09 and '10, a fan could be up to 1,500 horsepower?

21 A The range back then, we were doing a lot of
22 500 horsepowers up to 1,500 horsepowers, primarily
23 ventilation fans.

24 Q And is there another issue with regard to
25 the quality of the air in a mine?

1 A Yes, it's very important, because most
2 mines now run on diesel equipment so you have a lot
3 of gases, the diesels put off certain gases, you also
4 have the heat from the diesel equipment running, you
5 have the diesel smoke, and of course just being that
6 deep underground inherently there's no air quality at
7 all. Unless you're making air quality, you don't
8 have it, and that's the job of the fans is to provide
9 the working environment with air quality.

10 Q And what about what's the humidity like in
11 a mine where there's no ventilation?

12 A Well, you guys in Texas it's probably not
13 much, but it's 100 percent pretty much.

14 Q And why is that?

15 A Well, it's wet underground, a lot of water,
16 you have a lot of water so you're moving air. You
17 try to scrub out as much humidity as you can but
18 you're not very successful at it. You're actually
19 introducing humidity with the air conditioning
20 systems. They're not like in a building here where
21 you have a dry system, they have a wet system, so
22 humidity a lot.

23 Q Is it fair to say that the mines in Silver
24 Valley are dangerous places to work?

25 A Yes, they are. My partner Corey, in his

1 younger years he was buried up to his neck in the
2 mines at one time and thought he was going to lose
3 his life. My dad, as a miner, he lost his partner
4 that I know of, at least one, in a mining accident,
5 and I've had numerous friends perish in the deep
6 mines.

7 Q What about Mr. Weikel's father?

8 A His dad died when he was one to two years
9 old, he never really knew his father.

10 Q And what happened to him?

11 A He got buried by the rock, falling ground
12 they call it.

13 Q And you said Mr. Weikel almost lost his
14 life.

15 A He was very close to losing his life by the
16 time they got him out, yes.

17 Q Was he injured?

18 A Yes. He had falling rock, he was working
19 in a raise bore hole, catching up a raise bore hole
20 is what you call it. The raised bore, when you mine
21 from one level to the next back then they were doing
22 some experimental stuff with big boring machines so
23 they were pulling the big bore bit up through the
24 hole and the big boring machine left and was catching
25 up the back and had a fallen ground on him and buried

1 him and broke his back very severely, his leg, ankle.
2 He was supposed to never walk again but he was
3 resilient and he has, but he's got a lot of medical
4 problems today because of that.

5 Q Now, Mr. Zumbaum, the parties have
6 stipulated in paragraph 45 of the stipulation of
7 facts that during the tax years 2008, 2009 and 2010
8 Peak was engaged in the business of repairing,
9 servicing and manufacturing equipment for underground
10 mining and construction. Can you tell me a little
11 bit about the nature of the business of RocQuest?

12 A RocQuest has held our real estate. We own
13 a building in Osburn, Idaho and we had another
14 building in Hayden Lake, Idaho that housed our
15 electrical apparatus business, and then we have a
16 building in Elko, Nevada that housed our warehouse
17 and our on-site fan assembly

18 Q So does Peak have manufacturing or
19 production facilities in its business?

20 A Yes, in Osburn.

21 Q Osburn. Peak just has it in Osburn.

22 A Yes.

23 Q Osburn where?

24 A Idaho.

25 Q So the property that RocQuest owns, is any

1 of that property leased to Peak?

2 A Yes. The one facility in Osburn and the
3 one facility in Nevada is leased to Peak.

4 Q And so is there any property in RocQuest
5 that's not leased to Peak?

6 A Not at this time. Back then, yes, there
7 was the shop in Hayden that Premier Electric Motor
8 worked out of, and we owned that and we leased that
9 to Premier Electric Motor.

10 Q And so Premier, tell me a little bit about
11 Premier.

12 A Premier Electric Motor was our apparatus
13 shop that Corey and I were third owners with Frank
14 McKuen, he was our partner in that so it was a third,
15 third, third. That business started out small, we
16 grew it and it was actually Peak Mechanical gave it
17 about 80 percent of its work so we built a bigger
18 facility in Hayden, RocQuest built that facility and
19 we leased it back to Premier Electric Motor which was
20 an apparatus business in the motor rewind business
21 you have a lot of chemicals, a lot of real nasty
22 stuff to do electric motors with, so it was kind of
23 an environmental active business, so you've got to be
24 careful on how you do things there.

25 Q And the product that Premier produced, did

1 you say -- I believe I understood you to say that 80
2 percent of that product went to Peak?

3 A Yes. They rebuilt motors for us. Within
4 Peak we did a lot of rebuilding and remanufacturing
5 of ventilation fans so they're all electric motors so
6 the motors would come to us, we would send them over
7 there for repair. And then also in the manufacturing
8 of our submersible pump line, all the motors were
9 manufactured in that facility.

10 Q And can you tell me about the nature of the
11 business of ZW Enterprises?

12 A ZW was just kind of a lending company. My
13 secretary, after she left she wanted to buy a local
14 bar in town, so we made ZW, we gave her the money --
15 we financed it, basically. Corey and I, we're still
16 10 percent owners, so we started ZW so Peak wouldn't
17 have any liability against the bar.

18 Q And were the operations of ZW significant -
19 - ZW Enterprises, were they significant?

20 A No.

21 Q Is Osburn, Idaho -- you mentioned Silver
22 Valley, is Osburn, Idaho considered to be in Silver
23 Valley?

24 A Yes.

25 Q Have you ever heard of the Bunker Hill

1 Superfund site?

2 A Yes. We're right in the middle of the
3 Superfund site.

4 Q So are you saying that Osburn is in the
5 Superfund site?

6 A Yes, sir.

7 Q What is this Superfund site, what's your
8 understanding of what it is?

9 A Well, to my understanding, when they
10 designated it, it was one of the biggest Superfund
11 sites in the U.S. from 100 years of mining, a lot of
12 tailings, and then injecting into the rivers and
13 creeks, going through years of flooding spread the
14 mine tailings through the whole valley, and then
15 there was actually a lead/zinc smelter which was the
16 Bunker Hill lead/zinc smelter. So there's a lot of
17 lead stuff, and as we all know, lead with mental
18 health issues and stuff, so we got everybody seeing
19 the deal there and they come in 20-25 years ago and
20 started enacting a lot of Superfund site legislation
21 which moved on to mediation and a watchful eye on
22 every business in the valley.

23 Q Has the Superfund site now been cleaned up
24 completely?

25 A No. It won't be cleaned up for another,

1 they're saying, 50 to 60 years. They have an ongoing
2 cleanup every year.

3 Q Does the phrase "lead babies" mean anything
4 to you?

5 A We were all designated lead babies. Pretty
6 much if you grew up in the Silver Valley, you were
7 thought to be a lead baby.

8 Q Are you familiar with the Mine Safety
9 Health Act?

10 A They're the governing body for surface and
11 underground mining.

12 Q During the years 2008, 2009 and 2010, was
13 Peak subject to the Mine Safety Health Act?

14 A Yes. If you're involved in the mining
15 industry, you are subject to their rules and
16 regulations.

17 Q So if we could, I would like to focus on
18 the type of mining equipment that Peak had for sale
19 to its customers. Now, you've talked about
20 ventilation fans already.

21 A Yes.

22 Q But I wanted to ask you if a fan were to
23 fail in a mine, what would happen?

24 A If part of our ventilation fan, doesn't
25 matter if it's on the intake or exhaust side, they'd

1 pretty much have to evacuate the working area that
2 it's affecting. Under deep shaft mines it's usually
3 the complete mine, so if you have one of the big fans
4 goes down, you have to evacuate the mine, and of
5 course, that just leads to a loss of production, just
6 kind of a big cascade effect for the mines.

7 Q And do you have any idea what the cost of
8 operating a mine is?

9 A Millions of dollars a day.

10 Q And what about pumps, does Peak have
11 anything to do with pumps that are used in mines?

12 A Yes. We manufacture and supply a line of
13 submersible pumps.

14 Q And what's the function of a pump?

15 A Well, in the mines if you're underground,
16 of course, you have a lot of groundwater, so the
17 water is constantly infiltrating the mines, so they
18 use the pumps in areas to pump out the working areas
19 so the men can work. Basically it controls flood
20 underground and some operations the mines have that
21 much water that if you don't control it, over short
22 periods of time you can lose a level, which a level
23 is working levels they have, and if you lose your
24 pumping systems and have redundant systems and or
25 something happens to the redundant system, it can

1 actually flood the level so you have to evacuate that
2 level.

3 Q And the pumps that Peak sold in 2008, '09
4 and '10, could you tell me a little bit about the
5 range of capacities of these pumps?

6 A Yes. We sold and manufactured pumps from
7 8.2 horsepower up to 60 horsepower, pump maximum
8 gallons of about 2,000 gallons a minute will be the
9 largest ones, and the smaller ones probably pump
10 around 5- to 600 gallons a minute.

11 Q And during 2008, '09 and '10, did Peak do
12 any repair work?

13 A Yes, we did lots of repair work.

14 Q And what kind of repairs did you do?

15 A A lot of ventilation systems, fans and
16 stuff, a lot of pumping systems, and we did some
17 motor gears too, some mobile equipment.

18 Q And are you familiar with a mining truck?

19 A Yes. At that time we were manufacturing a
20 mining truck for the mining industry, so basically a
21 support vehicle for the underground used in various
22 ways. There's a man-rider we call it which you put
23 two guys in the cab and have capacity for eight to
24 ten guys in the back of the truck. Explosive
25 vehicles to haul explosives that, of course, would go

1 down in the mine to get the explosives where they
2 need to be. And could be a fuel/lube vehicle,
3 support vehicle hauling lubricants and diesel fuel,
4 things like that. So basically support vehicles.

5 Q Maybe you said this and I might have missed
6 it, though. How do you get these trucks down in the
7 mine?

8 A Depends on what mine you're at. They're
9 basically based off a Toyota pickup that we purchase
10 new and then we totally dismantle the truck. The
11 only things we use out of the truck is the frames and
12 the cabs, we install a Cummins diesel engine, rear
13 wheel axles, basically fabricate the whole truck
14 again. And then if they're going into a deep shaft
15 mine, they'll be componentized to get underground,
16 but if they're going into, let's say, a mine out in
17 Nevada which they operate out of pits, they have ways
18 to just drive into the mines. Not only do they have
19 shaft conveyance, but they have paddocks, they call
20 them, where they would drive into them so they'll
21 just drive the vehicles in.

22 Q So why wouldn't you just take a Toyota
23 truck and take it down into the mine?

24 A They're suited for the environment. First
25 of all, they don't have a diesel engine so you can't

1 run a gas engine underground, it's against MSHA rules
2 and very unhealthy. And they're just not rugged
3 enough so we have to make rugged enough for the
4 mining environment. The mining environment is very
5 hard on vehicles and equipment so you have to
6 specialize it for that environment.

7 Q What kind of axles do you put on these
8 trucks?

9 A We build our own. We have a one-ton axle
10 that we've kind of come up with through the years,
11 kind of a hybrid type axle.

12 Q What about hoist conveyances?

13 A We do some work on the hoist conveyances
14 too. Hoist conveyances are mainly elevators, they
15 run up and down the shaft in the mines and they run
16 on a series of guide wheels they're called, and
17 similar to your elevators here, they have wheels that
18 run on sides. We manufacture and remanufacture a lot
19 of the guide wheels. Hoist systems can run up to
20 1,800 to 2,000 feet a minute conveyance speed, so
21 it's a very, very critical part of the hoist system.
22 If you lose a wheel at that speed, it's detrimental
23 to the equipment and it will tear up the shafting.

24 Q What about one of these pumps that you put
25 into mines that pump fluid, what if that pump fails,

1 what would happen?

2 A It would fill the level. It depends on
3 where it's at and what it's doing. If they're using
4 it as a primary pump and it goes down and the backup
5 goes down, then it fills the sump and it will start
6 filling the level, flooding conditions, and basically
7 they'll have to evacuate that working area, which
8 translates into loss of production.

9 Q What is a mine air door?

10 A A mine air door is a large regulator door
11 within the mine system or the ventilation system. I
12 guess just like this eight-story building, you need
13 to get air where it needs to go, so you're bringing
14 massive amounts of air in from the surface, so
15 through the man, if you only have one fan but you
16 have all these levels and all these rooms, they have
17 to get to the rooms, and that's how you do it, you do
18 it through these mine doors which can be up to -- I
19 think the largest is about 18 feet by 18 feet.
20 They're large steel doors, hydraulically operated,
21 and they control where the air goes, and they drive
22 through them quite a bit because they're usually in
23 the main drifts so they have to operate independently
24 because they're bringing mine trucks through them,
25 support vehicles through them and stuff like that.

1 Q Is this a product that Peak sold during
2 2008, '09 and '10?

3 A Yes. We did a fair amount of business in
4 mine air doors.

5 Q Now, I believe you testified that you
6 repair mining equipment, that Peak repairs mining
7 equipment.

8 A Yes.

9 Q Are there any environmental issues
10 associated with repairing mining equipment?

11 A There is. When equipment comes back to us
12 for repairs, definitely not clean. The mining
13 environment is very muddy, very messy, so you pick up
14 a lot of trace metals, so if you come out of like a
15 lead/zinc mine, there's trace mud with lead/zinc in
16 it, probably ammonium nitrate from the blasting
17 function in the mine that it just gets mixed in with
18 the water and the mud, so it kind of transports it
19 back to our facility which at that point before we
20 can do anything with it, we have to clean it
21 thoroughly to work on it.

22 Q So how do you do that?

23 A Mostly pressure washing, steam cleaning,
24 some sandblasting.

25 Q So what about the fluid runoff from the

1 cleaning?

2 A Being as we're in a sensitive EPA air site
3 and good stewards -- and I'd do no matter where I was
4 at -- we control it with cleaning bays, sumps,
5 containment areas.

6 Q So what kind of containment areas do you
7 have?

8 A We have sumps so when we wash everything,
9 all the heavies or the fines, whatever comes off the
10 vehicle, goes into a sump and then at that point it's
11 treated and hauled off.

12 Q And what do you do with the fluid or the
13 residue that's left from the cleaning exercise?

14 A We treat it and then whatever is left we
15 have a company come in and take care of because
16 wherever we're located, we need to make sure we
17 follow all the rules.

18 Q And so how much material could you possibly
19 produce in a week or a month?

20 A We probably produce about 250 pounds a
21 month. It just depends on how busy it is and what
22 type of equipment is coming in, but I would say the
23 average is a couple hundred pounds a month.

24 Q So when the equipment is cleaned, is
25 special clothing required when cleaning?

1 A We have all of our guys wear PPE, which is
2 personal protective equipment, rubber boots, jackets,
3 safety glasses.

4 Q Does being in a Superfund site have any
5 impact on the regulation and oversight of Peak's
6 operations?

7 A I don't know if it has any effect on the
8 regulations but we always know they're there. We
9 know it on a business level and we know it on a
10 personal level. It's quite bad here. If you want to
11 dig a posthole in your backyard, you have to call the
12 EPA. You've got to get a piece of paper, they've got
13 to come and see how bit your posthole is, you have to
14 dispose of the material in the right place in town,
15 so it's always there, either business-wise or
16 personal-wise, we're just always aware of it.

17 Q Do you know whether Peak's production
18 facilities are located in a floodplain?

19 A We are.

20 Q And are there streams nearby?

21 A There's one about 200 feet from us.

22 Q And because of these pollutants, being in a
23 floodplain does that create any issues?

24 A Yes, and that's kind of what spurred the
25 Superfund site through the years of history is the

1 mining companies dumping their tailings back in the
2 day and floods and disbursed it through the valley.
3 And it's a very narrow valley, we're not talking --
4 it's probably two miles wide, three at the most, so
5 it's a very narrow valley so it's really concentrated
6 in that valley. It's not like it's a 50-mile wide
7 valley or something.

8 Q So what exactly -- and this may sound like
9 a silly question, and maybe it is -- what does it
10 mean to be in a floodplain?

11 A Well, it's just -- I don't know, you've got
12 to ask FEMA.

13 Q And who's FEMA?

14 A Federal -- we just know them by FEMA, but
15 anyway, they're the ones that designated floodplains,
16 flood zones, and that was very big down there in our
17 area because of the Superfund site and what you could
18 do, where you could build, where you could locate.
19 You can't build any new structures in the flood zone,
20 and so very, very regulatory.

21 Q Have you ever heard the term living in a
22 glass house?

23 A We kind of do there. And we're all aware
24 of it.

25 Q Now, in 2008, 2009 and 2010, how many mines

1 did you have equipment in in that time frame, just an
2 estimate?

3 A Probably around twelve.

4 Q Twelve?

5 A Yes.

6 Q And where were those mines located?

7 A Silver Valley, Nevada and Washington, we
8 did some work up there also.

9 Q Where is that?

10 A Washington State.

11 Q Washington State?

12 A Yes.

13 Q Do you ever sell products outside the
14 United States?

15 A We sell a lot of products in Australia on
16 the pumping side of things.

17 Q Now, during 2008, 2009 and 2010,
18 approximately how many employees worked for Peak?

19 A We probably had just for Peak, probably 17
20 at that time.

21 Q Mr. Zumbaum, who is Jill Howard?

22 A She's our financial manager and office
23 manager.

24 Q And when you say our financial manager, who
25 does she work for?

1 A She works for Corey and I.

2 Q She works for Corey?

3 A Corey and I.

4 Q Corey and you, but does she work for a
5 particular company?

6 A Peak Mechanical.

7 Q Peak Mechanical. Was she an officer of
8 Peak during that time, 2008, 2009, 2010?

9 A I believe so.

10 Q You think she was.

11 Now, Mr. Zumbaum, do you recall any
12 incidents where you had a negative experience with an
13 insurance company?

14 A On one of our buildings in 2008 we had a
15 pretty extreme snow year that year, so basically the
16 building was real close to collapse so we had seen
17 that happening, we went out and we got the snow off
18 the roof, and it stretched the roof quite badly and
19 was leaking and stuff after that event, and we got
20 rains up there, so it warmed up, we got a lot of
21 rains. Contacted our insurance company and after
22 months and months of negotiations and them sending
23 engineers in and experts and everything else, they
24 deemed a \$2,000 repair would fix the roof. And we
25 argued that, and they said, Nope, that's all we're

1 paying. And we ended up installing a new roof out of
2 pocket of our money, \$25,000 because a \$2,000 repair
3 was going to be nothing.

4 Q And when did that loss event occur that
5 you're talking about?

6 A I think that was in February of 2008.

7 Q In 2008, prior to the formation of the
8 Petitioner in this case, what was the name of the
9 insurance company that provided insurance to Peak?

10 A Back then, EMC maybe.

11 Q Did you say EMC?

12 A EMC possibly.

13 Q What does that stand for?

14 A I have no idea.

15 Q Do you know whether EMC provided you any
16 pollution coverage back at that time?

17 A No. I think in the valley we probably
18 couldn't get pollution insurance.

19 Q And so why not?

20 A Superfund site.

21 Q What was your understanding of the number
22 of insurance companies that were providing insurance
23 coverage a company might need in Silver Valley?

24 MR. MARKLEY: Excuse me, Your Honor. I
25 have to object. I don't know if he would have the

1 foundation to know that.

2 MR. ALBRIGHT: His understanding.

3 THE COURT: You can clarify the question.

4 THE WITNESS: Can you repeat that, please?

5 BY MR. ALBRIGHT:

6 Q Based on your understanding, what was your
7 understanding of the number of insurance companies
8 that would provide any insurance coverage to
9 companies like Peak in 2008, '09, '10?

10 A In Idaho I wouldn't know of any.

11 Q Do you recall any conversations with anyone
12 concerning captive insurance companies?

13 A Yes. I guess how I got aware of it was
14 talking back with Bob Pope and through our manager we
15 were talking to him and explaining the growth of our
16 company, and we had a lot of growth back then, and we
17 had conversations with Bob and he said, Well, you
18 know, you probably need to be more insured, and he
19 suggested a captive as a way that he was taking care
20 of some of his insurance needs.

21 Q And so now, Bob Pope, he was with which
22 company?

23 A Mining Equipment.

24 Q And this is the same company that you had
25 worked at?

1 A That I had worked at, yes.

2 Q And did he make a recommendation of anyone
3 that you might speak with about a captive insurance
4 company?

5 A He recommended Capstone. That's who he was
6 using.

7 Q Now, had Capstone contacted you prior to
8 your talking to Mr. Pope?

9 A No.

10 Q And did you reach out to Capstone?

11 A Yes, we did.

12 Q Now, just to be clear, did Capstone contact
13 you or did you contact Capstone?

14 A We contacted them.

15 Q We, who's we?

16 A Corey and me.

17 Q After you contacted Capstone, what happened
18 next?

19 A We chatted a little bit on the phone about
20 the captive and I guess kind of how it would work and
21 stuff, and then at that point Corey and I, we talked
22 about it, and then we decided to invite them out for
23 a site visit, which they did do that.

24 MR. ALBRIGHT: Your Honor, may I -- and
25 just to save time, I would like to put a copy of

1 Exhibit 16-J that's an exhibit already in evidence,
2 and Exhibit 34-J, I'd like to provide those to Mr.
3 Zumbaum.

4 THE COURT: You may.

5 BY MR. ALBRIGHT:

6 Q So, Mr. Zumbaum, I've provided you a copy
7 of Exhibit 34-J. Can you take a look at Exhibit 34-
8 J, please?

9 A Yes.

10 Q Do you know what that information in 34-J
11 is?

12 A It's a client background documents.

13 Q And client background documents for who?

14 A Peak Mechanical.

15 Q And do you know where that information came
16 from?

17 A It would have come from Capstone.

18 Q But the documents themselves, where did
19 they originate from?

20 A That I don't recall.

21 Q Well, take a look at them.

22 A That would have come from Peak.

23 Q Juts take a look through there and make
24 sure that that's information that you believe Peak
25 would have provided to Capstone.

1 A Yes, I believe they are, correct, from
2 Peak.

3 Q And so did anyone ever come out and visit
4 your business from Capstone?

5 A Yes, two persons actually.

6 Q Do you recall who those persons were?

7 A Stewart Feldman and Lance McNeel.

8 Q Lance McNeel?

9 A Yes.

10 Q And tell me were you with them during that
11 visit?

12 A Most of the visit. If I wasn't there -- I
13 was with them probably most of the day.

14 Q And what were they doing?

15 A They'd come and interviewed us. I believe
16 there were there for a day, maybe long, I don't quite
17 recall the length of time. They'd come and
18 interviewed us and talked about businesses, talked
19 about our risks, and then basically went through all
20 the companies. We actually traveled to look at both
21 operations in Osburn and then we went to the
22 operation in Hayden Lake also, which would be Premier
23 Electric Motor.

24 Q Now, do you know what the purpose of the
25 visit with you was about?

1 A To see if we would qualify for a captive, I
2 believe.

3 Q And if you would, I have a copy of Exhibit
4 16-P there in front of you.

5 A 16-J?

6 Q 16-J. I'm sorry.

7 A Yes.

8 Q And are you familiar with that document?

9 A Yes. This is our feasibility study, and I
10 believe I've seen a draft of this, I'm very familiar
11 with this document too.

12 Q Now, do you recall whether you saw --
13 Petitioner was incorporated what, in December of
14 2008?

15 A Approximately, yes.

16 Q Do you recall whether you saw a captive
17 feasibility study or a draft of a captive feasibility
18 study before the company was formed?

19 A Excuse me. Can you repeat that?

20 Q Do you recall whether you saw this captive
21 feasibility study or a draft of the study before the
22 company was formed?

23 A Yes. I would have seen and I've signed
24 that document for sure, yes.

25 Q Mr. Zumbaum, in paragraph 29 of the

1 stipulation of facts, the parties have stipulated
2 that during the years 2008, 2009 and 2010 you served
3 as the chief executive officer, president and
4 assistant treasurer of Petitioner.

5 A Yes.

6 Q And you understand who I'm talking about
7 when I say Petitioner?

8 A And so I understand correctly?

9 Q Reserve Casualty Corp.

10 A Yes, that's correct.

11 Q And Mr. Zumbaum, in paragraph 30 of the
12 stipulation of facts, the parties have stipulated
13 that Mr. Weikel was the vice president, secretary and
14 assistant treasurer of Petitioner.

15 A Yes, to my belief.

16 MR. ALBRIGHT: Your Honor, if I may, I
17 would ask if I could provide a copy of Exhibits 28-P,
18 29-P and 30-P to Mr. Zumbaum.

19 THE COURT: Yes.

20 MR. ALBRIGHT: Your Honor, may I approach
21 Mr. Zumbaum and hand him these copies of the
22 exhibits?

23 THE COURT: Yes.

24 BY MR. ALBRIGHT:

25 Q Mr. Zumbaum, can you identify Exhibit -- do

1 you have Exhibit 28-P in front of you there?

2 A Yes.

3 Q Can you tell me what Exhibit 28-P is?

4 A It's a general ledger for Reserve Casualty
5 Corp for 2008.

6 Q And do you have a copy of Exhibit 29-P in
7 front of you?

8 A Yes.

9 Q And can you tell me what Exhibit 29-P is?

10 A GL report for Reserve Casualty.

11 Q Is it the what?

12 A General ledger report.

13 Q And what about do you have Exhibit 30-P in
14 front of you?

15 A Yes. That is the general ledger for
16 Reserve Casualty.

17 Q For what year?

18 A 2010.

19 MR. ALBRIGHT: Your Honor, I would move
20 Exhibits 28-P, 29-P and 30-P into evidence.

21 MR. MARKLEY: Your Honor, I would object
22 this. This witness said that but there's no
23 foundation for him being able to identify how he
24 knows what they are. If there had been a foundation,
25 we would have already had a stipulation as to

1 authenticity.

2 THE COURT: Mr. Albright, if you could ask
3 the witness a few more questions about these
4 exhibits.

5 BY MR. ALBRIGHT:

6 Q Mr. Zumbaum, during 2008, 2009 and 2010,
7 you were the president of the Reserve Casualty
8 Corporation?

9 A Yes, sir.

10 Q And during the years 2008, 2009 and 2010,
11 you were the chief executive officer of Reserve
12 Casualty Corporation?

13 A Yes, sir.

14 Q And during 2008, 2009 and 2010, you were
15 the assistant treasurer of Petitioner?

16 A Yes, sir.

17 Q Mr. Zumbaum, were you familiar with the
18 records that were maintained by Reserve Casualty
19 Corporation during the years 2008, 2009 and 2010?

20 A Yes. I'm sure at some time they would come
21 across my desk.

22 Q And were those records maintained under
23 your direction, capacity and control?

24 A Yes, they were.

25 MR. ALBRIGHT: Your Honor, I offer these

1 exhibits in evidence.

2 MR. MARKLEY: Your Honor, the fact that he
3 may believe that at some time they came across his
4 desk I don't think establishes that they're business
5 records. I don't think he has indicated how he knows
6 they were prepared, who prepared them. That might be
7 a little different than a business record exception,
8 but I'm not aware of anything that's been testified
9 to so far that would indicate that he would have any
10 personal knowledge about this. The fact that he was
11 an officer, I understand that he was an officer and
12 chief executive officer, things of that nature, so I
13 don't think there's sufficient evidence to indicate
14 that this gentleman would actually have known
15 anything about these in particular.

16 THE COURT: Mr. Albright.

17 MR. ALBRIGHT: Your Honor, he's the
18 president of the company, these records are his
19 company's records, he's testified under oath that
20 these are his companies records. I guess I could ask
21 him some questions about whether records were
22 regularly maintained. They obviously were.

23 THE COURT: The Court is concerned about
24 how these were prepared or a little more information
25 about how these were prepared, if you want to ask him

1 a couple more questions.

2 BY MR. ALBRIGHT:

3 Q So, Mr. Zumbaum, do you know how these
4 records were maintained? Were these records
5 maintained during the years 2008, '09 and '10?

6 A We would have maintained them in our
7 office, yes.

8 Q You would have maintained them?

9 A Yes. They were provided to us, we would
10 have filed them and maintained them.

11 Q So you maintained a copy of the general
12 ledger in your office?

13 A I'm sure we did.

14 Q And so who would have made those entries in
15 the books and records?

16 A For these at the end of the year, they
17 would have been provided probably to our accounting
18 firm.

19 Q But who would have actually made the
20 entries in the accounting records themselves?

21 A That would have been Jill.

22 Q Jill?

23 A I believe so.

24 Q So was there a company that managed Reserve
25 Casualty Corp during the years 2008, 2009 and 2010?

1 A Capstone did.

2 Q Capstone?

3 A Capstone.

4 Q And do you know whether they maintained
5 records for Reserve under an agreement, under a
6 contractual agreement?

7 A I'm sure they did. I don't recall any
8 contractual agreement, but I would think that best
9 business practice that they knew.

10 Q But you're confident that these are the
11 general ledgers for Reserve Casualty Corp for the
12 years 2008, 2009 and 2010?

13 THE WITNESS: Objection. Leading question
14 what he's confident about. He's already said he has
15 an idea and we have this mishmash of Capstone and
16 Jill and him and I'm not sure anybody has said
17 anything about who really did anything here. So I
18 still object, and I object particularly to that
19 question.

20 THE COURT: I'm going to sustain the
21 objection on that question.

22 MR. ALBRIGHT: Your Honor, we'll call
23 another witness for these records.

24 THE COURT: Yes.

25 BY MR. ALBRIGHT:

1 Q Mr. Zumbaum, the parties have stipulated to
2 copies of insurance contracts that were issued by
3 Petitioner during 2008, 2009 and 2010 in paragraphs
4 55, 56, 57, 71, and 79 of the stipulation of facts.
5 Were you aware of that?

6 A Yes.

7 Q Do you know who set the premium amounts in
8 these policies?

9 A It would have been Capstone would have
10 advised on the amounts.

11 Q And who would have made the -- who had the
12 authority to actually determine what those premiums
13 would be?

14 A To determine what they were, it would have
15 been I.

16 MR. MARKLEY: I'm sorry, sir. I didn't
17 hear.

18 THE WITNESS: Excuse me. Would you repeat
19 that?

20 BY MR. ALBRIGHT:

21 Q Who had the ultimate authority to
22 determined the premiums that would be charged in
23 these insurance policies between Reserve Casualty
24 Corporation and Peak Mechanical?

25 A I don't know if I quite understand. I

1 would have okayed the costs, I wouldn't have
2 determined the amounts. They would have presented
3 the costs and I would have said that's affordable.

4 Q So somebody would have made a
5 recommendation to you?

6 A Yes, absolutely.

7 Q And is it your understanding that you had
8 the authority to make the determination as to whether
9 to adopt those amounts approved?

10 A Yes, it is.

11 MR. ALBRIGHT: Your Honor, I would ask for
12 permission to approach the witness and provide him a
13 copy of a stipulated exhibit, Exhibit 90-J.

14 THE COURT: You may approach.

15 MR. ALBRIGHT: May I approach, Your Honor?

16 THE COURT: Yes.

17 BY MR. ALBRIGHT:

18 Q Mr. Zumbaum, do you have a copy of Exhibit
19 90-J in front of you?

20 A Yes, sir.

21 Q And what is Exhibit 90-J?

22 A Settlement and release agreement.

23 Q And do you know the background as to why we
24 have Exhibit 90-J?

25 A Yes. It was for loss of business.

1 Q A loss of business. A loss of whose
2 business?

3 A Peak Mechanical's.

4 Q And when you say loss of business, was
5 there a claim made?

6 A Yes. We claimed -- yes, we did.

7 Q So tell me what you did?

8 A Well, what preempted this was loss of
9 business of one of our major clients and they moved
10 on to another supply house, through no fault of ours,
11 so we took a very good hit there, about 30 percent of
12 our business.

13 Q Do you recall the name of the customer?

14 A Stillwater Mining Company.

15 Q And when did they go to another provider?

16 A Exact dates, I don't know, but it would
17 have been before this. Exact dates, I don't recall.

18 Q And are you saying that Peak filed a claim
19 with --

20 A Reserve, yes.

21 Q With Reserve Casualty?

22 A Yes.

23 Q And do you know what policy that claim
24 would have been filed under?

25 A It would have been under the one that

1 protected us from loss of sales.

2 Q Now, what was the name of the customer
3 again?

4 A Stillwater Mining Company. They're a
5 platinum plating operation.

6 Q And do you know how that claim was made?

7 A We went through a process that I don't
8 recall exact steps that were taken ten years ago, I
9 don't recall the exact steps but it would have been
10 submitted to Capstone, I would have thought, but I
11 don't really recall the steps involved.

12 Q At that time, how long had Stillwater been
13 a customer of Peak?

14 A Ever since we started business, so quite
15 some time.

16 Q And you mentioned platinum plating. What
17 is platinum plating?

18 A Well, they're a platinum and palladium
19 mine. They supply a lot of the platinum and
20 palladium to the automotive industry.

21 Q And did you say what percentage of your
22 business this represented?

23 A Thinking back, probably around 30 percent
24 back then.

25 Q And so you have Exhibit 90-J there in front

1 of you. Is it 89-J or 90-J there?

2 A 90-J.

3 MR. ALBRIGHT: Now, Your Honor, maybe it
4 would be more productive if I gave Mr. Zumbaum
5 several exhibits that I could ask a series of
6 questions about.

7 THE COURT: And these are all in the
8 exhibits in the stipulation? That's fine.

9 MR. MARKLEY: This is not an objection, but
10 can I ask a question. I don't know how long counsel
11 will be continuing on his direct, but I'm starting to
12 get the part where I'm getting hypoglycemic, so if
13 it's not too much longer, I don't have a problem, but
14 I was wondering if you were going to cross-
15 examination after lunch.

16 THE COURT: I was going to ask the parties
17 if it was okay to do because the witness will have
18 been up here for a little bit, and I figured your
19 cross would probably not extremely short.

20 MR. MARKLEY: It will not be extremely
21 short.

22 THE COURT: So the Court was going to
23 suggest taking a break between the direct and the
24 cross.

25 MR. ALBRIGHT: It could be a while longer,

1 Your Honor, and we're agreeable to whatever the Court
2 would like to do.

3 THE COURT: Okay. If it's going to be a
4 while longer, then I guess we should take -- I don't
5 know if you're at a good stopping point now since
6 you're about to bring documents.

7 MR. ALBRIGHT: That's fine.

8 THE COURT: All right. How about we're in
9 recess till ten of 2:00.

10 MR. MARKLEY: That's fine, Your Honor.

11 THE COURT: Is that good?

12 MR. ALBRIGHT: That's fine, Your Honor.

13 THE COURT: All right. So you may step
14 down, and the Court will be in recess till ten of
15 2:00. We're in recess and we're off the record now.

16 (Whereupon, at 1:01 p.m., the trial was
17 recessed, to reconvene this same day,
18 Thursday, April 27, 2017, following a
19 lunch recess.)

20 THE COURT: You may proceed.

21 MR. ALBRIGHT: Your Honor, if I might, I
22 would like to retrieve those exhibits. We now have a
23 set of exhibits over here in the window, if that's
24 okay with the Court, for the witness, and I would
25 propose to put that book on the witness stand with

1 Mr. Zumbaum and retrieve those exhibits.

2 THE COURT: You may do so. And it's my
3 understanding that all of the exhibits in those books
4 are stipulated exhibits.

5 MR. ALBRIGHT: They are, Your Honor.

6 THE COURT: Okay. Yes. And just when you
7 speak of the exhibits, identify them, I believe
8 Respondent doesn't have the exact same book, so he
9 knows what exhibits you're referring to.

10 MR. ALBRIGHT: Yes, Your Honor.

11 THE COURT: Thank you.

12 MR. ALBRIGHT: Your Honor, if I could ask
13 Mr. Zumbaum to reach over and get the volume of
14 exhibits that are 89 through 93.

15 THE COURT: Yes, he may get them.

16 Mr. Albright, I think he's uncertain which?

17 MR. ALBRIGHT: May I show him?

18 THE COURT: Yes.

19 BY MR. ALBRIGHT:

20 Q Mr. Zumbaum, if you would turn to Exhibit
21 89-J, please. Do you have a copy of 89-J in front of
22 you there?

23 A Yes, sir.

24 Q And Exhibit 89-J is a check in the amount
25 of \$150,000, payable to Peak Mechanical & Components,

1 Inc. Is that what you have in front of you?

2 A Yes, sir.

3 Q Do you know why Reserve Casualty Corp
4 issued this check in 2009?

5 A I think that would be on the settlement for
6 the Still water loss.

7 Q And if you'd look, please, would you turn
8 to Exhibit 90-J? And do you know what -- and I may
9 have asked you this question already so I apologize -
10 - do you know what Exhibit 90-J is about?

11 MR. MARKLEY: Well, I have to object, Your
12 Honor. I think the document speaks for itself.

13 THE COURT: I also believe before the break
14 that he was asked about 90-J.

15 MR. ALBRIGHT: You don't think we need to
16 ask that question?

17 THE COURT: Right. If it's the same
18 question that was asked before because he did explain
19 what he thought it was for.

20 BY MR. ALBRIGHT:

21 Q Now, these checks that Peak is getting from
22 Reserve, these are checks in payment of a claim?

23 MR. MARKLEY: Your Honor, I have to object
24 to what these checks mean. I mean, right now we're
25 talking about one check. I know that there is checks

1 described in the stipulation but I don't know that
2 this witness knows what these checks mean.

3 THE COURT: If you could clarify the
4 question.

5 MR. ALBRIGHT: Yes.

6 BY MR. ALBRIGHT:

7 Q Mr. Zumbaum, I believe you testified that
8 Exhibit 89-J was a payment of a claim that had been
9 made by Peak.

10 A Yes.

11 Q And before we took a break for lunch, you
12 testified about Exhibit 90-J which was an agreement
13 regarding a claim with Peak on May 27, 2009.

14 A Yes.

15 Q And then the parties have stipulated that
16 the May 27, 2009 claim was made under the provisions
17 of the 2009 contract for special risk loss of major
18 customer insurance policy.

19 A Correct.

20 Q And the parties have further stipulated
21 that pursuant to the May 27, 2009 claim, Petitioner
22 agreed to pay \$164,820.

23 A Correct.

24 Q And then if you would turn to Exhibit 91-J,
25 which is kind of a small copy, hopefully you can read

1 it.

2 A Yes.

3 Q It's a check from Reserve Casualty Corp to
4 Peak Mechanical & Components, Inc. in the amount of
5 \$14,820.

6 A Yes.

7 Q And then if you would turn to Exhibit 92-J
8 and you see that Exhibit 92-J is a check made payable
9 to Peak in the amount of \$175,000.

10 A Correct.

11 Q And this is a check from Reserve Casualty
12 Corp to Peak Mechanical & Components.

13 A Correct.

14 Q And then the parties have further
15 stipulated that on January 30, 2012, Petitioner and
16 Peak amended the May 27, 2009 claim where Petitioner
17 agreed to pay Peak \$349,820 by two checks made
18 payable to Peak.

19 MR. MARKLEY: Your Honor, I have to object
20 that I don't know what the purpose is of Counsel
21 telling the witness what's been stipulated to when
22 it's stipulated to. I just don't understand the
23 point of that and where that's going because it's
24 stipulated, it's in the document -- I mean it's in
25 the stipulation.

1 MR. ALBRIGHT: Your Honor, a while ago I
2 asked Mr. Zumbaum about the checks and I'm just now
3 identifying the checks that I want to ask him a
4 question about.

5 THE COURT: Right.

6 MR. MARKLEY: I won't object to that.

7 THE COURT: I do understand Respondent's
8 point that you're repeating this but you're trying to
9 clarify exactly which checks you're referring to.

10 MR. ALBRIGHT: Yes, Your Honor.

11 THE COURT: So I think you can just say the
12 exhibit number and it's in the record.

13 BY MR. ALBRIGHT:

14 Q So Mr. Zumbaum, if you would look at
15 Exhibit 93-J. Do you know why Exhibit 93-J was
16 executed?

17 A There was another loss at Stillwater.

18 Q So now I've asked you a number of questions
19 about a number of checks that Reserve Casualty Corp
20 has written payable to Peak.

21 A Correct.

22 Q Do you know how those checks that you
23 received from Reserve -- do you know how those were
24 reported, if they were, for income tax purposes?

25 A Yes. They went back into operating the

1 facility, they went into the ledger as other income.

2 Q And so when you say other income, do you
3 mean taxable income?

4 A Yes. We used the money for operating
5 income.

6 Q Now, Mr. Zumbaum --

7 MR. MARKLEY: Excuse me. Do we know what
8 year that is, Your Honor? I don't think that was
9 asked and answered. I know that they were reported,
10 but what year?

11 THE COURT: If you could clarify that, if
12 you could clarify what year they were reported.

13 BY MR. ALBRIGHT:

14 Q Do you know, Mr. Zumbaum what year those
15 checks would have been reported in income?

16 A 2009.

17 Q When the checks were received?

18 A When the checks were received, they were
19 deposited.

20 Q Now, Mr. Zumbaum, did you ever have -- did
21 Peak ever have an issue regarding its income tax
22 returns prior to 2008?

23 A Yes, we did.

24 Q And do you recall what exactly happened?

25 A Well, we were getting our taxes done by a

1 local CPA and we just felt at the end of the tax year
2 that weren't paying enough taxes. We had a lot of
3 income, was taking a lot of deductions, and we just
4 felt this doesn't look right. So we took it over to
5 a major CPA firm in Coeur d'Alene, put the last three
6 years out on her desk, the gal which was a partner
7 there, she looked at them and she slid across the
8 desk and says, You guys got a lot of trouble. So us
9 not knowing taxes and stuff, What do you mean? She
10 said, Well, this guy is under-reporting, you guys owe
11 a lot of taxes. And we asked her to take on the
12 case, and she said, No, I don't do that. The firm
13 didn't want to do it, they actually got started on
14 it, it was too complicated, they gave it back to us.
15 So we hired I call him a forensic accountant. He
16 went back through the three years, restated all the
17 stuff, appealed to the IRS about fines and penalties,
18 and I believe they waived everything. I can't
19 remember the exact amount but I know it was over
20 \$200,000-some we owed the IRS, and of course, we
21 wrote the check and paid the money back.

22 MR. MARKLEY: Okay. I would move to strike
23 all that testimony because it's totally unresponsive
24 to the question of whether he had problems with the
25 IRS.

1 Apparently he had problems with an
2 incompetent CPA, CPA cleared up in part two was able
3 to resolve the matters, but it doesn't strike me that
4 answers the question. I'd move to strike it in
5 entirety.

6 THE COURT: I'm going to strike the
7 question and answer and if you could rephrase the
8 question.

9 BY MR. ALBRIGHT:

10 Q Mr. Zumbaum, do you recall having an issue
11 with your income tax returns for Peak prior to 2008?

12 A Yes.

13 Q And do you recall what tax years were
14 involved related to this issue?

15 A I don't recall the tax years.

16 Q Well, would it have been after 2000?

17 A It was probably between -- yes, probably
18 between 2002 and 2008, I would believe so.

19 Q And do you recall the events that -- do you
20 recall what happened with regard to your tax returns?

21 A We had to restate three years of returns.

22 Q And what was your understanding of why you
23 needed to restate those income tax returns?

24 MR. MARKLEY: Excuse me, sir. I'm sorry.
25 I have to object because the foundation is what his

1 understanding is. Again, I understand why Counsel is
2 going to this as concerning whether or not there was
3 a reason to think he needed policies against the IRS
4 coming after you, but that isn't where this question
5 is leading to. If he asks the question did the IRS
6 come and audit you or give you a nasty letter, that
7 would be fine, but we haven't heard that question
8 asked and I haven't heard any answer that would
9 indicate that's a possibility so far.

10 MR. ALBRIGHT: Your Honor, I'm at a loss to
11 respond to that. I think it's a fair question.

12 THE COURT: I'm going to allow the
13 question.

14 BY MR. ALBRIGHT:

15 Q So you had the income returns. You did
16 what with your income tax returns when you learned
17 there was a potential issue?

18 A We took them a larger accounting firm.

19 Q And by the way, who signs the tax returns
20 for Peak?

21 A I do.

22 Q And would you have signed these tax returns
23 that we're talking about?

24 A Yes.

25 Q So you took these returns to a different

1 accounting firm?

2 A Yes.

3 Q And what did they do?

4 A They looked at them and told us we needed
5 to restate them.

6 Q And what did you do?

7 A We did that.

8 Q And did you have to pay any additional
9 taxes as a result of having to restate?

10 A Yes, we did.

11 Q And did you or someone on your behalf
12 contact the IRS about restating?

13 A Somebody on our behalf.

14 Q And your understanding was that the IRS
15 waived penalties?

16 A Yes.

17 MR. MARKLEY: I don't want to interrupt,
18 but again I'll move to strike that too for the same
19 reason I did before, because there's no indication
20 that he had issues with the IRS.

21 The IRS apparently waived penalties on
22 whatever this is and it doesn't appear that there was
23 any issues between Mr. Zumbaum and the IRS.
24 Apparently there was questions about Mr. Zumbaum's
25 company tax return and the accountant. So the same

1 objection as before. I move to strike.

2 MR. ALBRIGHT: Your Honor, I don't
3 understand the objection.

4 THE COURT: I don't understand that
5 objection unless you're objecting to relevancy, but I
6 don't understand the objection that you just made.

7 MR. MARKLEY: Well, I think it's relevancy
8 as to whether he had problems with an accountant and
9 the accountant decided to change the amount of money
10 that was reported, because I don't think that has
11 anything to do with whether he had problems with the
12 IRS per se, so yes, relevancy on that ground.

13 THE COURT: I'm going to overrule the
14 objection.

15 BY MR. ALBRIGHT:

16 Q Mr. Zumbaum, in 2008, 2009 and 2010, maybe
17 2007 time frame, was the business of Peak -- was it -
18 - how was it doing?

19 A It was doing well.

20 Q And were you -- did you -- were you
21 expecting the business to grow or not?

22 A Yes, we were.

23 Q And you had some other businesses; I
24 believe you mentioned Premier?

25 A We had Premier Electric Motor and

1 Zuminshear [phonetic].

2 Q And previously your business had been
3 small.

4 A Yes.

5 Q And in fact, when you started the business
6 originally, Peak, how many people worked for the
7 business?

8 A Two.

9 Q That was in the late 2000s.

10 A When we first started the business.

11 Q Or late '90s.

12 A Nineties and 2000.

13 Q And so as your business grew, did you have
14 any concerns about the risks that you might be
15 facing?

16 A As we were growing, yes, we did.

17 MR. ALBRIGHT: Pass the witness, Your
18 Honor.

19 MR. MARKLEY: Bear with me a second.

20 THE COURT: All right.

21 CROSS-EXAMINATION

22 BY MR. MARKLEY:

23 Q Hi, Mr. Zumbaum. You had mentioned, one of
24 the questions that was asked of you, other than in
25 this particular case -- I'm going to talk about your

1 issues about maybe not paying the right amount of tax
2 or dealing with CPAs that you did not get along with
3 or didn't do that well with and they maybe were
4 incompetent, did you ever have IRS agents at the door
5 saying you owe us more tax, anything like that, other
6 than this case?

7 A No.

8 Q I'll call her Jill Howard. Is that her last
9 name?

10 A Yes.

11 Q What was her primary role?

12 A In what company?

13 Q In the Peak company.

14 A She was the secretary and financial
15 officer.

16 Q And when you say financial officer, what
17 would that encompass?

18 A She does payroll, receivables, 401(k) plan,
19 she takes care of general financial business.

20 Q And did she have any similar role, any type
21 of role with Reserve insurance?

22 A No.

23 Q None whatsoever?

24 A (No audible response.)

25 Q I'm sorry?

1 A No.

2 Q Just like Mr. Albright couldn't hear that
3 well, I have the same kind of problem here.

4 You had mentioned that the gentleman whose
5 name I don't remember at the moment, but anyway, the
6 gentleman who had been a mentor for you in your prior
7 business -- prior work, I should say. He told you
8 about the potential for dealing with Capstone. Is
9 that correct?

10 A Yes.

11 Q Now, when do you recall that being?

12 A That would have been probably 2007.

13 Q 2007. And what did he say about it, to the
14 best of your recollection?

15 A It was a long time ago, I don't think I
16 even recall how it even came up, we were just talking
17 general business.

18 Q Well, did you tell him that you had
19 business concerns that were not being addressed by
20 your other insurance companies?

21 A I don't believe that occurred in the
22 conversation.

23 Q Did you tell him that you had particular
24 specific kind of needs that were the type of
25 insurance coverage that he had been discussing with

1 you from Capstone?

2 A Excuse me. Would you repeat that?

3 Q Did you tell him that you had particular
4 insurance needs that were the type of insurance
5 coverage that Capstone might offer?

6 A No, I did not.

7 Q Did you have any discussions with him about
8 whether or not there was any economic or tax benefit
9 to having an insurance policy with Capstone?

10 A No.

11 Q So based upon those answers, what made you
12 get involved with taking on Capstone to have them
13 come out and look at your business?

14 A Well, like I said, it was just in general
15 conversation we were talking about risks, and he
16 mentioned maybe call these guys, they were doing a
17 good job covering his business.

18 Q And his business was -- you said before, I
19 apologize for not remembering exactly -- but Mining
20 Equipment?

21 A Mining Equipment Supply.

22 Q Now, I understand fully what your -- well,
23 I think I understand fully what Peak did. I'm a
24 little bit not clear on the other two. One was a
25 real estate venture that was RocQuest. Is that

1 right?

2 A Yes.

3 Q So was your property -- I should say Peak's
4 property, was that on the real estate that was owned
5 by RocQuest?

6 A Not where Peak Mechanical is located at.

7 Q Now, about this other, was it ZW?

8 A Yes.

9 Q And is it that you had just had a 10
10 percent in Jill Howard's business, is that it?

11 A No, not Jill Howard, another secretary.

12 Q Another secretary. So another secretary
13 you helped her out financial when she had a bar, I
14 guess. Is that right?

15 A That's correct.

16 Q So did all those businesses exist before
17 2008?

18 A Yes.

19 Q What's your best recollection -- and I
20 think you said Peak started up about '96 and so
21 forth?

22 A Yes, '97.

23 Q '96-97?

24 A Something like that.

25 Q And how about RocQuest?

1 A I couldn't give you a date on that one.

2 Q Would it have been after that?

3 A Yes.

4 Q Well, let's try to do it this way. How
5 long do you believe RocQuest existed that you were
6 co-owners before you engaged in these insurance
7 policies in this case?

8 A Probably three years.

9 Q Would that be the same for ZW too?

10 A Yes.

11 Q So when you entered into these policies
12 with Capstone and -- I'm sorry -- when Peak entered
13 into the policies with Reserve through the different
14 studies and Capstone's involvement, was your primary
15 interest about Peak or the other two, or just all
16 three?

17 A All three.

18 Q Now, you know about the different policies
19 that you had that Reserve had with Peak, do you not?

20 A I know what they are, not off the top of my
21 head. It's a long time ago.

22 Q Well, do you believe that the policies that
23 were held were going to be applicable to all the
24 entities that you owned or primarily Peak?

25 A Primarily Peak, though they did overlap

1 into the other entities.

2 Q And is that primarily Peak because of all
3 of what you talked about, about the dangers and so
4 forth?

5 A Right.

6 Q Now, you had insurance coverage before
7 Reserve had coverage of Peak starting in about 2008,
8 I believe, you had other insurance companies that
9 were covering Peak. Is that correct?

10 A Correct.

11 Q And I know you talked about having this
12 problem with the snow collapsing your roof and
13 flooding it out and so forth. Is that correct too?

14 A Yes.

15 Q But you had a real issue with that
16 insurance company?

17 A Yes, we did.

18 Q Did you ever jettison that insurance
19 company and say I don't want to deal with you
20 anymore, or did you keep them?

21 A We kept them.

22 Q Okay. Do you know when you got these new
23 policies through the Reserve company issuing policies
24 on Peak whether they had any particular type of
25 policy that would cover something like snow wrecking

1 your roof and flooding?

2 A Yes, I believe there was one out there.

3 Q You think it was. Do you know which one?

4 A No, I couldn't tell you.

5 Q But whether you got the right amount of
6 money that you wanted from the insurance policy that
7 you had before when the snow collapsed on the roof,
8 you still had a policy with that company for
9 potential snow damage even so. Right?

10 A I believe so.

11 Q Other than that snow issue that you talked
12 about, were there other losses that you can think of
13 that you had before 2008 where you had issues with
14 the insurance company?

15 A Not on that type of insurance.

16 Q Well, I should say on any type of
17 insurance.

18 A Probably auto.

19 Q Auto. But auto would be your own personal
20 auto?

21 A Company vehicles.

22 Q Did you get any kind of insurance policies
23 from Reserve for Peak that covered auto issues?

24 A I don't believe so.

25 Q You don't believe so.

1 So here is I think it was Mr. McNeel and
2 Mr. Feldman that came out of the study?

3 A Yes, sir.

4 Q So what's your best recollection of when
5 that would have been, in 2008?

6 A I can't recall.

7 Q Okay. Well, it was before you got a policy
8 that was set up between Reserve and Peak, was it not?

9 A Yes.

10 Q And they were out there about a day, I
11 believe?

12 A At least that, maybe longer.

13 Q Did you have to pay anything? When I say
14 you, I really mean Peak company. Did Peak company
15 and/or you personally have to pay anything for this
16 study?

17 A No.

18 Q So you didn't have to pay their expenses
19 either?

20 A No

21 Q Did they have any conversations with you --
22 that is, when I say they, either Mr. McNeel or Mr.
23 Feldman, about wow, this is also going to involve
24 saving taxes? Did that come up?

25 A Not that I recall.

1 Q Okay. So when you entered into this policy
2 with Reserve with Peak as the insured party, did you
3 think there was any kind of tax benefit to it at all?

4 A Well, we knew it hits the operating line.

5 Q When you say the operating line, what do
6 you mean?

7 A It's an expense.

8 Q So was it a bigger expense than you had
9 before?

10 A Yes.

11 Q And it was a bigger expense than you had
12 before for insurance. Is that right?

13 A Correct.

14 Q So would it have been a bigger expense by
15 the years in question, '08, '09 and '10, by as much
16 as more than \$300- or \$400,000?

17 A Probably around four.

18 Q About 400-?

19 A Yes.

20 Q So the insurance that you had before was
21 \$400,000 less than the insurance that Reserve was
22 insuring Peak for. Is that right?

23 A Roughly.

24 Q So you knew you were getting the ability to
25 claim a higher amount of deduction for your business

1 insurance expense. Is that right?

2 A Yes. It just flows back through. Yes.

3 Q Okay. Now, when you had the -- when
4 Reserve -- too many names of companies in here --
5 when you had Reserve insurance, where was your
6 understanding where Reserve insurance was domiciled,
7 headquartered, whatever word you want to use?

8 A Anguilla.

9 Q Anguilla. And did you know anything about
10 how the premiums would be determined for what Peak
11 would be paying Reserve?

12 A No.

13 Q Was there any discussion with you at all
14 about any relationship between the amount of money
15 Peak made, gross receipts, for example, and how much
16 the premiums would be?

17 A No.

18 Q Did you know that whatever premium was paid
19 by Peak to Reserve would go into the Anguillan
20 company, Reserve, and that it would not be taxable
21 because it was under \$600,000?

22 A I don't probably fully understand the
23 operating flow of that, to be honest with you.

24 Q So you didn't really fully understand that,
25 I understand what you're saying.

1 A I don't understand my insurance I've got to
2 pay.

3 Q Did you really fully understand much of
4 anything that Mr. McNeel and Mr. Feldman were telling
5 you about this activity?

6 A Back then I probably had a general idea how
7 it worked but I did not get into the nuts and bolts
8 of it. At that time I was operating four different
9 companies and I didn't understand every one of them
10 either.

11 Q So would it be fair to say that the one
12 that you understood the least was the insurance part?

13 A Yes.

14 Q Did you need Mr. Feldman or Mr. McNeel or
15 the other gentleman, Mr. Snyder, who testified this
16 morning, to explain exactly what was going on with
17 the insurance part?

18 A I'm sure somebody did at that time. Yes.

19 Q And this is not derogatory but would this
20 be a fair characterization that as to Peak you're
21 wearing one that and as to Reserve you're wearing
22 another that, but it's the same view. Is that fair?

23 A Yes.

24 Q So as one of the main owners of Peak you
25 were paying premiums to Reserve and Reserve is owned

1 by you as one of the main owners, you and Corey. Is
2 that correct?

3 A Yes.

4 Q Now, other than what was asked of you, I
5 think it was before lunch, what other type of records
6 were kept out in your office location regarding
7 policies or any other type of activities that Reserve
8 engaged in in your Idaho location?

9 A Whatever Capstone provided, we filed and
10 kept.

11 Q So Capstone would provide you with records
12 then in Idaho?

13 A Yes.

14 Q Can you tell us like what kind of records?

15 A I can't recall.

16 Q Well, okay. Give us like categories,
17 insurance policies, checks, documents, something?

18 A We've definitely got our policies and
19 financial stuff that we kept.

20 Q Did you have any records at all in Idaho of
21 what was going on under the auspices of the Reserve
22 business in Anguilla?

23 A I don't believe so.

24 Q Obviously you had records of what you were
25 doing with Peak.

1 A Yes. We had everything.

2 Q To file your tax returns and do your
3 business stuff and everything else.

4 A Sure.

5 Q Now, I don't know if you were here -- well,
6 yes, you were here when Mr. Snyder testified this
7 morning about the insurance that you paid Peak --
8 Peak paid Reserve for one month in 2008 in a large
9 amount, a premium of maybe more than 400,000. Do you
10 recall him testifying about that?

11 A Yes.

12 Q So were you aware that you were paying that
13 amount of insurance for that one-month period of
14 time?

15 A We were aware that it was retroactive, that
16 it had a look-back period.

17 Q And you were aware of that because you
18 believe it was in the insurance policy itself?

19 A I believe so.

20 Q So you never actually looked, though, did
21 you?

22 A No.

23 Q Did you ever actually look at any of the
24 insurance policies for any of the entities that you
25 had insured by Reserve for the Peak company, did you

1 actually look at them in detail?

2 A Probably scanned through them.

3 Q Scanned through them?

4 A A little bit. I mean, I don't look at the
5 one I've got now.

6 Q I'm sorry?

7 A I scanned through them.

8 Q You said you don't look at the one you have
9 now?

10 A I do. You kind of go through it. I mean,
11 it's out of sight until you need it.

12 Q So would it be fair to say that whenever
13 Mr. McNeel, Mr. Feldman or other folks from Capstone
14 told you about it, you believed it?

15 A They were our advisors. Yes.

16 Q When they did -- when Mr. McNeel and Mr.
17 Feldman did the feasibility study, did they actually
18 go around and look at various parts?

19 A Yes. They went through all operations and
20 aspects of the businesses.

21 Q Do you know anything about what your
22 company -- well, I won't say your company, but what
23 Reserve actually did in Anguilla?

24 A No, I don't.

25 Q So whatever Reserve was doing in Anguilla

1 that you would know about would be based upon what
2 Capstone people would say to you?

3 A Correct.

4 Q Did you have any conversations with anybody
5 from Capstone when they came out to talk to you on
6 the feasibility study about how much you would be
7 able to save as a result of engaging in having Peak
8 be insured by Reserve?

9 A No.

10 Q Bear with me. I have some questions from
11 before and I have questions from what he asked you
12 earlier.

13 So the mining equipment company you left in
14 '96-97. Is that right?

15 A That's correct.

16 Q And it was somewhere in approximately that
17 time period when you heard about that horrible
18 disaster, I think you said it was in New York, I
19 believe?

20 A It was while I was employed there.

21 Q While you were employed there. Where
22 someone was crushed horribly underneath tons of
23 stuff.

24 A Yes.

25 Q But you waited until approximately 2008 to

1 get a policy from Reserve for Peak for the kind of
2 potential catastrophic loss that knew about back at
3 that time when you were still working at this other
4 company?

5 A Correct.

6 Q Now, having a little bit of knowledge about
7 Interstate 90 or 94 going through your area, Coeur
8 d'Alene and all, can you explain to me, like Osburn
9 is basically between Coeur d'Alene and the Montana
10 border essentially?

11 A Correct.

12 Q Now, where is this EPA site, is it
13 gigantic?

14 A It extends from the Montana border -- I
15 mean, that's within the site -- all the way down to
16 Coeur d'Alene almost, because it encompasses the
17 whole river system all the way into the lake and then
18 surrounding the Coeur d'Alene Lake area.

19 Q So the whole EPA system covers all of Coeur
20 d'Alene Lake?

21 A They have been trying to get that into the
22 system, but originally it was from the Montana border
23 to, if you're familiar with the area, you know Fourth
24 of July Pass, where that comes out?

25 Q Yes.

1 A On that side basically to Wolf Lodge area
2 where the lake stops.

3 Q It's that whole top part of Idaho?

4 A It's about 50-some miles in length,
5 probably. From the Montana border to there, it's
6 probably 60 miles.

7 Q Is there mining activity within that EPA
8 I'll call it polluted area, the EPA area that's under
9 control of the EPA in terms of pollution, is there
10 mining activity actually in that area?

11 A Yes.

12 Q The deep type of mining that you had talked
13 about before?

14 A Yes.

15 Q Okay. So when you -- you had explained in
16 a lot of detail about how you put together equipment
17 and the Toyota -- I think you said Toyota -- that got
18 sent down and so forth, that's within an area that's
19 under EPA -- I won't say control but -- well, how
20 would you characterize it?

21 A Under watch.

22 Q Under watch.

23 A Constant surveillance.

24 Q Nowadays the last number of years, is there
25 really very stringent EPA watch on that area?

1 A There -- like I say, it's still an active
2 Superfund site, so yes, they're out and about most
3 days. Yes.

4 Q Would it have been more active, you know,
5 years ago, let's say 20 years ago than it is now?

6 A It was more active in, you know, the 2000s,
7 2000 up. Probably the majority of the cleanup was
8 done between, you know -- I don't know when it
9 started, it started it the early '90s, ramped up
10 pretty good in the 2000s up to about 2014, and now
11 it's kind of -- it's racked back down a little, but
12 they're committed to do X amount of dollars every
13 year, I believe.

14 Q That's the Bunker Hill Superfund EPA site?

15 A I believe it was tagged that, yes. That
16 was kind of the ground zero for it.

17 Q You were aware, I think, at some point in
18 time that if a mine shut down because of EPA or
19 regulatory reasons, due to Superfund or otherwise or
20 maybe even FEMA, that would mean tremendous financial
21 losses in the mining company?

22 A Yes, and in our company also.

23 Q And that would filter down to you. Right?

24 A Yes, it would.

25 Q So when did you first become aware that

1 that was a potential kind of problem?

2 A When we started the business, we knew it.
3 We kind of grew up with that site being there and
4 always in the news what's going on, and the mining
5 companies hiding their water discharge and an ongoing
6 battle with the EPA.

7 Q So again, it's kind of the same question I
8 asked you a little while ago about when you finally
9 got a policy for issues that would be along the lines
10 of those kind of problems caused by a mining company
11 shutdown then causing you to have a financial issue,
12 that would have been in '08. Would that be correct?

13 A Yes.

14 Q I'm not that familiar with the river, so
15 tell me about -- it's not the Yellowstone River, is
16 it?

17 A Coeur d'Alene River.

18 Q Coeur d'Alene River. So tell me about the
19 floodplain of the river.

20 A Well, that's a FEMA designation, and it
21 pretty much encompassed the whole valley there too,
22 and they have designated it a floodplain area.

23 Q And where is your business in location to -
24 - are you down at the lower level where the
25 interstate goes through Osburn or are you in another

1 location?

2 A We're right next to the interstate.

3 Q Right next to the interstate?

4 A Yeah. We're about 100 feet away.

5 Q And how far is the river from there?

6 A About another 100 feet on the other side,
7 150 feet, probably.

8 Q And so how when did -- so how long have you
9 been there? Again, since '96-97?

10 A No. We probably moved in there '98-99,
11 something like that.

12 Q And again, you were there '98-99 more or
13 less, and then the kind of insurance you got for the
14 floodplain insurance through Reserve would, again,
15 have been in '08. Is that right?

16 A Yes.

17 Q You had equipment, I think you said, in
18 twelve mines somewhere in maybe Nevada, I believe.

19 A Yes.

20 Q And Washington State too?

21 A Washington, Nevada and Idaho, yes.

22 Q How many of them were in the area local?

23 A Back then? Probably three.

24 MR. MARKLEY: I have some documents I'd
25 like to show you. If I could have these marked as

1 the next number, which would be an R number, please.

2 May Mr. Batory approach and give --

3 THE COURT: And has Petitioner's counsel
4 seen these documents?

5 MR. MARKLEY: Yes. I just gave them to
6 him.

7 (Pause.)

8 BY MR. MARKLEY:

9 Q Mr. Zumbaum, do you recall about a week ago
10 sending my office a fax saying that you only had
11 available to you two checks in regard to the subpoena
12 that you were served in this case as Peak, as the
13 owner or representative of Peak, and you were given a
14 subpoena and you sent a fax back to me requesting
15 that you not need to appear on Monday, the 24th, and
16 representing that you only had two checks. Do you
17 recall that?

18 A No, I don't.

19 MR. MARKLEY: May I approach, Your Honor?

20 THE COURT: Yes.

21 MR. MARKLEY: And have this marked as an
22 exhibit, the next R exhibit.

23 THE COURT: Yes.

24 MR. MARKLEY: Thank you.

25 THE CLERK: It's marked for identification

1 as Exhibit 98-R.

2 MR. MARKLEY: Thank you.

3 (The document referred to was
4 marked for identification as
5 Respondent Exhibit 98-R.)

6 BY MR. MARKLEY:

7 Q Do you have that in front of you, Mr.
8 Zumbaum?

9 A Yes.

10 Q Now, does that refresh your recollection of
11 whether or not you advised me on April 18, 2017, that
12 you have provided all the documents with copies of
13 documents responsive to the above subpoenas through
14 Mr. Albright and that they consist of copies of
15 canceled checks that were written by Peak during 2010
16 and 2011.

17 A Yes.

18 Q So would you agree that that statement in
19 there is accurate?

20 A Yes.

21 Q Okay. So that refreshes your recollection.

22 A Yes.

23 Q So in terms of the subpoenas that you --
24 were given to Peak for all documents relating to
25 activities involving Peak or Reserve insurance

1 company, you were only able to provide us with those
2 two checks. Is that correct?

3 A Yes.

4 MR. MARKLEY: I'm almost done, Your Honor,
5 I think. All right. Thank you.

6 MR. ALBRIGHT: I guess 98-R is not offered.

7 MR. MARKLEY: No. It was a refreshing of
8 recollection, and he remembered it anyway.

9 REDIRECT EXAMINATION

10 BY MR. ALBRIGHT:

11 Q Mr. Zumbaum, earlier Mr. Markley asked you
12 about the insurance claim that you filed regarding
13 Peak's roof. Could you please explain what happened
14 to the roof that made you file the claim?

15 A It got stretched out due to the snow we
16 got, extreme weight.

17 Q When you say it got stretched out, what
18 does that mean?

19 A Well, due to the extreme weight, it popped
20 the seams. It was a corrugated roof, industrial
21 roof, and so we had leakage throughout the building.

22 Q And after that happened, did you contact
23 your insurance company?

24 A Yes.

25 Q And earlier I believe you testified that

1 your insurance company at that time was EMC?

2 A I believe so.

3 Q And do you recall when the damage to your
4 roof occurred?

5 A It was in February, I believe, of that
6 year.

7 Q And what year was that?

8 A That was 2007-2008; it might have been
9 January.

10 Q January of?

11 A It was either January or February of 2008.

12 Q And how long after the damage occurred did
13 you contact your insurance company?

14 A Probably did immediately.

15 Q And did you review your insurance policy
16 before you contacted the insurance company?

17 A No.

18 Q Earlier Mr. Markley asked you if you
19 believed that your insurance would provide coverage
20 for that claim. Do you recall that?

21 A Excuse me?

22 Q Earlier, I believe, Mr. Markley asked you
23 if you believed that your insurance would provide
24 coverage for that claim.

25 A Yes. We believed it would.

1 Q And did you believe that you had coverage?

2 A Yes, sir.

3 Q Did anyone tell you that you did not have
4 coverage?

5 A No.

6 Q Well, what about the insurance company?
7 What did they tell you?

8 A They came out and did a study, they sent
9 out their specialist three different times and said,
10 This is how to fix it, and here's the money to repair
11 it. It didn't suffice for the repair, and we went
12 out and got quotes and had professional advice on it,
13 too, and ours was to replace it.

14 Q And did they immediately tell you -- how
15 long did it take them to basically tell you how much
16 they were going to pay?

17 A About six months.

18 Q And what did you do after they told you
19 that?

20 A We put a new roof on the building; we had
21 no option.

22 Q And did this experience have any impact on
23 you in whether or not you wanted to form a captive
24 insurance company?

25 A Yes, it did. Yeah.

1 Q And what was that?

2 A Just that if we owned -- if we were part of
3 the captive and stuff, then we'd process the claims
4 quicker and have a little better service.

5 Q And did the experience with the tax
6 returns, did that have any impact on you in deciding
7 to form the captive?

8 A Probably in the back of our minds.

9 Q Now, Mr. Markley asked you about waiting
10 until 2008 to form the captive insurance company. Is
11 there any reason why you waited that long to form the
12 captive insurance company?

13 A Well, before that we didn't have the
14 business. We kind of hit our stride and growth at
15 that time. Before that we were a lot smaller.

16 Q And I believe Mr. Markley asked you whether
17 you read your insurance policies.

18 A Yes, he did.

19 Q And do you normally read your insurance
20 policies?

21 A Probably not as well as I should.

22 Q Would you ask your insurance person to
23 explain what kind of coverage you had?

24 A I guess if a question arose or an incident
25 arose, we'd call our agent.

1 Q I believe Mr. Markley also asked you
2 whether you paid for the feasibility study. Do you
3 recall whether you paid for the feasibility study or
4 not?

5 A I don't believe we did.

6 Q But do you recall whether you did?

7 A No, I don't recall.

8 (Pause.)

9 MR. ALBRIGHT: Your Honor, we have some
10 checks here, copies of checks that on direct I should
11 have asked Mr. Zumbaum about these checks, and these
12 were checks that were the subject of the supplemental
13 stipulation, and we're not at the point where we can
14 stipulate yet. I wonder if I can ask permission to
15 go ahead and have Mr. Zumbaum identify these checks
16 and go ahead and put them in the record?

17 MR. MARKLEY: May I just have a moment to
18 see what they are?

19 THE COURT: I was going to ask to share
20 them with Respondent's counsel and if Respondent's
21 counsel had any questions about them and allow him to
22 question the witness about them also.

23 MR. MARKLEY: Can we go off the record for
24 a minute?

25 THE COURT: We can go off the record.

1 MR. MARKLEY: Thank you.

2 (Off the record.)

3 MR. ALBRIGHT: Your Honor, I believe that
4 this is actually not going beyond the scope of issues
5 that were raised in cross-examination. Mr. Markley
6 asked some questions about some checks, and these are
7 the checks that Mr. Markley was referencing in his
8 questions to Mr. Zumbaum, and I was merely going to
9 have Mr. Zumbaum identify these checks, mark them as
10 an exhibit and offer them in evidence.

11 MR. MARKLEY: I never said that they were
12 going beyond the scope of cross-examination. This
13 only came up because Mr. Albright said that he had
14 forgotten to do it in the first place, so we were
15 trying to do some degree of I'll use the term horse
16 trading, and if the position is that this is part of
17 the scope of cross-examination -- I'm sorry -- part
18 of redirect as a result of my cross, that's fine.

19 I was just trying to have some
20 conversations about something that also related to
21 what Mr. Zumbaum testified about him sending a fax
22 saying he did not have any more documents, and quite
23 simply, I did not put in the subpoena that related to
24 the documents that he said he didn't have, so that's
25 all this was about.

1 And so at some point in time when Mr.
2 Albright is finished, I'm going to show Mr. -- I
3 don't know whether it's going to be objected to or
4 not -- Mr. Zumbaum the subpoena and ask him is that
5 the subpoena that he received and, as a result of
6 that, sent me, nicely enough, a fax saying he didn't
7 have any more than those two checks. So that's all
8 this is about.

9 THE COURT: The Court is slightly confused.
10 It's my understanding, Mr. Albright, that you just
11 wanted to ask some questions in case something didn't
12 come in as part of the second stipulation. Is that
13 correct?

14 MR. ALBRIGHT: That's partly the case, Your
15 Honor, but also Mr. Markley raised a question about
16 these checks on his cross-examination of Mr. Zumbaum,
17 and I was going to have him identify the checks that
18 Mr. Markley was asking about.

19 THE COURT: Okay. I will allow the
20 documents to be marked by the trial clerk. And how
21 many do you have?

22 MR. ALBRIGHT: I'm sorry.

23 THE COURT: How many documents?

24 MR. ALBRIGHT: Your Honor, I'd propose to
25 do this as just one exhibit; it's copies of several

1 checks. May I approach, Your Honor?

2 THE COURT: Yes.

3 THE CLERK: It's marked for identification
4 as Exhibit 99-P.

5 (The document referred to was
6 marked for identification as
7 Petitioner Exhibit 99-P.)

8 MR. ALBRIGHT: Your Honor, may I approach
9 the witness and provide a copy of a document that's
10 been marked for identification as Petitioner's
11 Exhibit 99-P for identification?

12 THE COURT: Yes.

13 MR. ALBRIGHT: And I've provided a copy to
14 Mr. Markley as well.

15 MR. MARKLEY: Yes, he has.

16 BY MR. ALBRIGHT:

17 Q Mr. Zumbaum, do you have a copy of the
18 document that's been marked for identification as
19 Exhibit 99-P for identification in front of you?

20 A Yes, I do.

21 Q And can you identify what Exhibit 99-P is?

22 A They're checks written out of Peak
23 Mechanical from the D.A. Davidson account.

24 Q And how many pages of checks are there?

25 A Four.

1 MR. ALBRIGHT: Your Honor, I'd offer 99-P
2 into evidence.

3 MR. MARKLEY: No objection, Your Honor.

4 THE COURT: 99-P is admitted.

5 (The document referred to,
6 having been previously
7 marked for identification as
8 Petitioner Exhibit 99-P,
9 was received in evidence.)

10 MR. MARKLEY: May I ask some additional
11 questions, Your Honor?

12 THE COURT: Yes.

13 MR. MARKLEY: Well, I have to ask Mr.
14 Albright if he was finished.

15 RECROSS-EXAMINATION

16 BY MR. MARKLEY:

17 Q Mr. Zumbaum, here we are again. You had
18 said that as a result of the snow incident -- we'll
19 call it that, the snow and tin roof incident -- that
20 by setting up Reserve insurance company you'd be able
21 to process claims quicker and get better service?

22 A Yes.

23 Q So Peak would be getting better service
24 from Reserve. Right?

25 A Right.

1 Q And you predominantly were the owners of
2 Peak and you were predominantly the owners of
3 Reserve. Is that correct?

4 A Correct.

5 Q So essentially you would be giving yourself
6 better service. Would that be true?

7 A Yes. You can look at it that way.

8 Q Now, you had mentioned with reading the
9 insurance policies and stuff that normally you would
10 just call your agent to find out what it maybe said
11 if you couldn't figure it out?

12 A Correct.

13 Q Would you compare that scenario in this
14 case here, if you had an issue with calling your
15 agent would you be calling Capstone?

16 A Yes.

17 Q And you had talked about how at some point
18 in time you didn't get around to getting the policies
19 in this instance, in this particular case, until
20 later because your business hadn't been built up that
21 well.

22 A Correct.

23 Q Well, would it be true, though, that
24 without regard to that, whatever risk you had before
25 you got these policies, let's say five, ten years

1 ago, the risks would be the same as when you got the
2 policies, it would just be a matter of how much money
3 you had in the business. Would that be right?

4 A No, that would not be right.

5 Q You would have more risk as the years went
6 on as a result of building up your company?

7 A Correct. We had more exposure because we
8 had more equipment.

9 Q You had more equipment out?

10 A Yes.

11 MR. MARKLEY: So that would be the reason
12 for that. All right.

13 May I approach, Your Honor, and have an
14 exhibit marked?

15 THE COURT: Yes.

16 MR. MARKLEY: Respondent's exhibit.

17 THE CLERK: Marked for identification as
18 Exhibit 100-R.

19 (The document referred to was
20 marked for identification as
21 Respondent Exhibit 100-R.)

22 (Whereupon, the above-entitled matter was
23 continued to Volume 3.)

24

25

1 CERTIFICATE OF TRANSCRIBER AND PROOFREADER

2 CASE NAME: Reserve Mechanical Corp, f.k.a. as

3 Reserve Casualty Corp. v. Commissioner

4 DOCKET NO.: 14545-16

5 We, the undersigned, do hereby certify that the
6 foregoing pages, numbers 87 through 186, inclusive,
7 are the true, accurate and complete transcript
8 prepared from the recording made by electronic
9 recording by Leslie Berridge, on April 27, 2017,
10 before the United States Tax Court at its session in
11 Houston, Texas, in accordance with the applicable
12 provisions of the current verbatim reporting contract
13 of the Court, and have verified the accuracy of the
14 transcript by comparing the typewritten transcript
15 against the verbal recording.

16

17 _____

18 Nancy H. King 05/18/2017

19 (Transcriber) (Date)

20

21 _____

22 Laurel H. Stoddard 05/19/2017

23 (Proofreader) (Date)

24

25

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IN THE UNITED STATES TAX COURT

In the Matter of:)
)
RESERVE MECHANICAL CORP., f.k.a.)
RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
v.)
)
COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

Volume: 3
Pages: 187 through 228
Place: Houston, Texas
Date: April 27, 2017

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IN THE UNITED STATES TAX COURT

 In the Matter of:)
)
 RESERVE MECHANICAL CORP., f.k.a.)
 RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
 v.)
)
 COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

Room 7006
Casey U.S. Courthouse
515 Rusk Avenue
Houston, Texas

April 27, 2017

The above-entitled matter came on for
trial, pursuant to notice, at 9:30 a.m.

BEFORE: HONORABLE KATHLEEN KERRIGAN
Judge

APPEARANCES:

For the Petitioner:

VAL J. ALBRIGHT, Esquire
MICHELLE Y. KU, Esquire
Gardere Wynne
2021 McKinney Avenue, Ste. 1600
Dallas, Texas 75201
214-999-3000

1 APPEARANCES: (continued)

2 For the Respondent:

3 G. ROGER MARKLEY, Esquire
4 THOMAS F. HARRIMAN, Esquire
5 NASEEM J. KHAN, Esquire
6 JUSTIN D. SCHEID, Esquire
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8 Internal Revenue Service
9 200 W. Adams Street
10 Chicago, Illinois 60606
11 312-368-8243

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1 C O N T E N T S

2 WITNESSES: DIRECT CROSS REDIRECT RECROSS VOIR DIRE

3 For Petitioner:

4 Norman Zumbaum 191

5 Steve W. Kinion 197 209

6 220 222

7 For Respondent

8 None

9 OPENING STATEMENT ON BEHALF OF RESPONDENT:

10 OPENING STATEMENT ON BEHALF OF PETITIONER:

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	E X H I B I T S		
	EXHIBITS:	IDENTIFIED	RECEIVED
1			
2			
3	100-R	previously	194
4	101-R and 102-R	192	194
5	103-P	220	221

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1 P R O C E E D I N G S

2 RECROSS-EXAMINATION (CONTINUED)

3 MR. MARKLEY: May I approach, Your Honor?

4 THE COURT: Yes.

5 BY MR. MARKLEY:

6 Q Mr. Zumbaum, I've handed you something and
7 ask if you've ever seen that before. It's a
8 subpoena. Have you seen that before?

9 A Yes, I have.

10 Q Okay. Now, I know it's a lot of writing,
11 but when I was asking you a little while ago, I gave
12 you a document to refresh your recollection about
13 your response to me, were you responding about what
14 was requested in this particular subpoena to you?

15 A Yes.

16 Q Okay. And so you can identify it and you
17 believe that this is the subpoena that you received?

18 A I believe it is.

19 Q So would it be accurate to say that the
20 documents that you mentioned in that fax, which your
21 recollection was refreshed about so we didn't put
22 that in to actual evidence, that this is the subpoena
23 that you referred to the testimony that you gave as
24 to requests of documents by us?

25 A I believe so.

1 Q Do you have any reason to not think that?

2 A No, I don't.

3 MR. MARKLEY: May I approach again, Your
4 Honor?

5 THE COURT: Yes.

6 THE CLERK: Marked as Exhibit 101-R.

7 Marked for identification as Exhibit 102-R.

8 (The documents referred to were marked for
9 identification as Respondent's Exhibits
10 101-R and 102-R.)

11 BY MR. MARKLEY:

12 Q Mr. Zumbaum, I've handed you -- we already
13 went through 100, which was that first subpoena. Do
14 you also have 101?

15 A No.

16 THE COURT: Are 101 and 102 supposed to be
17 RocQuest?

18 MR. MARKLEY: No, Your Honor. Mr. Zumbaum
19 was handed the wrong documents. I apologize. My
20 mistake.

21 THE CLERK: Exhibit 101-R is RocQuest and
22 Exhibit 102-R is ZW Enterprises.

23 MR. MARKLEY: Mr. Zumbaum, now I believe
24 I'm handing you 101 and 102.

25 THE COURT: And does Mr. Albright have

1 everything?

2 MR. MARKLEY: Yes, he does.

3 THE COURT: Okay.

4 BY MR. MARKLEY:

5 Q And one is a subpoena for RocQuest and one
6 is a subpoena for ZW. Is that correct?

7 A Correct.

8 Q And I'll ask you the same question as
9 before: Do you recall sending a fax to our office
10 saying that you only had a certain number of checks -
11 - I believe it was two checks -- that you could
12 respond to the subpoenas. Is that correct?

13 A Correct.

14 Q And would that also apply to these
15 subpoenas for RocQuest and ZW as well?

16 A Correct.

17 Q So kind of the same question as a few
18 minutes ago, so whatever was in the Peak subpoenas
19 and the RocQuest subpoena and the ZW subpoenas, the
20 only items that you were able to provide that's
21 listed in those subpoenas were the documents that
22 were sent in that fax as noted in that fax. Is that
23 correct?

24 A Correct.

25 MR. MARKLEY: I would move for the

1 admission of 100, 101 and 102-R, Your Honor.

2 MR. ALBRIGHT: Your Honor, no objection.

3 MR. MARKLEY: Thank you.

4 No other questions. Thank you.

5 THE COURT: 100-R, 101-R and 102-R are
6 admitted.

7 MR. MARKLEY: Thank you, Your Honor.

8 (The documents referred to, having been
9 previously marked for identification as
10 Respondent's Exhibits 100-R through 102-
11 R, were received in evidence.)

12 MR. ALBRIGHT: Your Honor, I'd like to ask
13 one clarifying question.

14 THE COURT: Yes.

15 FURTHER REDIRECT EXAMINATION

16 BY MR. ALBRIGHT:

17 Q I believe Mr. Markley said something about
18 two checks. Do you recall that?

19 A Yes.

20 Q And I hand you Exhibit 99-P, and there are
21 actually more than two checks in Exhibit 99-P.

22 A Correct.

23 THE COURT: Thank you. You may step down.

24 (Whereupon, the witness was excused.)

25 MR. ALBRIGHT: May I proceed?

1 THE COURT: Yes.

2 MR. ALBRIGHT: Petitioner calls Steve
3 Kinion.

4 MR. MARKLEY: Your Honor, can we have a
5 couple of minutes to move things around here, because
6 I'm actually not going to do three witnesses in a
7 row.

8 THE COURT: Okay. Sure. We'll go off the
9 record for a minute.

10 (Off the record.)

11 THE CLERK: All rise. Please be seated.

12 MR. ALBRIGHT: Petitioner calls Steve
13 Kinion.

14 MR. SCHEID: Your Honor, if I may, before
15 we get into the next witness, Respondent, as you're
16 well aware now, had three subpoenas outstanding with
17 respect to Mr. Zumbaum, who has just completed his
18 testimony. Respondent does not intend to call him
19 any further, and therefore, he can be released from
20 those three subpoenas.

21 THE COURT: Okay. Thank you.

22 MR. ALBRIGHT: Your Honor, we have
23 discussed with Respondent's counsel, Mr. Markley
24 specifically, about possibly stopping after Mr.
25 Kinion's testimony today, if the Court is willing to

1 do so. I just wanted to ask and see if that was
2 okay.

3 THE COURT: Okay. And the Court was
4 wondering if you could tell what witnesses you're
5 expecting for tomorrow then.

6 MR. ALBRIGHT: Your Honor, I believe we
7 would call Mr. McNeel tomorrow, and we're planning on
8 calling Esperanza Mead, Mr. McNeel -- hold on a
9 second, I have to look at my notes. Your Honor, we
10 would propose to call tomorrow, we'll have Dr.
11 Doherty -- in this order -- Dr. Doherty, Lance
12 McNeel, Esperanza Mead, Michael Solomon, Gary Fagg,
13 and I believe Mr. Liptz will also be here tomorrow,
14 if we possibly get to him. And that should pretty
15 much fill out the day, I would think.

16 THE COURT: And then you have more
17 witnesses on Monday?

18 MR. ALBRIGHT: Yes, Your Honor. It would
19 be Stewart Feldman.

20 THE COURT: You don't have to give me a
21 definitive; I just was wanting to know if you were
22 still going to continue with more witnesses on
23 Monday, but tomorrow make sure Respondent's counsel
24 knows the witnesses that are going to be called on
25 Monday.

1 MR. MARKLEY: I just want to make sure Mr.
2 Feldman is not being called tomorrow.

3 MR. ALBRIGHT: We can agree not to call him
4 tomorrow.

5 MR. MARKLEY: Thank you.

6 MR. ALBRIGHT: Petitioner calls Steve
7 Kinion.

8 Whereupon,

9 STEVE KINION having been first duly sworn,
10 was called as a witness herein and was examined and
11 testified as follows:

12 THE CLERK: Can you please state your name
13 and address for the record?

14 THE WITNESS: Steve Wayne Kinion. Home
15 address is 1635 Blue Place, Springfield, Illinois
16 62704.

17 THE CLERK: Thank you. You may be seated.

18 MR. ALBRIGHT: I'm going to take a risk on
19 using Mr. Markley's podium here. I don't know if
20 it's going to hold, but we'll see.

21 DIRECT EXAMINATION

22 BY MR. ALBRIGHT:

23 Q Good afternoon, Mr. Kinion.

24 A Mr. Albright, good afternoon.

25 Q Mr. Kinion, where are you currently -- are

1 you currently employed?

2 A I am currently employed, yes.

3 Q And who's your current employer?

4 A I'm a partner in the law firm of Zack Stamp
5 in Springfield, Illinois.

6 Q Could you spell that, please?

7 A Z-A-C-K, and two words, S-T-A-M-P.

8 Q And how long have you been employed by that
9 firm?

10 A Since 1999.

11 Q Now, do you have a relationship -- well,
12 let me ask you about your practice at Zack Stamp,
13 what kind of a practice do you have there?

14 A Our practice almost exclusively focuses in
15 insurance law matters, primarily insurance
16 regulation, also focus on insurance company taxation
17 and captive insurance. I don't do captive insurance
18 right now due to my current engagement with the State
19 of Delaware.

20 Q You say your current engagement with the
21 State of Delaware. Could you tell me what that is?

22 A Yes. Since January of 2009, I have been
23 contractually engaged with the State of Delaware. My
24 current job which has been July 2009 was to serve as
25 the director of the captive insurance program.

1 Previous to that, from January until July 2009, I
2 held a title of senior advisor for regulatory policy
3 for the insurance commissioner.

4 Q So you've worked for the State of Delaware
5 from when to when?

6 A From January to 2009 to the present day.

7 Q And you've been the director of the captive
8 -- what did you say?

9 A The proper term is Bureau of Captive and
10 Financial Insurance Products.

11 Q And you've held that title or that job
12 since when?

13 A July of 2009.

14 Q And what are your duties as the director of
15 the captive insurance program for the State of
16 Delaware?

17 A My primary duty, Mr. Albright, is to be the
18 chief regulator of captive insurance companies of
19 Delaware. Delaware is a domicile that is now the
20 third largest captive domicile in the United States
21 and ranks as the sixth largest captive domicile
22 globally. So in my capacity as captive insurance
23 director, I regulate captives of all types and sizes,
24 we have currently licensed over 1,000 captive
25 insurance companies since my tenure.

1 Q Now, when you became the director in July
2 of 2009, what were the number of captives that were
3 being regulated by the State of Delaware at that
4 time?

5 A Thirty-eight.

6 Q So you went from 38 to more than 1,000?

7 A Yes.

8 Q What do you attribute that growth to?

9 A I attribute that growth in part to the
10 structure of Delaware's corporate and business entity
11 law system, and what I have found both in the
12 corporate insurance world and the captive insurance
13 world is -- as may be common knowledge for some but
14 maybe not for all, but certainly probably in the
15 legal community it's would be somewhat common
16 knowledge -- most business entities in the United
17 States are domiciled in the State of Delaware,
18 whether as corporations or limited liability
19 companies or some other form of business entity.

20 And when you form a captive insurance
21 company in Delaware, the mechanics, I would say, of
22 corporate governance, for instance, do not change, so
23 if the parent of the captive, if the captive owner is
24 a Delaware corporation and the captive insurance
25 company itself is a Delaware corporation, then in

1 terms of protocol on how to handle board meetings and
2 keep minutes, those are all the same. Many captive
3 owners find that very appealing because it's a
4 practice they're already undergoing, they're doing
5 and they probably have been doing that practice for
6 many years.

7 Q Have you -- in your capacity, in your role
8 with the State of Delaware, have you had any
9 experience with captive insurance companies formed in
10 Anguilla?

11 A Yes.

12 Q Could you explain for the Court what that
13 experience has been?

14 A That experience probably, I would say,
15 could categorize as two part, the first part being
16 that as a captive insurance regulator, we commonly
17 communicate with each other on captive insurance
18 topics, and when I use the pronoun "we," Mr.
19 Albright, I'm speaking of not only captive insurance
20 regulators not only here domestically within the
21 United States but internationally as well, and that
22 would certainly fall within the realm of Anguilla in
23 the Caribbean realm.

24 Additionally, we've had captive insurance
25 companies redomesticate or move from Anguilla into

1 Delaware, and through that redomestication process,
2 I've examined Anguilla law and the quality of the
3 insurance regulation in Anguilla. And certainly when
4 a company moves from one domicile to another as a
5 captive insurance company, you always want to be sure
6 that you're not inheriting the losing domicile's
7 problem.

8 Q And so how many redomestications of
9 Anguilla captive insurance companies have you been
10 involved in with the State of Delaware?

11 A My recollection is approximately ten, that
12 could be maybe a little higher.

13 Q And by redomestication, you mean the
14 captive insurance company in Anguilla is becoming a
15 Delaware captive insurance company?

16 A Yes.

17 Q Now, has Delaware been recognized by any
18 publications as a domicile for formation of captives
19 by industry press or otherwise?

20 A Yes, it has. Captive Review Magazine,
21 which is one of the magazines that is strictly
22 devoted to covering the news in the captive insurance
23 world, named Delaware as the U.S. Onshore Domicile of
24 the Year in the year 2013. Let me add, only two U.S.
25 domiciles have been given that distinction by Captive

1 Review Magazine, Vermont which has been the longest
2 standing, probably the best known captive insurance
3 domicile in the United States, and Delaware, so we
4 like to consider Delaware in a very exclusive club.
5 But we've also been recognized by Captive Review
6 those times and we have come in second to Vermont, as
7 following that category of getting honorable mention
8 or some other high awards of distinction, distinctive
9 adjectives. So yes, and we have also been noted in
10 other trade magazines as being a good domicile in
11 general.

12 Q And what about yourself, have you received
13 any recognition as a captive insurance regulator?

14 A I have. Both for the years 2016 and 2015,
15 the same Captive Review Magazine listed me in what's
16 called their Power 50 which is the 50 most
17 influential people in the global captive insurance
18 industry, and in both 2016 and 2015 I ranked as the
19 fourth most influential person. Also, I 2016,
20 Captive Review Magazine recognized me as the Captive
21 Insurance Advocate of the Year, and also bestowed
22 upon me the honor of being named an enterprise risk
23 captive pioneer.

24 Q What is Captive Insurance Advocate of the
25 Year, what is that about?

1 A That is about in terms of being a person
2 who recognizes issues of importance to the captive
3 insurance industry and fostering those issues for the
4 betterment of the industry.

5 Q So in your -- putting aside Anguilla for
6 the moment, do you have to work with other captive
7 insurance regulators within the United States outside
8 of Delaware in your job?

9 A Yes.

10 Q Could you speak to that some?

11 A Absolutely, be happy to. Again, captive
12 insurance companies do not just redomesticate from a
13 foreign country or UK, United Kingdom territory like
14 Anguilla to the United States, we also have
15 redomestications a captive may move from Tennessee to
16 Delaware, or sometimes is the case from Delaware to
17 Tennessee. When that occurs, of course, we captive
18 insurance regulators from the various states talk
19 amongst ourselves and we compare the captives, making
20 sure that the captive is complying with the laws, for
21 instance, in Delaware if moving to Tennessee, and I
22 would advise my counterpart in Tennessee to consider
23 maybe certain attributes or certain idiosyncrasies
24 about that captive insurance company.

25 I'd consider it to be somewhat of a robust

1 conversation that we have, and oftentimes we captive
2 regulators, both domestically and internationally,
3 just will ask questions of each other in terms of
4 best practices, how would you regulate a certain type
5 of captive under this circumstance. We're all
6 looking to refine the industry and make it a better
7 industry at all times.

8 Q Do you ever deal with insurance regulators
9 from the European Union countries?

10 A I have, yes.

11 Q And could you speak to that?

12 A Yes. I attend what's known as supervisory
13 colleges. For instance, last December I traveled to
14 France for a supervisory college that was hosted by
15 the French regulators, the German regulators were
16 there, United Kingdom was there, Switzerland,
17 Singapore, as well as the European Union Captive
18 insurance, Mr., Albright, is an international
19 industry, it crosses oceans, it crosses boundaries,
20 so it's very important to deal with regulators in
21 other countries. Last year I went to China and gave
22 classes on insurance to my Chinese regulatory
23 counterparts in Beijing.

24 Q Okay. So prior to working for the State of
25 Delaware, when did you first become involved in

1 insurance regulatory matters?

2 A I graduated from law school in 1995 and my
3 first job out of law school was going to work for the
4 Oklahoma Insurance Department. I actually began
5 working at the Oklahoma Insurance Department my last
6 semester in law school, and that was my baptism of
7 fire, and I've been dealing with insurance matters
8 now, I guess, for 22 years.

9 Q And did you have any involvement with the
10 Oklahoma State Board for Property and Casualty Rates?

11 A Yes. I was general counsel for the State
12 Board for Property and Casualty Rates in the mid
13 1990s while I was at the Oklahoma Insurance
14 Department from 1995 to 1999.

15 Q And is there any other insurance experience
16 that you've had that we haven't touched on?

17 A Yes. I have served as the chairman of the
18 Oklahoma Health Insurance High Risk Pool; I served on
19 that board from 1999 to 2008, and I served as the
20 chairman from 2000 until 2008. I also served on the
21 Oklahoma Comprehensive Health Insurance Plan board of
22 directors from 2002 until 2007. I have served on the
23 boards of directors of two insurance companies. In
24 addition, I was the chair of the Insurance Regulation
25 Committee for the American Bar Association. That

1 probably summarizes besides my legal practice.

2 Q And tell me a little bit about your
3 educational background, please.

4 A I graduated from Northeastern State
5 University in Oklahoma with a bachelor's degree, and
6 then I moved on to the University of Tulsa and earned
7 a joint degree, a JD-MBA.

8 Q Have you ever been recognized as an expert
9 witness in a case previously?

10 A Yes.

11 Q Can you speak to that?

12 A Yes. Those were cases that arose out of
13 Oklahoma, cases that I would categorize as bad faith
14 cases in which a claimant filed suit against an
15 insurance company, and I was engaged by the law firm
16 representing the insurer to provide written
17 testimony.

18 Q And was that in federal court or state
19 court?

20 A Both.

21 Q Have you done any writing about captive
22 insurance regulation?

23 A Yes.

24 Q Could you please briefly describe that?

25 A Sure. My most recent article was titled

1 "Go Captive" and that was in the Insurance Regulatory
2 Examiner Society, I-R-E-S, newsletter that was
3 published last November. Prior to that, last year I
4 co-wrote an article with another lawyer named Jeff
5 Simpson about a series of LLC captives. I'll just
6 briefly explain. Limited liability companies in
7 Delaware and probably seven or eight other states
8 have formed something called a series beneath them,
9 and we've been using that business model for captive
10 insurance since 2010. I've written about captive
11 governance in a publication called The Risk Retention
12 Reporter. I have written on regulatory matters for
13 the Federation of Regulatory Counsel Quarterly
14 Journal. And I've also written for the American Bar
15 Association's publications on insurance.

16 MR. ALBRIGHT: Your Honor, I would ask
17 permission to have this document marked as
18 Petitioner's exhibit for identification next in
19 order.

20 THE COURT: And are you going to ask the
21 Court to qualify him as an expert?

22 MR. ALBRIGHT: Your Honor, I believe that
23 we've demonstrated that Mr. --

24 THE COURT: Right.

25 MR. ALBRIGHT: Yes, and I would offer him.

1 THE COURT: Yes.

2 MR. ALBRIGHT: I would offer him as an
3 expert on insurance regulatory matters.

4 THE COURT: Yes.

5 MR. SCHEID: Your Honor, may I have an
6 opportunity to voir dire the witness?

7 THE COURT: Yes.

8 VOIR DIRE

9 BY MR. SCHEID:

10 Q Good afternoon, Mr. Kinion.

11 A Good afternoon, sir.

12 Q My name is Justin Scheid, I'm an attorney
13 and I represent the Internal Revenue in this case.

14 A Glad to meet you, Mr. Scheid.

15 Q I just want to briefly go through a few of
16 your qualifications with respect to your opinions
17 that you're offering in this case. First off, Mr.
18 Kinion, what specific involvement have you had with
19 Anguilla insurance regulators?

20 A Well, I know the insurance regulator in
21 Anguilla and I began my specific involvement, as my
22 answer to Mr. Albright's question earlier, was
23 principally in the redomestication of captive
24 insurance companies from Anguilla to Delaware.

25 Q And as you told Mr. Albright earlier, that

1 required you to examine Anguilla law. Is that right?

2 A Yes, not just, though, examine Anguilla
3 law, I look at the totality of the incoming candidate
4 for Delaware redomestication. That means I look at
5 the financial statements, I look at the audits that
6 have been submitted to the regulators in Anguilla by
7 that captive insurance company, whatever other
8 regulatory matters of interest there may be. We try
9 to do what I call a very thorough examination of
10 incoming captive insurance companies into the State
11 of Delaware. That is not specific to Anguilla alone,
12 that is a protocol that is adopted for everyone.

13 Q So you would do that process, you would
14 look at the financial statements and the audits for
15 any captive that wanted to redomesticate in Delaware.
16 Correct?

17 A I think that's the regular practice. Yes.

18 Q But specifically with respect to Anguilla
19 law, what would you examine as it relates to Anguilla
20 law as an Anguillan entity redomesticates in Delaware

21 A I would look at, for instance, is the
22 captive insurance company abiding by Anguilla law, is
23 it filing on a timely basis its annual financial
24 statement, it's annual audited financial statement.
25 Has it reported and sought prior regulatory approval

1 of material transactions, for instance between the
2 captive and its owner or the captive and maybe an
3 independent or outside third party? I would look at
4 is that captive maintaining its solvency margin under
5 Anguilla law. Has that captive -- have the people
6 who are running that captive -- Mr. Zumbaum -- do
7 they qualify and fit the fit and proper standards
8 that Anguilla law imposes upon them?

9 I also would look at in terms of what type
10 of licensing status does that captive insurance
11 company have. If we're speaking here in terms
12 specifically of Reserve Mechanical, that would be a
13 Class B license. Is Reserve Mechanical, as an
14 example, if it were to be redomesticated into
15 Delaware, I would look at has it complied with the
16 requirements of that particular kind of license. For
17 instance, is it only selling the products or types of
18 insurance that particular type of license allows it
19 to sell.

20 Q But are you making those assessments as it
21 relates to Delaware law?

22 A No.

23 Q In other words, making sure that the
24 incoming entity, as it's redomesticated, complies
25 with Delaware law?

1 A No. I'm looking at it if it has complied
2 with Anguilla law.

3 Q And what would be your purpose for making
4 sure that it complies with Anguilla law as it's
5 redomesticated?

6 A As I said earlier, one of the keys to
7 redomesticating captives as the gaining captive
8 domicile is you do not want to inherit someone else's
9 problem, and what I mean by that is you want to make
10 sure that when a captive is redomesticated in
11 Delaware it's a good captive, the people who run that
12 captive know what they're doing and have a good habit
13 of complying with the law.

14 Q And how many entities have you done this
15 check for?

16 A As I said earlier in my testimony, I
17 believe it was approximately ten; it could be a
18 little more.

19 Q Have you ever completed an application for
20 a Class B insurance license in Anguilla?

21 A No. I would never have, nor would I have
22 completed an application for a license in any state.

23 Q Have you ever prepared or reviewed the
24 required annual audit under Anguilla law?

25 A I have reviewed the annual audit but I have

1 never prepared an annual audit under Anguilla nor any
2 other state.

3 Q And your review would relate, as you said
4 earlier, only to the redomestication in Delaware. Is
5 that correct?

6 A That's correct.

7 Q Do you know what the difference is between
8 a Class B insurer's general license, like the one
9 that Reserve was issued, and a Class B insurer's
10 unrestricted license?

11 A Yes.

12 Q What's that difference?

13 A Well, a Class B insurer license that
14 Reserve Mechanical has -- if I understand your
15 question correctly -- that one allows a captive
16 insurance company to be domesticated -- or licensed,
17 rather, in Anguilla, and it allows it to sell
18 insurance products on a foreign basis. In other
19 words, it is not selling insurance products within
20 Anguilla. It requires a \$100,000 minimum
21 capitalization requirement, and it also uniquely
22 allows it to offer what they call long-term insurance
23 coverage which under Anguilla law is defined as a
24 life insurance type product or a disability insurance
25 type product.

1 Q Now, what's a Class B insurer's

2 unrestricted license in Anguilla?

3 A Well, if I understand you correctly, there

4 is a Class B status that only requires a \$10,000

5 capitalization requirement, and under that status,

6 that Class B type of insurer may only insure the

7 risks of its sole parent or its parent.

8 MR. SCHEID: Give me just a second, Your

9 Honor.

10 BY MR. SCHEID:

11 Q Mr. Kinion, do you know how the Anguilla

12 Insurance Commission establishes solvency margins?

13 A Yes. It's written in statute.

14 Q And does the Anguilla Insurance Commission

15 use a Solvency II analysis?

16 A No, I don't believe they use a solvency II

17 analysis, although Anguilla is a United Kingdom

18 territory, I do not believe Anguilla has Solvency II

19 equivalents.

20 Q Have you ever computed a premium to surplus

21 ratio for an Anguillan insurance company?

22 A Yes.

23 Q And when have you done that?

24 A When I conduct the redomestications I do

25 that. It's a rather simple calculation. I look at

1 the premium to surplus ratio; I typically like to
2 have a three-to-one premium to surplus ratio in
3 Delaware.

4 Q Do you have any experience with Anguillan
5 insurance examinations or enforcement actions?

6 A Only in those that I have seen in terms of
7 candidates, and my recollection, sir, right now is I
8 have not seen any enforcement actions because if
9 there had been an enforcement action, I would not
10 accept that particular candidate for redomestication,
11 I would not have approved their redomestication to
12 Delaware.

13 Q So again, that would only come up in the
14 context of the redomestication?

15 A That's correct, and again, let me say we
16 only want to redomesticate the good companies, not
17 some other domicile's problem.

18 Q Do you have any experience reviewing
19 Anguilla domiciled insurance company investments?

20 A Yes, because that is part of the
21 redomestication process because we look at what type
22 of investments a captive that is seeking to come into
23 Delaware holds.

24 Q Now, I understand that you're a lawyer and
25 you do have a practice currently that relates to

1 insurance taxation. Is that correct?

2 A Insurance regulation, and we do some tax
3 work in the firm as well.

4 Q And you're not offering any opinion as it
5 would relate to taxation in this case of insurance
6 companies. Correct?

7 A No. Let me clarify, taxation is primarily
8 at the state level.

9 Q Now, you have some prior experience also
10 with establishing property casualty rates. Is that
11 correct?

12 A Yes.

13 Q And that would be at the Oklahoma State
14 Board. Is that right?

15 A Oklahoma State Board for Property and
16 Casualty Rates.

17 Q And you're not offering any opinion as it
18 would relate to premium analysis or premium
19 computation in this case. Correct?

20 A No.

21 Q That's a correct statement.

22 A That's a correct statement.

23 Q Now, your prior expert experience that Mr.
24 Albright went through with you, that all related to
25 the application of Oklahoma insurance law. Is that

1 correct?

2 A Yes.

3 Q Have you ever provided any expert testimony
4 or opinions as it would relate to Anguilla law prior
5 to this case?

6 A No.

7 Q You went through some articles that you've
8 written. Have you ever written any articles
9 involving Anguilla law?

10 A No.

11 Q You mentioned that you attend what you
12 called supervisory colleges. Right?

13 A Yes.

14 Q Have Anguilla regulators or the Anguillan
15 Insurance commission ever been present at any of
16 those supervisory colleges?

17 A No.

18 Q I think you also indicated earlier that as
19 part of your sort of two-pronged involvement with
20 foreign insurance regulators, in addition to what
21 we've described with the redomestication, that you
22 also communicate with other regulators. Right?

23 A Yes, that's correct.

24 Q Have you ever had any communications with
25 Anguilla insurance regulators?

1 A Yes.

2 Q And what were the nature of those
3 communications?

4 A Again, issues involving redomestication
5 principally.

6 Q So again, relating to those ten or so
7 insurance companies that redomesticated to Delaware?

8 A And I know I've spoken with the Anguilla
9 insurance regulators just on a casual basis. I saw
10 them -- this is April, I saw them last month, for
11 instance, in San Diego at a captive insurance
12 conference and we had lunch.

13 Q And that was a casual interaction.
14 Correct?

15 A Yes. We discussed rugby, for instance.

16 Q So would you say that the totality of your
17 experience as it relates to Anguilla law would relate
18 to the ten or so captives that have redomesticated
19 from Anguilla to Delaware? Is that correct?

20 A That would be correct, and again, the
21 conversations I've had and just general knowledge of
22 Anguilla law.

23 MR. SCHEID: Your Honor, Respondent would
24 renew its objections to the qualification of Mr.
25 Kinion as an expert in insurance law as it would

1 relate to Anguillan law.

2 We certainly have no objection as it would
3 relate to Delaware or Oklahoma law, but we would
4 renew our objections as stated in our motion in
5 limine for the reasons set forth.

6 THE COURT: Mr. Albright, do you want to
7 respond before I rule?

8 MR. ALBRIGHT: Yes, Your Honor.

9 Your Honor, Petitioner submits that Mr.
10 Kinion has demonstrated that he is an expert in
11 captive insurance regulation, and I would also submit
12 that -- and this is from the regulatory perspective -
13 - and also, testimony about the law is normally not
14 permitted, but Tax Court Rule 146 permits such
15 testimony in the case of foreign law, although I
16 don't think there are any real controversial issues
17 here about -- or very technical issues about what
18 Anguillan law is because the parties have stipulated
19 and we have exhibits in the record with the insurance
20 statutes of Anguilla and also the regulations related
21 to Anguilla law. And all Mr. Kinion is doing is
22 making a comparison of whether Anguilla law, their
23 regulation meet good practices.

24 THE COURT: The Court recognizes that Mr.
25 Kinion is qualified to testify as an expert.

1 MR. ALBRIGHT: Your Honor, are you ready
2 for me to proceed?

3 THE COURT: Yes.

4 MR. ALBRIGHT: Your Honor, I would ask that
5 this document be marked Petitioner's exhibit next in
6 order. It's Mr. Kinion's report.

7 THE COURT: You may approach.

8 THE CLERK: The expert report of Steve
9 Kinion is marked for identification as Exhibit 103-P.

10 (The document referred to was marked for
11 identification as Petitioner Exhibit 103-
12 P.)

13 MR. ALBRIGHT: Your Honor, I would ask
14 permission to provide Mr. Kinion a copy of Exhibit
15 103-P marked for identification. May I approach?

16 THE COURT: Yes, you may.

17 DIRECT EXAMINATION (RESUMED)

18 BY MR. ALBRIGHT:

19 Q Mr. Kinion, do you have a copy of the
20 document that's been marked for identification as
21 Petitioner's Exhibit 103-P?

22 A Yes.

23 Q And can you tell me what Exhibit 103-P is?

24 A Exhibit 103-P is the opinion that I
25 provided regarding Reserve Mechanical Corporation,

1 otherwise known as Reserve Casualty.

2 MR. ALBRIGHT: Your Honor, I'd offer
3 Petitioner's Exhibit 103-P into evidence.

4 MR. SCHEID: No objection, Your Honor.

5 THE COURT: 103-P is admitted.

6 (The document referred to, having been
7 previously marked for identification as
8 Petitioner Exhibit 103-P, was received in
9 evidence.)

10 BY MR. ALBRIGHT:

11 Q Mr. Kinion, we only have five minutes, so
12 could you give a high-level review of what you did
13 and the opinions that are set forth in your report?

14 A Hello, Mr. Albright. And I think the best
15 way to do that would be to look at the executive
16 summary portion of my opinion. There the opinion
17 rests upon four pillars, as I've written.

18 That would be: Are the laws of Anguilla
19 within the regulatory norms for captive insurance
20 laws? The answer to that is yes. The second pillar
21 being: Was Reserve Casualty regulated in a manner
22 consistent with Anguilla's laws? My opinion is yes,
23 it was. The third pillar being: Is Reserve's
24 capitalization satisfactory in terms of regulatory
25 norms? I believe, yes, it is. And finally: Do the

1 policies that were issued by Reserve transfer risk?

2 Again, yes.

3 MR. ALBRIGHT: Pass the witness, Your
4 Honor.

5 THE COURT: Thank you.

6 CROSS-EXAMINATION

7 BY MR. SCHEID:

8 Q Good afternoon again, Mr. Kinion.

9 A Hello.

10 Q I want to focus first on your third pillar
11 that you just described and specifically your opinion
12 that Reserve's capitalization would satisfy
13 regulatory norms. Now, on page 10 of your report you
14 reviewed Reserve's investments, and you concluded
15 that they're within the type of investments that an
16 insurer normally purchases. Right?

17 A Yes, that's correct.

18 MR. SCHEID: But if we look at Exhibit 32-J
19 -- just a moment. Your Honor, may I approach the
20 witness to hand the witness a copy of the stipulated
21 exhibit binder?

22 THE COURT: Yes.

23 BY MR. SCHEID:

24 Q Mr. Kinion, what I've handed you is an
25 excerpt of the stipulated exhibits. If you could

1 turn to tab 32, we'll look first at Exhibit 32-J.
2 Look at Bates number 8801, it's RSV-0008801, 32-J.
3 This is Reserve's America West bank account statement
4 from March 31, 2009.

5 Now, if we look at the top of the exhibit -
6 - again, referring to 32-J, 8801 -- the statement
7 reflects Reserve's address in Osburn, Idaho. Right?

8 A Yes.

9 Q And if we look at the ending balance which
10 is sort of in the middle of that page 8801, Reserve
11 is holding \$59,992 in a U.S. bank account. Right?

12 A No. It would be \$599,992.

13 Q I'm sorry. I misspoke. But that's in a
14 U.S. bank account. Right?

15 A Yes, that appears to be correct.

16 Q Now, is that common for an Anguilla
17 domiciled insurer?

18 A To hold money in a U.S. bank, is that the
19 question?

20 Q Yes.

21 A Yes. That can happen because under a Class
22 B license for a foreign company -- under a Class B
23 foreign license in Anguilla, it is not required for
24 Class B licensee to maintain the funds in an Anguilla
25 bank.

1 Q Let's turn to your pillar four and that
2 opinion that Reserve's policies transfer insurance
3 risk. And for this opinion you relied on the terms
4 of the insurance policies. Right?

5 A Yes, that's correct.

6 Q And you state in your report on page 10
7 that Reserve's policies show that they transfer risk
8 in accordance with the definition of insurance
9 business. Right?

10 A Yes.

11 Q And specifically, you reference the risk of
12 loss for punitive damages in your report. Right?

13 A Yes.

14 Q So if we could take a look at Exhibit 45-J,
15 which is in the same binder if you flip back, and
16 this is the special risk punitive rap liability
17 insurance policy for 2009, if we turn a few pages in
18 on Exhibit 45-J to Bates number RSV-0005952 -- are
19 you there, Mr. Kinion?

20 A I am.

21 Q And if we look at the top of the page, this
22 is the coverage form, it identifies the insureds as
23 Peak Mechanical, RocQuest, and ZW Enterprises.

24 Right?

25 A Yes.

1 Q And below in the insuring agreement it says
2 that Reserve will pay to indemnify those insureds for
3 claims which is a defined term. Right?

4 A I don't see it. You're asking me the claim
5 is defined on Bates number 0005952? I don't see the
6 definition of claim on that page.

7 Q No. And I agree it isn't a defined term,
8 but it does in the insuring agreement portion say
9 that Reserve will pay to indemnify those insureds for
10 claims as defined. Is that correct?

11 A Typically claim is defined. Yes.

12 Q And if we flip to the following page of
13 Exhibit 45-J at 5953, we see the definition of claim.
14 Right? At paragraph 5A?

15 A Yes. I read it now. Correct.

16 Q And claim is a demand for payment of
17 punitive or exemplary damages. Right?

18 A Correct, yes.

19 Q Has Peak Mechanical ever had a demand
20 against it for payment of punitive or exemplary
21 damages?

22 A I don't know.

23 Q Has RocQuest or ZW Enterprises ever had a
24 demand against it?

25 A I don't know.

1 Q Mr. Kinion, who is paying for your time in
2 testifying here today and for preparation of your
3 report?

4 A I was engaged by the Feldman Law Firm.

5 MR. SCHEID: Thank you very much, Your
6 Honor. No further questions.

7 MR. ALBRIGHT: I have no further questions,
8 Your Honor.

9 THE COURT: Okay. You may step down.

10 THE WITNESS: Thank you, Your Honor.

11 (Whereupon, the witness was excused.)

12 MR. ALBRIGHT: Your Honor, could we,
13 consistent with our prior discussion, reconvene in
14 the morning?

15 THE COURT: Okay. While we're still on the
16 record, I have a practice of just at the ending of
17 the day going over which exhibits have been admitted
18 and if there's a disagreement to let the trial clerk
19 know: 97-P, 99-P, 100-R, 101-R, 102-R, and 103-P
20 were all entered today.

21 The Court is going to recall one of its
22 cases from the calendar at nine o'clock tomorrow, but
23 we should be able to start -- this case will be
24 recalled, with agreement of the parties, at 9:15 in
25 the morning.

1 (Whereupon, at 4:15 p.m., the above-
2 entitled matter was concluded.)

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1 CERTIFICATE OF TRANSCRIBER AND PROOFREADER

2 CASE NAME: Reserve Mechanical Corp, f.k.a. as

3 Reserve Casualty Corp. v. Commissioner

4 DOCKET NO.: 14545-16

5 We, the undersigned, do hereby certify that the
6 foregoing pages, numbers 187 through 228, inclusive,
7 are the true, accurate and complete transcript
8 prepared from the recording made by electronic
9 recording by Leslie Berridge, on April 27, 2017,
10 before the United States Tax Court at its session in
11 Houston, Texas, in accordance with the applicable
12 provisions of the current verbatim reporting contract
13 of the Court, and have verified the accuracy of the
14 transcript by comparing the typewritten transcript
15 against the verbal recording.

16

17 _____

18 Nancy H. King 05/18/2017

19 (Transcriber) (Date)

20

21 _____

22 Laurel H. Stoddard 05/19/2017

23 (Proofreader) (Date)

24

25

<p><u> </u> \$ \$10,000 214:4 \$100,000 213:20 \$59,992 223:11 \$599,992 223:12 <u> </u> 0 0005952 225:5 05/18/2017 228:18 05/19/2017 228:22 <u> </u> 1 1,000 199:24 200:6 10 222:13 224:6 100 192:13 194:1 100-R 190:3 194:5,10 226:19 101 192:14,16,24 194:1 101-R 190:4 192:6,10,21 194:5 226:19 102 192:16,24 194:10 102-R 190:4 192:7,10,22 194:1,5 226:19 103 220:11 103-P 190:5 220:9,15,21,23,2 4 221:3,5,8 226:19 14545-16 186:5 187:5 228:4 146 219:14 1600 187:19 1635 197:15 187 186:23 228:6 191 189:4 192 190:4</p>	<p>194 189:4 190:3,4 197 189:5 1990s 206:13 1995 206:2,14 1999 198:10 206:14,19 <u> </u> 2 200 188:6 2000 206:20 2002 206:22 2007 206:22 2008 206:19,20 2009 198:22,24 199:1,6,13 200:2 223:4 224:17 2010 208:10 2013 202:24 2015 203:14,18 2016 203:14,18,19 2017 186:25 187:11 228:9 2021 187:19 209 189:5 214-999-3000 187:20 22 206:8 220 189:5 190:5 221 190:5 222 189:5 228 186:23 228:6 27 186:25 187:11 228:9 <u> </u> 3 3 186:22 31 223:4 312-368-8243 188:7 32 223:1</p>	<p>32-J 222:18 223:1,2,6 38 200:6 <u> </u> 4 4:15 227:1 45-J 224:14,18 225:13 <u> </u> 5 50 203:16 515 187:10 5953 225:13 5A 225:14 <u> </u> 6 60606 188:6 62704 197:16 <u> </u> 7 7006 187:9 75201 187:20 <u> </u> 8 8801 223:2,6,10 <u> </u> 9 9:15 226:24 9:30 187:13 97-P 226:19 99-P 194:20,21 226:19 <u> </u> A a.m 187:13 abiding 210:22 able 193:20 226:23 above-entitled 187:12 Absolutely 204:11 accept 215:10</p>	<p>accordance 224:8 228:11 account 223:3,11,14 accuracy 228:13 accurate 191:19 228:7 action 215:9 actions 215:5,8 actual 191:22 actually 194:21 195:6 206:4 Adams 188:6 add 202:24 addition 206:24 217:20 Additionally 201:24 address 197:13,15 223:7 adjectives 203:9 admission 194:1 admitted 194:6 221:5 226:17 adopted 210:12 advise 204:22 advisor 199:2 Advocate 203:21,24 afternoon 197:23,24 209:10,11 222:8 against 207:14 225:20,24 228:15 ago 191:11 193:18 agreement 225:1,8 226:24 Albright 187:18 192:25 194:2,12,16,25</p>
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IN THE UNITED STATES TAX COURT

In the Matter of:)
)
RESERVE MECHANICAL CORP., f.k.a.)
RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
v.)
)
COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

Volume: 4
Pages: 229 through 325
Place: Houston, Texas
Date: April 28, 2017

1 IN THE UNITED STATES TAX COURT

2

In the Matter of:)

3

RESERVE MECHANICAL CORP., f.k.a.)

4

RESERVE CASUALTY CORP.,)

5

Petitioner,) Docket No. 14545-16

6

v.)

7

COMMISSIONER OF INTERNAL REVENUE,)

8

Respondent.)

9

Room 7006
Casey U.S. Courthouse
515 Rusk Avenue
Houston, Texas

10

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12

April 28, 2017

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The above-entitled matter resumed for
trial, pursuant at 9:18 a.m.

14

15

BEFORE: HONORABLE KATHLEEN KERRIGAN
Judge

16

APPEARANCES:

17

For the Petitioner:

18

VAL J. ALBRIGHT, Esquire
MICHELLE Y. KU, Esquire
Gardere Wynne
2021 McKinney Avenue, Ste. 1600
Dallas, Texas 75201
214-999-3000

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1 APPEARANCES: (continued)

2 For the Respondent:

3 G. ROGER MARKLEY, Esquire
4 THOMAS F. HARRIMAN, Esquire
5 NASEEM J. KHAN, Esquire
6 JUSTIN D. SCHEID, Esquire
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C O N T E N T S

WITNESSES:	DIRECT	CROSS	REDIRECT	RECROSS	VOIR DIRE
For Petitioner:					
Neil A. Doherty	234	239	266	273	
S. Lance			284	295	
McNeel, Jr.	296				
For Respondent					
None					

	E X H I B I T S		
	EXHIBITS:	IDENTIFIED	RECEIVED
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3	104-P	235	236
4	105-R	242	
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1 P R O C E E D I N G S

2 (9:18 a.m.)

3 THE CLERK: Docket Number 14545-16, Reserve
4 Mechanical Group, formerly known as Reserve Casualty
5 Corp. Please state your appearances.

6 MR. MARKLEY: Good morning, Your Honor.
7 Roger Markley for Respondent.

8 MR. SCHEID: Justin Scheid for Respondent.

9 MR. HARRIMAN: Tom Harriman for Respondent.

10 MS. KHAN: Naseem Khan for Respondent, Your
11 Honor.

12 MR. ALBRIGHT: Val Albright for the
13 Petitioner. Good morning, Your Honor. Michelle Ku
14 and Mr. Zumbaum are also here, but they're not in the
15 courtroom. Well, there's Mr. Zumbaum. Ms. Ku is not
16 here yet this morning. She will be here a little
17 later.

18 THE COURT: All right. Thank you. You may
19 be seated.

20 Are there any preliminary matters before
21 Mr. Albright calls his witness?

22 MR. SCHEID: Nothing from Respondent, Your
23 Honor.

24 MR. ALBRIGHT: Nothing from Petitioner,
25 Your Honor.

1 THE COURT: All right. You may proceed.

2 MR. ALBRIGHT: Yes. Petitioner calls Dr.
3 Neil A. Doherty.

4 THE CLERK: Please raise your right hand.
5 Whereupon,

6 NEIL A. DOHERTY

7 having been first duly sworn, was called as
8 a witness herein, and was examined and testified as
9 follows:

10 THE CLERK: Can you please state your name
11 and address for the record.

12 THE WITNESS: Neil Alexander Doherty, 234
13 Parfitt Way Southwest, Bainbridge Island, Washington
14 98110.

15 THE CLERK: Thank you. You may be seated.

16 THE WITNESS: Thank you.

17 DIRECT EXAMINATION

18 BY MR. ALBRIGHT:

19 Q Good morning, Dr. Doherty.

20 A Good morning.

21 Q Dr. Doherty, are you currently employed?

22 A No. I'm retired.

23 MR. SCHEID: Your Honor, Respondent may be
24 able to dispense with some of this. Respondent's
25 willing to stipulate to the qualifications of Dr.

1 Doherty in this case.

2 THE COURT: Okay. So Mr. Doherty is
3 accepted as an expert. Is that correct?

4 MR. SCHEID: Yes. We have no objection,
5 Your Honor.

6 THE COURT: Yes.

7 MR. ALBRIGHT: Your Honor, I would ask that
8 this be marked for identification as Petitioner's
9 Exhibit next in order.

10 THE COURT: You may approach and have it
11 lodged.

12 MR. ALBRIGHT: And I'm handing Respondent's
13 counsel a copy. (Handing document.)

14 THE CLERK: The expert report of Neil
15 Doherty is marked for identification as Exhibit 104-
16 P.

17 (The document referred to was
18 marked for identification as
19 Petitioner's Exhibit 104-P.)

20 MR. ALBRIGHT: Your Honor, may I provide
21 Dr. Doherty with a copy of Exhibit -- the exhibit
22 that's marked for identification as --

23 THE COURT: Yes.

24 MR. ALBRIGHT: -- 104-P?

25 BY MR. ALBRIGHT:

1 Q (Handing document.) Dr. Doherty, would you
2 please -- do you have a copy of the document that's
3 been marked for identification as Exhibit 104-P? Do
4 you have it in front of you?

5 A I do. Yes.

6 Q And can you tell me what Exhibit 104-P is.

7 A This is an expert report I wrote in
8 connection with this case.

9 MR. ALBRIGHT: Your Honor, I'd move Exhibit
10 104-P into evidence.

11 MR. SCHEID: No objection, Your Honor.

12 THE COURT: 104-P is admitted.

13 (The document referred to, having
14 been previously marked for
15 identification as Petitioner's
16 Exhibit 104-P, was received in
17 evidence.)

18 BY MR. ALBRIGHT:

19 Q Dr. Doherty, have you reviewed Exhibit 104-
20 P, your report, since you prepared it?

21 A Yes.

22 Q And is there anything in the report at this
23 time that you would like to correct?

24 A I think I had one or two very minor typos.
25 I can't remember where they are now, but essentially

1 it's correct.

2 Q Okay. Dr. Doherty, can you tell me what
3 your assignment was in terms of preparing this
4 report.

5 A To look at the facts of the case in front
6 of us and determine, as an economist, whether this
7 constituted insurance.

8 Q And, Dr. Doherty, have you been recognized
9 by this Court in other cases as an expert?

10 A Yes, I have.

11 Q Could you speak to that, please.

12 A Oh --

13 MR. SCHEID: Objection, Your Honor. He's
14 already been qualified as an expert in this case.

15 THE COURT: I'll allow the question.

16 THE WITNESS: I've been in a number of
17 cases. I think the first one I was in was the Harper
18 case. I was in several others. One was called Black
19 Hills. Another was a case involving Sears and
20 Allstate. Securicor -- there are two or three. It's
21 several others as well.

22 BY MR. ALBRIGHT:

23 Q And you were recognized as an expert in
24 those cases?

25 A Yes, I was.

1 Q And did you reach a conclusion regarding
2 the -- this particular case in your report?

3 A Yes, I did. I used the criteria of whether
4 the facts of this suggested there was risk
5 distribution, risk transfer, and whether this would
6 be commonly accepted as insurance as that term is
7 normally understood. And on those criteria and using
8 my experience as an economist, I determined that this
9 was, in fact, insurance.

10 Q Dr. Doherty, have you written any books
11 concerning insurance?

12 A Oh, several. I've written -- I think my
13 first book was a risk management book. I've written
14 a book on -- two books on insurance pricing, one of
15 which was to do with the economics of insurance
16 pricing. The other one was to do with various
17 economic and actuarial models of insurance pricing,
18 and using the financial perspective to develop new
19 models of insurance pricing. That was cowritten with
20 an actuary. I've written other books on economics
21 which touch on insurance as well.

22 MR. ALBRIGHT: Your Honor, I pass the
23 witness.

24 MR. SCHEID: Good morning, Your Honor.
25 Just Scheid for Respondent.

1 CROSS-EXAMINATION

2 BY MR. SCHEID:

3 Q Good morning, Professor Doherty.

4 A Good morning.

5 Q Mr. Doherty, who's paying for your time for
6 the preparation of your report and the time for you
7 to testify in this case?

8 A The law firm which is employing me.

9 Q And what's the name of that law firm?

10 A It's The Feldman Law Firm.

11 Q Do you have an engagement agreement with
12 The Feldman Law Firm?

13 A Yes, I do.

14 Q And does that relate to just this case?

15 A It relates to a series of cases involving
16 Capstone member companies, member associates.

17 Q How many cases is that?

18 A Two so far.

19 Q Have you previously consulted for Capstone
20 under prior engagement agreements?

21 A Yes, I have.

22 Q And what were the nature of those
23 engagements?

24 A Just let me correct that. When you said,
25 previously consulted, I'm referring to the other

1 cases I just -- the other case I just said.

2 Q There's one prior case?

3 A There's one prior case involving a
4 particular company, which is in the Capstone program,
5 but I've also consulted about the Capstone program in
6 general, the general structure of it.

7 Q Okay. So just so I'm clear, you've
8 previously consulted on the Capstone program itself.
9 Correct?

10 A Yes.

11 Q And you've also previously consulted on one
12 other case, other than this current case.

13 A Yes.

14 Q Is that correct?

15 A That's correct.

16 Q Now, with respect to your consulting in the
17 prior Capstone arrangement, what was the nature of
18 that arrangement?

19 A To look at the overall arrangement, with
20 its various participating companies and to decide
21 whether that overall arrangement made sense as an
22 insurance structure. Did the economics of it make
23 sense? Would it be thought of as insurance by an
24 economist?

25 Q So is it essentially the same engagement as

1 it relates to this case, with the exception of the
2 specific facts of the reserve?

3 A Yes, it was. I would think this is a
4 special case of that more general engagement.

5 Q Okay. And when did that original general
6 consulting arrangement with Capstone start?

7 A Oh, gosh. I guess it was about three years
8 ago. I can't remember the exact year now.

9 Q And then you also specifically consulted on
10 one case akin to the case that we have at issue here?

11 A Yes.

12 Q Are the facts in that case generally the
13 same as the facts in this case?

14 A Very similar.

15 Q And you haven't consulted on any other
16 cases, other than that one prior case. Is that
17 correct?

18 A That's correct.

19 MR. SCHEID: Your Honor, I have a document
20 that I'd like to have marked for identification. May
21 I approach, Your Honor?

22 THE COURT: Yes, you may approach.

23 MR. SCHEID: (Handing document.)

24 THE CLERK: A memorandum from a Stewart
25 Feldman to Dr. Neil Doherty is marked as Exhibit 105-

1 R.

2 (The document referred to was
3 marked for identification as
4 Respondent's Exhibit 105-R.)

5 MR. SCHEID: And if the record would
6 reflect, I'm handing a copy of Exhibit 105-R marked
7 for identification to Petitioner's counsel. (Handing
8 document.)

9 May I approach, Your Honor, to hand a copy of Exhibit
10 105-R marked for identification to the witness?

11 THE COURT: Yes.

12 BY MR. SCHEID:

13 Q (Handing document.) Professor Doherty,
14 what I've just handed you is a copy of what's been
15 marked as Exhibit 105-R for identification. Do you
16 recognize this document?

17 A Yes, I do.

18 Q And this document was included in the
19 supplemental materials to your expert report in this
20 case. Is that correct?

21 A Correct.

22 Q And did you review this document in
23 connection with your preparation of your expert
24 report?

25 A Yes.

1 Q And if we look at just the first paragraph,
2 it states, if we look at Exhibit 105-R for
3 identification, the second sentence, they're asking
4 for a consulting arrangement, and this would be used
5 in two pending cases in U.S. Tax Court, Reservoir
6 Casualty Corp. and Connection Casualty Corp. Did I
7 ready that correctly?

8 A Yes, you did.

9 Q And so did you consult on both Reservoir
10 Casualty Corp. and Connection Casualty Corp.?

11 A I did not do any specific work on those
12 particular organizations. What this led to was a
13 general report on the Capstone program.

14 Q Okay. So that's the general report that we
15 just previously discussed.

16 A Yes.

17 Q While we're here, looking again at the same
18 language in Exhibit 105-R for identification, did you
19 prepare any reports with respect to Reservoir
20 Casualty Corp. or Connection Casualty Corp.?

21 A No.

22 Q I want to move on to your opening report.
23 In section 1(b) of your opening report, you define
24 insurance, and you define insurance as "a financial
25 arrangement in which contributions of multiple

1 parties, each exposed to the possibility of loss, are
2 used to compensate those that actually suffer loss."
3 Is that correct?

4 A That's correct.

5 Q Now, insurance, as you state, requires
6 multiple parties. Right?

7 A Yes.

8 Q And so a financial arrangement with a
9 single insured would not be insurance under your
10 definition. Correct?

11 A I wouldn't exclude that. There is a debate
12 about whether self-insurance is or is not insurance.
13 Some people would say yes; some people would say no.
14 So there's a little ambiguity there. But I'm being
15 conservative here and considering insurance that's
16 involving multiple parties.

17 Q Right. And that's your definition in your
18 opening report. Correct? Multiple parties. Right?

19 A That's right.

20 Q So you need at least two separate entities
21 to have an insurance arrangement. Right?

22 A Yes.

23 Q Now, if the reinsurer -- and in this case,
24 we know it's PoolRe. Right?

25 A Yes.

1 Q -- is related, so if PoolRe's related to
2 the insured, which is Reserve -- right? -- in this
3 case under the reinsurance arrangement?

4 A You mean -- when you say the reinsurance
5 arrangement, do you mean the arrangement by which
6 PoolRe cedes back insurance to the various member
7 companies of Capstone?

8 Q Right. And that would be the quota share
9 program. Is that right?

10 A Yes.

11 Q Okay. So if we focus on the quota share
12 program, we have PoolRe as the reinsurer. Correct?

13 A Yes.

14 Q And we have Reserve as the insured under
15 that arrangement. Correct?

16 A Well, not quite. Policies are insured both
17 with Reserve and with PoolRe, but the pooled policies
18 of the various member companies, which are insured
19 with PoolRe, are then ceded back to the various
20 captive companies.

21 Q So how would you define "insured" under
22 that arrangement?

23 A Insured?

24 Q They are the insured.

25 A No. The insured is Peak.

1 Q Under the reinsurance arrangement --

2 A Okay.

3 Q -- between PoolRe and Reserve, how would
4 you define Reserve?

5 A Reserve is the primary insurer essentially.

6 Q Okay. So let's go with that definition.

7 So if we call PoolRe the reinsured and Reserve as the
8 primary insurer -- correct? -- under the reinsurance
9 arrangement --

10 A Well, it's not quite like that. PoolRe is
11 not reinsuring Reserve. When a risk is being
12 allocated, part of the risk, the bottom part of the
13 risk, is allocated to Reserve, and the upper layer of
14 the risk is allocated to PoolRe. So technically
15 speaking, PoolRe is not reinsuring Reserve. It's
16 just a higher layer insurer. However, it then cedes
17 reinsurance back to Reserve and other captive
18 companies.

19 Q So maybe we can go about this a different
20 way then. If PoolRe were related to Reserve through
21 Capstone being the general manager for --

22 A Yes.

23 Q -- both entities -- do you agree with that
24 statement?

25 A Yes.

1 Q If that were the case, does that satisfy
2 your definition of insurance?

3 A Well, those arrangements are compatible
4 with my definition of insurance certainly.

5 Q Okay. So the relatedness through the
6 manager Capstone of PoolRe and Reserve doesn't impact
7 your opinion on whether this is insurance or not.

8 A That level of relatedness doesn't. I mean,
9 there's no ownership involved in that relationship.

10 Q What level of relatedness would impact your
11 opinion on insurance?

12 A Well, the relatedness is simply that
13 they're two insurers and taking different layers of a
14 risk, so they're related in the sense that they're
15 part of the same program. That's one aspect of the
16 relationship.

17 And a second aspect of the relationship is
18 that PoolRe is then ceding out insurance -- actually
19 this is really reinsurance now -- back to Reserve and
20 the other captive companies. Now, all the aspects of
21 the relationship I've just described are all parts of
22 a normal insurance relationship.

23 Q And the fact that Capstone manages both
24 PoolRe and Reserve doesn't impact your analysis. Is
25 that correct?

1 A No.

2 Q Does it impact your analysis?

3 A No, it doesn't impact my analysis.

4 Q Continuing with your definition of
5 insurance, you have the idea that each of these two
6 separate entities have to be exposed to the
7 possibility of loss. Right?

8 A Which two separate entities? PoolRe and
9 Reserve?

10 Q I'm stepping back from the PoolRe/Reserve.
11 I'm going back to your general definition of
12 insurance --

13 A Oh, okay. Got you.

14 Q -- which involves multiple parties, each
15 exposed to a risk of loss. Correct?

16 A Yes.

17 Q And so loss, that is important to insurance
18 companies?

19 A Yes. Clearly it's important to the
20 insured, because that's the reason the insured seeks
21 insurance, to get rid of the risk. The insurance
22 company is accepting the possibility of loss.

23 Of course, it's then going to diversify
24 that risk in various ways, so it is exposed to the
25 loss in the sense that that diversification process

1 is never pure and idealized in the sense that the
2 risk totally vanishes. So in that sense, yes, the
3 insurance company is also subject to some sort of
4 loss.

5 Q So loss then is important to the insured
6 because it gives them a history of what their prior
7 risk is. Correct?

8 A That's not part of my definition.

9 Q I'm following up on what you just said.
10 You said loss history is important to the insured.

11 A I never mentioned loss history. What I
12 said was that -- your first question is about the
13 possibility of loss to both parties, the insured and
14 the insurer, is important.

15 Q Right.

16 A I said, yes, it's important to the insured,
17 because that's the reason for seeking insurance. The
18 insurance company has the possibility of loss because
19 it accepts the risk. Whether it's actually subject
20 to a loss when it combines those risks depends on the
21 completeness of diversification.

22 Q Okay. And that goes to your purpose about
23 homogeneity of losses. Is that correct?

24 A I never mentioned homogeneity at all.

25 Q In your report, I'm saying. In your

1 report, you mention homogeneity. Does that go to
2 homogeneity?

3 A Well, that was an illustration of how you
4 could diversify a risk, but only an illustration.

5 Q Okay. All right.

6 A It wasn't a necessary condition for
7 diversification or for pooling.

8 Q All right. Now, getting back to the loss
9 discussion, loss data allows insurance companies to
10 create rates. Is that correct?

11 A Yes.

12 Q And are premiums computed upon loss data?

13 A To the extent that loss data are available,
14 you would use them in computing premiums. Yes.

15 Q Okay. Now, turning to your report -- we're
16 going to move away from that -- at page 17 -- and
17 this is -- again, we're referring to your report,
18 Exhibit 104-P. You note in your report that the loss
19 histories are rather what you call sparse for members
20 of the Capstone program. Right?

21 A Yes.

22 Q And the lack of loss history impacts your
23 ability to show how much reduction is really achieved
24 for each of the members of the Capstone program. Is
25 that correct?

1 A That's correct.

2 Q And you state at page 17 in your report
3 that you cannot give precise estimate of the degree
4 of risk reduction achieved in this program. Right?

5 A Yes. And that's not to say there can't be
6 any estimates of the amount of loss reduction -- risk
7 reduction. It's simply to say that in the -- with
8 the paucity of data, you're not going to get accurate
9 estimates of the amount of loss reduction.

10 Q Turning away from that, let's turn to
11 something else. The Capstone program, you reviewed
12 the insurance binders in this case. Is that correct?

13 A Yes.

14 Q And the Capstone program here involves a
15 single premium for all three of the named insureds.
16 Correct?

17 A I understand that's correct. Yes. Can I
18 just qualify that slightly?

19 Q No, you may not. There's no question
20 pending.

21 A Oh, I'm sorry.

22 Q If you'll turn back to your report, which
23 is 104-P, at page 9, section 1(c), you have a
24 discussion on homogeneity.

25 A Yes.

1 Q And previously you've given some examples
2 in your report, and with respect to those examples,
3 you state that you assume the risks are homogeneous.
4 Correct?

5 A Yes.

6 MR. SCHEID: Your Honor, I have a document
7 that I'd like to have marked for identification. May
8 I approach, Your Honor?

9 THE COURT: Yes.

10 MR. SCHEID: (Handing document.)

11 THE CLERK: Document titled, Policies in
12 pool by policy type, 2008, will be marked as Exhibit
13 106-R.)

14 (The document referred to was marked for
15 identification as Respondent's Exhibit
16 106-R.)

17 MR. SCHEID: Let the record reflect I'm
18 handing a copy that's been marked as Exhibit 106-R
19 for identification to Petitioner's counsel.
20 (Handing document.)

21 May I approach, Your Honor, to hand the witness a
22 copy of what's been marked --

23 THE COURT: Yes.

24 MR. SCHEID: -- as 106-R for
25 identification?

1 BY MR. SCHEID:

2 Q (Handing document.) Professor Doherty,
3 I've just handed you what's been marked as Exhibit
4 106-R for identification. This is a group exhibit.
5 It consists of policies in pool by policy type for
6 2008, 2009, and 2010. This was attached as a
7 supplemental exhibit to your opening report. Is that
8 right?

9 A Yes.

10 Q And you reviewed this in preparing your
11 opening report?

12 A Yes, I did.

13 Q If we could just go through each of these
14 policies in a little bit of detail, now, these are
15 the -- when we say policies in pool by policy type,
16 these are the policies in the PoolRe entity.
17 Correct?

18 A I understand that's correct. Yes.

19 Q And so if we look at just the first
20 coverage, this is auto gap. It's the third coverage
21 down. There's one policy in PoolRe with that
22 coverage. Is that correct, in 2008?

23 A Yes.

24 Q And the same with errors and omissions,
25 there's one policy in 2008 in PoolRe.

1 A Correct.

2 Q And excess liability following form,
3 there's one policy in PoolRe in 2008.

4 A Yes.

5 Q And if we continue on with product pricing
6 insurance deal, products errors and omissions,
7 professional liability gap, reps and warranties,
8 special risk commercial chiropractic medical or
9 malpractice gap, special risk commercial garage gap,
10 those are all single policies in PoolRe. Correct?

11 A Correct.

12 Q And if we continue with special risk
13 commercial umbrella, special risk excess policy,
14 special risk labor relations, special risk -- let's
15 see -- continue to the next page, special risk OCIP
16 policy, special risk property extensions, special
17 risk repossession expense, special risk warranty,
18 these are all single policies in PoolRe. Correct?

19 A Correct.

20 Q I don't need to belabor the point in going
21 to 2009 and 2010. But when you have a single policy
22 in PoolRe for each of these coverages, how is there
23 any homogeneity?

24 A By definition, there can't be homogeneity
25 in one policy, but I'm not relying on homogeneity to

1 say whether there's insurance or not. In fact, I
2 would never rely on homogeneity to say whether
3 there's insurance.

4 I should also point out here that for many
5 of the other policies here, there are multiple
6 policies in the program, things like directors and
7 officers, and so on. There are many policies of that
8 type. So this is a mixture. Some types of policies,
9 there are single policies. Some types of policies,
10 there are multiple policies, we have a mixture of
11 single things, multiple things, all combined together
12 in this pool.

13 Q But you're not relying on homogeneity at
14 all in connection with your opinion. Correct?

15 A Not in deciding whether this is insurance
16 or not. I've not heard that requirement imposed on
17 whether insurance exists by anyone short of the
18 current circumstances.

19 MR. SCHEID: Thank you, Your Honor. No
20 further questions.

21 THE COURT: Mr. Albright and Mr. Scheid,
22 before I let you question, I have a couple of
23 questions for Dr. Doherty.

24 MR. ALBRIGHT: Sure.

25 THE COURT: My questions are pretty basic,

1 but I just want to make sure I have a understanding
2 of this. On page 4 of your opening report, at the
3 end of the second to last paragraph, you talk, "In
4 addition, PoolRe insures a pool of vehicle service
5 contracts of unrelated parties, and this pool is
6 reinsured back to Reserve and the other captives in
7 the Capstone Group."

8 And in your report you have -- also have
9 some documents, Figure 2 and Figure 3. Could you
10 just kind of walk through how this arrangement, this
11 type of arrangement would work.

12 THE WITNESS: Can we do it sequentially in
13 terms of the figures --

14 THE COURT: Yes, yes.

15 THE WITNESS: -- 1, 2, 3? Figure 1
16 describes the Capstone program as was just described
17 by the counsel, that you've got the Capstone program
18 which involves PoolRe and involves various companies
19 which are members of this program.

20 Each of the member captive companies is
21 owned by someone else, so -- and in this particular
22 case, Peak owns Reserve. So Reserve is an insurance
23 company. So in Figure 1, the related operating
24 businesses would be companies like Peak. The captive
25 insurance companies would be companies like Reserve.

1 So the first layer insurance, that red
2 arrow on the top, shows the contract by which the
3 bottom layer of insurance for Peak's risks is insured
4 by Reserve, and, of course, other companies in the
5 program are doing the same thing. I think you've got
6 50 companies or so doing the same thing.

7 At the same time, if you go back to the
8 operating companies like Peak, you see an arrow going
9 down in a northeasterly direction, saying, Second
10 layer insurance stop loss. Now, what's happening
11 here is that for Peak, it might have decided that the
12 first -- I'm just plucking a number out of the air
13 now -- the first million dollars of that loss are
14 going to be insured with Reserve, and anything over a
15 million dollars is then insured with another
16 insurance company, PoolRe, which is this company
17 which is insuring all the second layers of all 50
18 operating companies.

19 And this is kind of normal in the insurance
20 practice. You'll often get a risk being placed with
21 several insurance companies in the form of layers.
22 The first layer is insured with one insurance
23 company, the second layer with another insurance
24 company, and that's known as layered insurance.

25 Now, PoolRe has taken on lots of these

1 second-layer companies insurances from companies like
2 Peak, so it has a portfolio of these second layers.
3 And then you'll see quota share reinsurance has a red
4 arrow pointing to the northeast now, going back to
5 the captive, which is companies like Reserve.

6 So what PoolRe is doing is sort of blending
7 all these risks together and reinsuring them back to
8 the captives on a proportionate basis. So, now, each
9 captive insurance company is getting the first layer
10 of insurance of its owner company, and it's getting -
11 - well, using the number 50, if there are 50 member
12 companies, it's getting one-fiftieth of the combined
13 second-layer insurances of all the member companies.

14 So the captive now has a blended portfolio.
15 It's got a chunk of the owner's risk, plus a small
16 share of the total risk of all the member companies
17 in the Capstone program. So that's the first part of
18 the arrangement.

19 Now, the second part of the arrangement,
20 this comes in under the unrelated Capstone members,
21 and what's happening here is the PoolRe is taking on
22 insurance from two types of entities. It's doing
23 what I suggested a moment ago. It's taking the
24 insurance more like the captives, the second layer of
25 that, but it's also then taking on insurance from

1 outside parties, parties totally outside the captive
2 insurance arrangement.

3 And when you referred to these vehicle
4 service contracts, this is what I'm talking about. I
5 think at different times in the captive program, it's
6 been different types of policies. I think they've
7 taken some credit risk as well at different times.
8 So this is also insured by PoolRe, and then PoolRe
9 will take this blended portfolio of risk and then
10 cede it back to the captives like Reserve.

11 So what the captives end up with is three
12 types of insurance in their portfolio. They have
13 the bottom layer of insurance from the owner
14 companies, sister companies. They have the blended
15 insurance, the higher layers of all the other member
16 companies in the captive program, and they have
17 roughly a one-fiftieth share in that, an average of
18 one-fiftieth share. And in addition, they have a
19 share of this outside business. So you have this now
20 composite portfolio in each of the captives.

21 THE COURT: Is the share of outside
22 business, I mean, is where I wanted more detail,
23 because I wasn't sure if the captives, when it goes
24 back from PoolRe, are the captives providing some
25 insurance if something happens to one of this -- like

1 one of the vehicle service contracts?

2 THE WITNESS: What had happened here is
3 that whoever's insuring with PoolRe these vehicle
4 service contracts, they're reinsuring PoolRe, if
5 something happened on one of those contracts, they'd
6 lodge a claim, and if the claim then was sufficient
7 to trigger this PoolRe reinsurance arrangement, then
8 PoolRe is sort of on the hook for that.

9 But then PoolRe has reinsured that risk
10 back to the captive, so ultimately that would fall
11 back on the captive, and the captive would ultimately
12 be bearing that risk.

13 THE COURT: All right. That's what I
14 wanted to be clear, that the captive is bearing the
15 risk for the unrelated insurance.

16 THE WITNESS: Yes. It's bearing the risk
17 for the unrelated insurance. It's bearing the risk
18 for the other -- part of the risk for the other
19 member companies, and it's bearing the risk of its
20 owner as well.

21 THE COURT: All right. Then my other
22 question was having to do with company -- just from
23 your experience, companies that set up captive
24 insurance companies. Do they usually also keep
25 existing insurance policies, or sometimes is this

1 captive insurance used because they're having trouble
2 getting insurance?

3 THE WITNESS: I'm not sure there's even a
4 typical case of captive insurance. There's such a
5 variety of circumstances. But it's quite common for
6 a company that sets up the captive to place some
7 insurance in the external unrelated marketplace, some
8 insurance in the captive, and there can be various
9 reasons for that.

10 One reason might be that it does have a
11 sufficient number of internal exposures. You know,
12 if you imagine a fleet of trucks or something like
13 this, it's got sufficient diversification internally
14 that it can actually put this in a captive, and then
15 -- but then it will usually blend that the captive
16 will usually take on outside insurance as well and
17 blend that. So it's not uncommon for a company to
18 have outside insurance and captive insurance.

19 Or it could be simply that the marketplace
20 for some of the risk of the company is just so thin
21 and prices or availability is such a problem that
22 they establish a captive and use that process.

23 THE COURT: And when you -- or some of your
24 questions with Respondent's counsel, how there wasn't
25 enough, you know, history of losses, was it from when

1 you looked at -- just to be clear, without a history
2 of losses, how was it hard to know that the right
3 premiums are being paid and there's enough in the
4 captive insurance companies to cover the loss, or
5 there's also enough in PoolRe to provide the second
6 layer that's going from the captive -- going from
7 PoolRe to the captives?

8 THE WITNESS: Well, first of all, I mean,
9 I'm not an actuary, and I haven't done an actuarial
10 analysis to show whether the reserves are precisely
11 accurate, and I haven't done a precise premium
12 calculation on any of these. But it's normal in
13 insurance to have a range of situations.

14 You know, if you're thinking about
15 something like auto insurance, we have large
16 databases. We have lots of loss history, and it's
17 fairly easy to come up with rates. And then, you
18 know, auto insurance is not homogeneous. You know,
19 there are different people with different levels of
20 probability of an accident. So there's enough data
21 then to even classify the rates according to
22 different circumstances and different features of the
23 policyholders.

24 Now, that's one extreme. Now, the other
25 extreme, you'll have a risk, you know, something I've

1 been involved in, is, say, insurance of satellites or
2 terrorism insurance. Terrorism insurance obviously
3 became the issue after 2001. There was an insurance
4 market. It was a pretty thin market at first for
5 terror insurance. But we don't have large databases
6 on terrorism attacks.

7 So we can't use a big loss history to
8 calculate the probability of a loss or to calculate a
9 premium. So we have to use other methods, you know.
10 We have to think about expert judgments about this.
11 How does this risk relate? Is it more or less than
12 some other risk where we know the value of that risk?

13 So we use other less formal techniques to
14 try and get at rates. Now, obviously, there's a
15 bigger margin of error in those rates. I can't say
16 those rates are always 100 percent accurate or even
17 90 percent accurate, and you win on some and lose on
18 the others. But, you know, that's normal procedure.
19 And we've got a whole spectrum in between those two
20 extremes.

21 THE COURT: And I think this is my last
22 question. On the PoolRe, where you explained -- I'm
23 looking at Figure 1 -- on the blended pool premiums,
24 and that's based by looking at the Capstone members,
25 and you talked about the one in 50 of that. Should

1 those -- should there be diversification among those
2 related Capstone, or is it -- I was unclear sometimes
3 when referring to diversification if you're talking
4 about the history of the -- the different liens of
5 the policies or diversification of the different
6 types of companies that are part of this.

7 THE WITNESS: I'm talking diversification
8 in the sense that each of those member companies has
9 various types of risks, has liability risks, has
10 property risks, et cetera. They're going to insure
11 those risks, and part of those risks are going to go
12 to PoolRe. So I can't remember offhand how many
13 policies there are. There are several hundred
14 policies in that.

15 Now, the question is: Those policies are
16 separately exposed to the possibility of having
17 claims. They may not be entirely independent, but,
18 you know, if Peak has a claim on its liability
19 policy, that's probably unconnected whether another
20 member such as Marylebone has a claim on its property
21 policy.

22 Now, these are separate events, and when I
23 talk about diversification now, I mean that by
24 holding a number of these policies, losses on each of
25 the policies are sort of random events, so that the

1 overall risk to PoolRe from the collection of
2 policies is somehow washed out. You know, you win on
3 some; you lose on the others. And you get at least
4 some level of predictability and risk reduction.

5 You know, it's not the same level as risk
6 reduction as Allstate does when it insures a
7 portfolio of many million, tens of millions of cars.
8 It's not at that level, but nevertheless, you would
9 get very significant risk reduction in a pool like
10 this.

11 THE COURT: I actually do have one more
12 question just to clarify. This is just a
13 hypothetical and I'm looking -- if you had a related
14 operating business, and they went for -- they had a
15 sudden claim against an unexpected accident, and they
16 went to their captive, and the accident was 2
17 million, and from their captive insurance, they --
18 I'm just making up round numbers here -- their
19 captive insurance gave them 1 million. So then
20 they'd go to the PoolRe to get the second million.

21 THE WITNESS: Yes. And then that second
22 million -- in the first instance, PoolRe would be
23 responsible for that. However, PoolRe has then
24 insured that loss with all the other --

25 THE COURT: Right. So --

1 THE WITNESS: -- captive companies.

2 THE COURT: So PoolRe could go -- that was
3 the -- I was going to follow up after -- all right.
4 So PoolRe could go back -- I'm using 50, because that
5 was the number -- could go back to the 50 companies,
6 and they'd all have to pay -- would PoolRe pay any of
7 that million, that second million, or do they go back
8 for all that 1 million to the 50 companies?

9 THE WITNESS: They go back for all the 1
10 million to the 50 companies, so Reserve -- it might
11 be exactly one-fiftieth, because -- but on average,
12 it'd be one-fiftieth each.

13 THE COURT: And I'm just speaking in --
14 these numbers, I'm just using this as a hypothetical.

15 THE WITNESS: Yes.

16 THE COURT: Okay. That was my questions.
17 Mr. Albright.

18 REDIRECT EXAMINATION

19 BY MR. ALBRIGHT:

20 Q Dr. Doherty, Respondent's counsel asked you
21 about use of captive insurance managers. Are you
22 familiar with that?

23 A Yes.

24 Q And in the case of captive insurance
25 companies, is it customary for a captive insurance

1 company to have a manager or a management company?

2 A It's common. I wouldn't say it's
3 customary. Some have managers; some don't. So a
4 large Fortune 500 company may not have a captive --
5 an outside captive manager. But small companies
6 obviously don't have the inside expertise and
7 probably would have a captive manager.

8 Q And in -- as you're -- based on your
9 familiarity with the use of a captive insurance
10 manager, what does a captive insurance manager do?

11 A It can be various thing. It can be the
12 usual functions of an insurance company from setting
13 premiums, managing reserves, paying claims, et
14 cetera. It can be those things. It can be also
15 setting up a feasibility study in the first place.
16 So it would be the usual functions of an insurance
17 company, because those skills aren't available in-
18 house.

19 Q And I believe that Respondent's counsel
20 also asked you about insurance policies that set a
21 single premium for more than one insured. Do you
22 remember that question?

23 A Yes.

24 Q If you have a number of related companies,
25 in your experience, have you seen insurance policies

1 that are written with -- that cover the related
2 companies collectively?

3 MR. SCHEID: Objection, Your Honor. It's
4 very leading.

5 THE COURT: I'm going to allow the
6 question.

7 THE WITNESS: I'm a little unsure about the
8 question. Can you repeat it.

9 BY MR. ALBRIGHT:

10 Q So let's say you have a company, and it has
11 some subsidiaries.

12 A Yes.

13 Q And it goes to get -- to purchase
14 insurance.

15 A Yes.

16 Q Have you encountered situations in your
17 experience where the company would obtain a policy
18 that covered all of the insureds in the same policy?

19 A You mean, all the predecessor companies?

20 Q Yes.

21 MR. SCHEID: Objection, Your Honor. Again,
22 it's a leading question.

23 THE COURT: I'm still going to allow the
24 question.

25 THE WITNESS: Yes. I've seen situations

1 where both the principal company in the group and the
2 subsidiaries are insured on a single policy. Yes.

3 BY MR. ALBRIGHT:

4 Q Would you believe that that would be
5 unusual to do it that way?

6 A Not at all.

7 Q Now, Respondent's counsel asked you about
8 homogeneity.

9 A Yes.

10 Q Can you explain what that is.

11 A Homogeneity means that if you have a number
12 of policies, each of the policies is covering the
13 risk of a loss. What homogeneity means is that each
14 of those losses has to have the same chance of
15 happening, what a statistician or an actuary would
16 say with the same distribution of possibilities of
17 happening, so, you know, if we're talking about
18 automobiles, your chances of crashing your car and
19 the value of the car are the same as mine and the
20 same as everybody else's. That's what homogeneity
21 means.

22 So that the expected value of the claim
23 payment from the insurance company is exactly the
24 same for every individual in that. Now, what we
25 normally do when we're illustrating what insurance is

1 about is give a little example where we've got a lot
2 of policies and they're all the same, and we can see
3 the effectiveness of risk pooling, because it means
4 that the risk is --

5 There's an expression. The risk falls
6 lightly on the insurance company, because it's going
7 to going to win on some and lose on the others. It
8 can predict its aggregate losses very carefully.
9 That's what homogeneity means. One never encounters
10 it in practice. There are degrees of deviations from
11 that.

12 Q So could you explain why you never
13 encounter that in practice.

14 A Simply because no two things are the same.
15 You know, I guess the closest you're going to get to
16 this insurance is -- in insurance is something like
17 life insurance, where every life insurance policy
18 covers someone's death. So the policies are
19 identical in that sense, but each of them covers the
20 possibility of someone dying.

21 But what we're concerned about when we're
22 writing insurance is the future value of that
23 liability to the insurance company. You know, what's
24 the probability of each person dying? And this, of
25 course, varies, you know. It varies according to

1 age. It varies according to health. It varies
2 according to gender. It varies according to, you
3 know, social habits, all sorts of things.

4 So what you've got, even in a life
5 insurance portfolio, is a mixture of different
6 things, so then we have to look at the data and
7 calculate the premiums, with adjustments for those
8 differences. And from there upwards, I think, things
9 get more and more mixed bags.

10 Q Could you explain what you mean by that.

11 A You know, if you look at, say, commercial
12 fire insurance, commercial fire insurance covers
13 everything from the fire risk to the mom-and-pop shop
14 around the corner to the fire risk from Monsanto
15 Chemicals. They're all in the same portfolio, and
16 they're all called fire risks. Yet the claims cost
17 to the insurance companies are orders of magnitude
18 different.

19 So, you know, there's no -- not even
20 anything approximately close to homogeneity in a
21 portfolio like that. And then you get reinsurance
22 companies where they're insuring different lines of
23 insurance in the same reinsurance portfolio.

24 Q So is there a difference between the person
25 who does the loss forecasts and an underwriter, for

1 example?

2 A The actuary typically does the loss
3 forecast, to the extent that there's data. If
4 there's paucity of data, then actuaries might make a
5 stab at it, but then loss forecasts may be
6 supplemented by judgments of underwriters. You know,
7 they might start with the actuaries' estimates based
8 on poor data and then in their experience, do they
9 think this is greater than the crude forecasts or
10 less than the crude forecasts. So underwriters
11 sometimes enter into the loss estimate process.

12 But formally speaking, the actuary is the
13 first line. Now, when you get to situations where
14 there is no data at all, you know, something such as
15 terrorism insurance in the early 2000s or even now,
16 or satellite insurance in the 1990s,
17 there's virtually no data there, so, you know,
18 actuaries obviously can't be employed, and you get
19 presumably in those circumstances, underwriters,
20 technicians, you know, scientists, all making
21 judgments about the likelihood of certain things
22 happening, and therefore, the required premiums.

23 Q And I believe you said you would never rely
24 on whether there's homogeneity in determining whether
25 there's insurance. Did you say that?

1 A Yes.

2 MR. ALBRIGHT: May I have a moment, Your
3 Honor?

4 (Pause.)

5 MR. ALBRIGHT: Pass the witness, Your
6 Honor.

7 MR. SCHEID: Just a brief, I guess,
8 redirect, Your Honor -- or recross. I'm sorry.

9 REXCROSS-EXAMINATION

10 BY MR. SCHEID:

11 Q Focus first on your responses to the
12 Court's questions. In response to one of the Court's
13 questions, you mentioned an entity, Marylebone.

14 A Marylebone.

15 Q Marylebone. Is that an engagement that you
16 had with Capstone as well?

17 A Yes.

18 Q And did you prepare a report in the
19 Marylebone case?

20 A Yes, I did.

21 Q Okay. So when I asked you previously
22 whether you had prepared reports in any other cases,
23 was that the one other case that you were
24 referencing?

25 A Yes, it was.

1 Q You also mentioned in response to the
2 Court's questions to -- as it relates to
3 diversification, you mentioned that you were looking
4 at diversification also in the context of the member
5 companies to the captives. Did I understand that
6 correctly?

7 A Yes.

8 Q Did you review all of the captives in the
9 underlying companies in PoolRe?

10 A No.

11 Q The Court also, as we were going through
12 the figures to the report, Figure 1, I think, asked
13 about sort of the normalcy of this arrangement. Do
14 you recall that?

15 A Yes.

16 Q And you said this arrangement is a normal
17 arrangement. Is that right?

18 A I don't think I said that.

19 Q So this arrangement isn't a normal
20 arrangement?

21 A This is a particular arrangement here to
22 satisfy a particular risk management need. What I
23 said was a normal arrangement is for a situation
24 where a company will insure one layer of risk with a
25 primary insurer and then a second layer of risk with

1 another primary insurer on top of that, so, in fact,
2 you might get multiple layers. What I was saying,
3 that's a normal arrangement.

4 Q Okay. What's the particular risk
5 management need here, reflected in Figure 1?

6 A The risk management need here is you have
7 all these operating companies which are exposed to
8 risks. Some of those risks are farmed out to the
9 outside insurance market, but because they don't like
10 risk, they don't like uncertainty, and some of those
11 risks are difficult to place in the outside market,
12 they've sought another solution, and this is the
13 solution.

14 Q Okay. But you didn't review all the other
15 operating companies. Right? You just said.

16 A I didn't review them in the sense of
17 individually reviewing them. I reviewed the Capstone
18 program in general.

19 Q Okay. Going sort of along that line of
20 normal and because you did review the Capstone
21 program in general -- right? Is that correct?

22 A Yes.

23 Q How normal is it for the captive insurance
24 company here in Figure 1 and PoolRe to have the same
25 manager?

1 A If you mean by normal, how frequent is it,
2 I can't tell you how frequent it is. It doesn't
3 strike me as being an unusual solution, given the
4 circumstances we're trying to solve here, the risk
5 management problems we're trying to solve. It
6 doesn't sound to me unusual.

7 Q So outside of the Capstone program and your
8 other experience in insurance, have you ever seen a
9 captive insurance company and a reinsurer managed by
10 the same manager?

11 A Well, all the captive programs I've seen
12 have all been different. They've all been tailor-
13 made to specific circumstances. I haven't come
14 across one precisely like this. No.

15 Q So outside of the Capstone program, you've
16 never seen a captive insurance company managed by the
17 same manager as the reinsurer. Is that correct?

18 A I haven't reviewed a program which is quite
19 like this before, so, you know, I haven't come across
20 a case which is precisely like this. No.

21 Q So the answer is you've never seen a
22 captive insurance company and a reinsurer managed by
23 the same manager. Right?

24 A I stick by my previous answer, which is --

25 Q Which is --

1 A -- on record.

2 Q Which is yes. Right?

3 A I said I've not seen precisely this set of
4 circumstances and this solution.

5 Q Now, continuing on that line of normalcy,
6 when we look at the captive insurance companies, how
7 normal is it for all the captive insurance companies
8 to be managed by the same manager?

9 A Part of the problem I'm having is with the
10 use of the word "normal." By normal, do you mean
11 frequent, or by normal, do you mean is this a
12 rational solution to a particular problem? Is it
13 what people --

14 Q I'm --

15 A -- wouldn't normally come up with, given
16 these circumstances?

17 Q How would you define "normal"?

18 A It could be either of those. In the second
19 interpretation, I would think, given these
20 circumstances, this is a sensible arrangement. A
21 normal risk management person might very well come up
22 with an arrangement like this.

23 Q Okay. So using your definition of normal,
24 how normal is it for a captive insurance company to
25 be -- for all the captive insurance companies to be

1 managed by the same manager?

2 A I just told you. I think it would be a
3 normal response to come up with a solution like this,
4 given these circumstances. It would be consistent
5 with my economic interpretation of what's going on,
6 so in that sense, it would be normal. Now,
7 quantifying normal is somewhat difficult. I've
8 simply said it's normal.

9 Q So let's look at it a different way.
10 Outside of the Capstone program, which you've
11 reviewed in detail, have you ever seen all of the
12 captives in a reinsurance pool managed by the same
13 manager?

14 A Well, I've not come across a case with
15 these circumstances, so, no, I haven't seen it.

16 Q The Court asked a little bit about PoolRe
17 and how PoolRe would pay claims. Do you recall that
18 line of questioning?

19 A Yes.

20 Q Have you seen anything to indicate that
21 PoolRe paid any claims on the coverages at issue in
22 the case?

23 A I haven't reviewed the loss data, but
24 PoolRe wouldn't be the ultimate repository of risk
25 here. The ultimate repository of risk would be the

1 captive companies themselves, so --

2 Q Have you seen anything to indicate that the
3 captive companies paid any claims under the insurance
4 arrangements at issue here?

5 A When you say -- do you mean Reserve in
6 particular?

7 Q I mean -- we'll take Reserve in particular
8 first.

9 A I don't recall seeing Reserve in particular
10 paying.

11 Q How about any of the other captives?

12 A I can't remember the loss history here.

13 Q So if I turn just very briefly to the
14 questions asked by Petitioner's counsel, he asked you
15 about what a captive manager is. Do you recall that
16 --

17 A Yes.

18 Q -- question? Are you familiar with captive
19 consultants?

20 A Various terms are used. There's captive
21 consultants, captive promoters, captive managers. I
22 never quite know what people mean in a particular
23 context.

24 Q Is there a difference in your mind between
25 a captive consultant and a captive manager?

1 A A consultant would typically be a person
2 who advises but doesn't take an active part in
3 running the program. A captive manager would take an
4 active part in, as the term suggests, managing the
5 program.

6 Q Have you seen situations outside of the
7 Capstone program where the captive manager both
8 advises and prepares the feasibility study and does
9 the background documentation, but then also manages
10 the captive?

11 A Yes, I have.

12 Q Under what circumstances?

13 A I can think of one or two cases. They were
14 very dissimilar to this, in the sense that there
15 wasn't a program where various captives blended their
16 risks together, but situations where you had a
17 smaller company or a medium-sized company that's
18 established a captive. The captive insures obviously
19 the parent's risk, but it also insures outside risk,
20 and that program has been evaluated and managed by an
21 outside party.

22 Q Petitioner's counsel also asked you about
23 the premiums. As we're well aware now, there's a
24 single premium for the three named insureds --

25 A Yes.

1

2 Q -- in this case. Correct?

3 A Yes.

4 Q And you mentioned, I think, in response
5 that you've seen that in the context of subsidiaries,
6 where there's a single premium. Right?

7 A Yes.

8 Q Are ZW and RocQuest subsidiaries of Peak?

9 A I'm not entirely sure what their legal
10 status is, whether they're subsidiaries, whether
11 they're affiliates. I'm not entirely sure.

12 Q Have you ever seen a single premium being
13 issued where the companies are not subsidiaries?

14 A Where they're affiliates, in other words?

15 Q Where they're not subsidiaries.

16 A I've since a single premium used when
17 they're very closely related, where the ownership
18 structure is all tied together. Now, there are
19 various ways of doing that. I've seen variations on
20 that theme.

21 Q And what are the ways of doing that?

22 A The ways of having organizational
23 structures where they're very closely related?

24 Q No. What are the ways of having a single
25 premium when they're not subsidiaries?

1 A You charge a single premium. I'm not sure
2 what the question is. You have a single premium, and
3 that covers the entities in that family.

4 MR. SCHEID: If I may have just a moment,
5 Your Honor --

6 THE COURT: Yes.

7 (Pause.)

8 MR. SCHEID: No further questions, Your
9 Honor.

10 MR. ALBRIGHT: No further questions, Your
11 Honor.

12 THE COURT: Okay. And we're going to go
13 off the record for a second.

14 (Whereupon, a short recess was taken.)

15 THE COURT: Mr. Albright, are you done with
16 Dr. Doherty?

17 MR. ALBRIGHT: Your Honor, we've considered
18 whether to offer the rebuttal report, I guess,
19 conditionally on Mr. Riggin's report being admitted
20 later in the trial, and given Dr. Doherty's family
21 situation -- he has a family emergency -- Petitioner
22 believes that it makes sense to go ahead and put the
23 rebuttal report in the record as the Court suggested
24 and Respondent's counsel agreed, as I understand it.

25 But we would like to not totally close the

1 door on bringing him back if we decided that we
2 needed to. I don't think we will, but I would just
3 like to keep the option open.

4 MR. SCHEID: Your Honor, Respondent has no
5 objection to that.

6 THE COURT: All right. That's fine.

7 MR. ALBRIGHT: So may I --

8 THE COURT: Yes. You may proceed.

9 MR. ALBRIGHT: Your Honor, may I have a
10 copy of this --

11 THE COURT: Yes.

12 MR. ALBRIGHT: -- report marked for
13 identification as Petitioner's exhibit next in order?

14 THE COURT: Yes, you may approach.

15 MR. ALBRIGHT: (Handing document.)

16 THE CLERK: The rebuttal expert report of
17 Donald Riggin is marked for identification as Exhibit
18 107-P.

19 (The document referred to was marked for
20 identification as Petitioner's Exhibit
21 107-P.)

22 MR. ALBRIGHT: Your Honor, may I provide a
23 copy of the document that's been marked for
24 identification as Exhibit 107-P for identification to
25 Dr. Doherty?

1 THE COURT: Yes.

2 FURTHER REDIRECT EXAMINATION

3 BY MR. ALBRIGHT:

4 Q (Handing document.) Dr. Doherty, do you
5 have a copy of Exhibit 107-P in front of you there?

6 A Yes.

7 Q And are you familiar with Exhibit 107-P?

8 A Yes, I am.

9 Q Can you tell me what Exhibit 107-P is.

10 A It's a rebuttal report which I wrote
11 recently. It actually addresses the expert witness
12 report of Mr. Riggin.

13 Q Okay. And that expert report, your
14 understanding, was filed in this case --

15 A Yes.

16 Q -- or submitted in this case?

17 A Yes.

18 Q And if you'll look -- okay.

19 MR. ALBRIGHT: Your Honor, I offer this
20 report in evidence.

21 MR. SCHEID: Your Honor, Respondent has no
22 objection to the admission of 107-P marked for
23 identification in evidence.

24 THE COURT: 107-P is admitted, and it's
25 conditionally admitted to the admission of Dr.

1 Riggin's report. Thank you.

2 (The document referred to, having been
3 previously marked for identification as
4 Petitioner's Exhibit 107-P, was received
5 in evidence.)

6 BY MR. ALBRIGHT:

7 Q Dr. Doherty, could you briefly summarize
8 your conclusions that you make in this report for the
9 Court.

10 A I have certain disagreements with the
11 analysis of Mr. Riggin. Much of that concerned the
12 requirement in his report that you needed a portfolio
13 of homogeneous and independent risks to have
14 insurance. That objection was really based on two
15 general principles, one of which is that insurance
16 portfolios are never homogeneous and they're never
17 independent.

18 They invariably comprise policies or risks
19 which are different to different degrees. Some of
20 them are more or less similar. Some of them are very
21 dissimilar. So when we talk about insurance, it's
22 really all about combining the risks of different
23 parties into a pool, such that the predictability of
24 the pool allows the insurer to operate with a certain
25 amount of financial stability and all the insureds

1 have off-loaded their risk onto the insurance
2 company.

3 In my experience both as a teacher and a
4 consultant and some experience both as a broker and
5 an underwriter, I've never seen a requirement for the
6 characterization of insurance that the risks must be
7 homogenous and independent.

8 Another part of that objection is that the
9 objection seems to be based on the lore of large
10 numbers, and the lore of large numbers is the
11 mathematical principle which says that when you do
12 have homogenous and independent events and you pool
13 them all together, the average loss in that pool gets
14 very, very close to a constant figure, so it's very
15 predictable. And that's essentially the principle
16 upon which insurances seem to work.

17 Now, that's just the sort of first
18 approximation for explaining insurance. All the real
19 work in terms of figuring out what happens in a
20 portfolio is all about the deviations. It's all
21 about the degrees of differences. It's all about the
22 degrees of correlation. So, you know, when we do any
23 real-life problem, we always recognize that things
24 are not homogenous, and we look at how the pool
25 functions, given the differences in the pool.

1 So to have insurance, you need a pool of
2 risks. They don't have to be homogenous, and they
3 never are in practice. If we stuck to that
4 requirement, I don't think there's any insurance
5 exists anywhere in the world.

6 The second part of the objection is that
7 Mr. Riggin argues that you really need a pool of
8 homogenous risks in order to estimate adequate
9 premiums, and, you know, it's true if you have a pool
10 of homogenous risks and that's been operating for a
11 long time, you have a large history of claims data,
12 and if they're all the same, we simply divide the
13 claims by the number of homogenous units, and we've
14 got a premium.

15 So, you know, insurance would clearly work
16 in those circumstances, but, you know, real life has
17 warts on it, and what we need to do now is set
18 premiums when things are different.

19 Now, from Mr. Riggin's report, he seems to
20 suggest you can't set adequate premiums when you
21 don't have a pool of homogenous risks. Well, that's
22 simply not true. You can set premiums when you've
23 got different risks in the pool, so assuming, first
24 of all, we've got a large pool and they're different,
25 there are numerous statistical and actuarial

1 techniques for measuring premiums from that data and
2 differentiating the different levels of risk in this
3 pool.

4 So, you know, I'm in my seventies. I pay a
5 different premium for someone who's driving their car
6 who's in their twenties. You know, we're very
7 different risks. The actuaries and the underwriters
8 have figured out what that differential is, precisely
9 because we're different. And that's true in all
10 insurance pools.

11 You know, we've got techniques that
12 generally come under the title of multivariant
13 analysis, which allow us to look at the data and then
14 decide what premium to allocate for this section of
15 the pool, what premium for that section of the pool.

16 And he also seemed to tie the idea of
17 having actuarial premiums or manual premiums to
18 whether insurance exists in principle or not, and,
19 you know, that just doesn't seem right to me.

20 As I mentioned before, being involved to
21 some extent in writing about and actually consulting
22 on terrorism insurance and satellite insurance, we
23 simply don't have databases in those cases. We can't
24 set actuarial -- actuaries to work on figuring out
25 what the expected loss is, and we don't have a rating

1 manual. We have to use other methods to set
2 premiums. And yet it's still insurance.

3 So the homogeneity idea is just an overly
4 restricted -- restrictive criteria for deciding
5 whether there's insurance.

6 MR. ALBRIGHT: Your Honor, may I have this
7 document that I'm holding here marked for
8 identification as Petitioner's Exhibit next in order?

9 THE COURT: Yes.

10 MR. ALBRIGHT: (Handing document.)

11 THE CLERK: An article by Donald Riggin,
12 titled, "What creates insurance in a captive is
13 marked for identification as Exhibit 108-P.

14 (The document referred to was marked for
15 identification as Petitioner's Exhibit
16 108-P.)

17 MR. ALBRIGHT: Your Honor, may I provide
18 Dr. Doherty a copy of Exhibit 108-P?

19 THE COURT: Yes.

20 MR. ALBRIGHT: (Handing document.) One
21 second.

22 (Pause.)

23 BY MR. ALBRIGHT:

24 Q Now, Dr. Doherty, in your rebuttal report,
25 Exhibit 107-P, you have an attachment to your

1 rebuttal report, and you state there -- it says, "I
2 also reviewed an article by Mr. Riggin entitled,
3 "What creates insurance in a captive?"

4 A Yes.

5 Q And so I've handed you a copy of Exhibit
6 108-P.

7 A Yes.

8 Q Do you have that there in front of you?

9 A I do.

10 Q What is Exhibit 108-P?

11 A It's an article by Mr. Riggin. I'm not
12 sure where it was published, entitled, "What creates
13 insurance in a captive?"

14 Q Now, do you recall whether this particular
15 article was listed in his report, in Mr. Riggin's
16 report?

17 A I think it was, but I'm not entirely sure.

18 Q Okay. In review this article, did you have
19 any observations about how it might impact Mr.
20 Riggin's report?

21 A Well, it certainly explains the emphasis in
22 his report on the insistence that you have to have a
23 pool of homogenous risks for insurance to exist. And
24 if you didn't have that, then you would have
25 something which he describes as generic

1 diversification or generic portfolio diversification,
2 which he defined to be not insurance.

3 Q And does he comment -- he comments on the
4 Harper versus Commissioner case.

5 A Yes, he does.

6 Q And also he comments on Revenue Ruling
7 2005-40.

8 A Yes.

9 Q Do you have any observations about that
10 commentary in this article?

11 A As regards the Harper case, I'm very
12 familiar with the Harper case, since I was an expert
13 witness in that particular case. And as I recall the
14 facts of that case, I don't recall any suggestion
15 that homogeneity was a requirement in deciding
16 whether insurance existed in that particular case.

17 The situation there was that it was a
18 shipping company which sent packages for clients to
19 various parts of the country or parts of the world,
20 and the insurance, which was placed in the captive,
21 was of two parts.

22 First of all, under some statute or other,
23 a carrier has responsibility up to \$200 for any loss
24 or damage to article, so it was a liability to the
25 carrier. And that liability was insured in the

1 captive. But in addition, shippers could elect to
2 insure at their own price, paying a premium, for any
3 risk above \$200, and that risk was placed in the
4 captive.

5 So, you know, were these homogenous? No,
6 they weren't. But they were similar types of risks,
7 but there was never any discussion of whether
8 homogeneity, as far as I can remember, was a
9 requirement in there, so that's one thing.

10 As regards the Revenue Rule 2005-40, as I
11 recall in that --

12 MR. SCHEID: Objection, Your Honor. We'd
13 object to this as just all sort of legal argument and
14 mostly based upon relevance.

15 MR. ALBRIGHT: Well, Your Honor, may I
16 speak to that?

17 THE COURT: Yes.

18 MR. ALBRIGHT: Mr. Riggin in this report is
19 commenting on the homogeneity aspect of the issue
20 that we're discussing, and he is commenting on the
21 Harper case, that particular aspect of the Harper
22 case, and also he's commenting on the homogeneity as
23 it relates to Revenue Ruling 2005-40.

24 I'm not asking Dr. Doherty for a tax
25 opinion. I'm just asking him about his views of Mr.

1 Riggin's comments about homogeneity in the context of
2 Harper and in the context of Revenue Ruling 2005-40.

3 MR. SCHEID: Your Honor, if I may briefly
4 respond.

5 THE COURT: You may briefly respond.

6 MR. SCHEID: First of all, I think that
7 does get into legal argument. If it's purely a
8 discussion of homogeneity in the context of
9 insurance, obviously Professor Doherty is not
10 qualified as an expert in any area relating to the
11 taxation of insurance.

12 Further, this isn't in Mr. Riggin's report
13 itself. This is an article that, I believe, he cited
14 in his report. Certainly to the extent that there
15 would be questioning of Mr. Riggin with respect to
16 what he wrote in this article, that may be
17 appropriate, but as it relates to questioning
18 Professor Doherty, I would still object based upon
19 relevance.

20 THE COURT: Do you want to respond to him?

21 MR. ALBRIGHT: Yes, Your Honor. It would
22 seem that statements made by Respondent's expert
23 would certainly be fair game in addressing his
24 report.

25 THE COURT: This -- I think this last --

1 I'm going to allow the answer to this question, but,
2 I think, after this question, we've kind of covered -
3 - I want to pronounce it correct -- homogeneity of
4 the insurance and in the report.

5 So the witness may answer the question.
6 You may have to repeat it for him.

7 BY MR. ALBRIGHT:

8 Q Would you like for me to repeat the
9 question?

10 A Certainly as it refers to the Revenue
11 Ruling.

12 Q Well, do you -- down in the third paragraph
13 of Exhibit 108-P, it states, "The odd thing about
14 this is that for over a decade, everyone, including
15 the IRS, chose to disregard the homogenous mention in
16 the Revenue Ruling."

17 MR. SCHEID: Objection, Your Honor. I'd
18 move to strike that question. It's reading from a
19 document that's not in evidence.

20 THE COURT: If you could rephrase the
21 question if the document's not in evidence.

22 BY MR. ALBRIGHT:

23 Q Dr. Doherty, Exhibit 108-P seems to suggest
24 that Mr. Riggin believes that the IRS or Respondent
25 has disregarded the homogeneity requirement.

1 A He seems to say that. Yes.

2 Q Yes. So it sounds like maybe he's taking a
3 more restrictive view of what insurance is than
4 Respondent.

5 MR. SCHEID: Objection, Your Honor. The
6 witness has no foundation to state --

7 THE COURT: I'm going to --

8 MR. SCHEID: -- what Mr. Riggin's views are
9 in this case or with respect to the argument.

10 THE COURT: I'm going to sustain the
11 objection.

12 MR. ALBRIGHT: I'm sorry, Your Honor?

13 THE COURT: I'm sustaining the objection.

14 MR. ALBRIGHT: No further questions, Your
15 Honor.

16 MR. SCHEID: If I may ask just one
17 question, Your Honor --

18 THE COURT: Yes.

19 FURTHER RECROSS-EXAMINATION

20 BY MR. SCHEID:

21 Q Dr. Doherty or Professor Doherty -- I'm
22 sorry -- in this case, there was actuarial data used
23 to compute the premiums. Is that correct?

24 A That's my understanding. Yes.

25 Q Thank you.

1 MR. SCHEID: No further questions, Your
2 Honor.

3 MR. ALBRIGHT: No further questions, Your
4 Honor.

5 THE COURT: You may step down. Thank you.
6 (Whereupon, the witness was excused.)

7 THE COURT: You may proceed.

8 MR. ALBRIGHT: Petitioner calls Lance
9 McNeel. Your Honor, it'll be just a minute before he
10 gets here.

11 (Pause.)

12 THE CLERK: Would you raise your right
13 hand.

14 Whereupon,

15 SYNOTT LANCE McNEEL, JR.

16 having been first duly sworn, was called as
17 a witness herein, and was examined and testified as
18 follows:

19 THE CLERK: Will you please state your name
20 and address for the record.

21 THE WITNESS: Synott Lance McNeel, Jr.,
22 6127 Stoney Brook, Houston, Texas 77036.

23 THE CLERK: Thank you. You may be seated.

24 DIRECT EXAMINATION

25 BY MR. ALBRIGHT:

1 Q Good morning, Mr. McNeel.

2 A Good morning.

3 Q Are you employed by Capstone Associated
4 Services, Limited?

5 A Yes.

6 Q Were you employed by Capstone Associated
7 Services, Limited, during 2008, 2009 and 2010?

8 A Yes.

9 Q And at that time, did you have a title at
10 Capstone Associated Services, Limited, 2008, 2009 and
11 2010?

12 A Yes. I was the director of the insurance
13 operation, insurance department.

14 Q And were you a vice president also?

15 A Yes, yes.

16 Q When did you first join Capstone as an
17 employee?

18 A August of 2006.

19 Q And prior to that time, where were you
20 employed?

21 A I was employed with Computer Sciences
22 Corporation, CSC.

23 Q And how long did you work for Computer
24 Sciences Corporation?

25 A Since early 2000. I guess that's six

1 years.

2 Q About six years?

3 A Yes.

4 Q From around 2000 to 2005?

5 A Yes. 2006.

6 Q Did you hold -- did you have any titles at
7 Computer Sciences Corporation?

8 A Yes. I was the site manager for a Houston
9 operation. They're a big company, so they have
10 operations all over the place.

11 Q And did you hold other jobs at Computer
12 Sciences Corporation?

13 A Yes. I was a -- I managed a customer
14 service operation.

15 Q Now, was there anything about this
16 experience at Computer Sciences Corporation that
17 related to insurance? I guess, let me back up a
18 second. What was the business of Computer Sciences
19 Corporation?

20 A Computer Sciences Corporation is a large
21 computer software company. Most of their business
22 was defense contracting. That's how they started,
23 and that was the main part of their business, but
24 they also bought a company by the name of Policy
25 Management Insurance Company -- no, no, no. It was

1 Policy Management Services.

2 Q And what was Policy Management Services?

3 A It was also a computer development company
4 that was focused on the insurance industry. But they
5 also -- they focused on the insurance industry as far
6 as the software is concerned, but they had a side
7 operation, which is what I was involved in that did
8 outsourcing for some of their clients, so they would
9 sell large computer systems to large insurance
10 companies.

11 And those companies would say, I love your
12 system, but I don't really want to -- I don't want to
13 go through the trouble of staffing it and keeping all
14 the systems running. So PMSC would do that on an
15 outsourcing basis.

16 Q Did you do anything in your job at Computer
17 Sciences Corporation that involved insurance?

18 A Yes. I managed a life insurance operation
19 that -- we had a slight new business operation, but
20 most of it was servicing existing business.

21 Q Okay. And were there -- the number of
22 policies that were involved?

23 A It was over 300,000 policies. They were
24 all life insurance policies, small limit life
25 insurance policies.

1 Q Okay. And did you act as an underwriter
2 for Computer Sciences Corporation or not?

3 A Like I said, there was a new business
4 operation that reported to me. They were pretty much
5 self-sustaining, but I was ultimately responsible for
6 it.

7 Q And then that business function did some
8 underwriting?

9 A Yes.

10 Q Where did you work prior to working for
11 Computer Sciences Corporation?

12 A I worked for Marsh that was -- in the Marsh
13 operation, actually merged with the Johnson & Higgins
14 operation, which is where I was employed for most of
15 that time.

16 Q And when did you work for Marsh?

17 A They -- let's see. They acquired J&H in
18 probably 1996 or '97, and I left there in 1999.

19 Q Okay. And the business of Marsh, what was
20 the business of Marsh?

21 A Marsh is an international insurance broker.
22 I mean, they -- and then they -- I mean, that's the
23 short answer, but there's a lot more to that.

24 Q What work did you do at Marsh?

25 A Marsh had a subsidiary. Actually it goes

1 back to J&H had a subsidiary that was managing
2 general underwriter. So that operation did
3 underwriting for various companies. Our largest
4 contract was with AIG, but we also did work with
5 General Reed, and we worked on a brokerage basis with
6 a few other companies, not necessarily an
7 underwriting basis.

8 Q What does an insurance broker do?

9 A An insurance broker places insurance rather
10 than actually underwrites it.

11 Q Where did you work prior to working for
12 Marsh?

13 A Well, again, it was J&H. Prior to J&H, I
14 worked for Nationwide Insurance Company.

15 Q Okay. Did you ever work for Barmore
16 Insurance Agency?

17 A Yes.

18 Q And what was Barmore Insurance Agency?

19 A It was a local -- I mean, it still -- well,
20 they sold out, but it's a local insurance agency.

21 Q And what did you do for that company?

22 A I was an insurance producer.

23 Q What is an insurance producer?

24 A An insurance agent.

25 Q You were an insurance agent. Okay.

1 A Yes.

2 Q Did you ever work for Nationwide Insurance
3 Company?

4 A Yes.

5 Q And what jobs did you hold with Nationwide
6 Insurance Company?

7 A I was a commercial agent, a commercial
8 lines agent, and, you know, it's what you would
9 normally think of as an insurance agent, but we did
10 have some significant underwriting authority, so I
11 kind of did both.

12 Q You did both?

13 A Yes.

14 Q Did you say you did underwriting?

15 A Yes.

16 Q Okay. And as an underwriter, what do you
17 do?

18 A You evaluate the risks of the, you know,
19 either the client or the prospect, whichever
20 classification they fall into. You evaluate them.
21 You price them, you know, and negotiate with them,
22 because rarely does -- your initial quote that you
23 give them is something that they want.

24 Q Okay. And then you said you worked for
25 Johnson & Higgins.

1 A Yes.

2 Q What time period did you work for Johnson &
3 Higgins?

4 A Well, I worked for Johnson & Higgins twice.
5 Out of school, I worked from, let's see, from 1981
6 through 1985 maybe or '6.

7 Q Okay. And, again, the business of Johnson
8 & Higgins, what did Johnson & Higgins do?

9 A Johnson & Higgins was an insurance broker,
10 and I started out -- I was in a, I guess you'd call
11 it, a management training program. I started out in
12 the marine department, doing marine and oil and gas
13 brokerage. From there, I moved into the employee
14 benefits area.

15 Then I moved into their accounting
16 operations to learn, you know, how the accounting
17 works; moved on to the property department and then
18 to the casualty department. So they were structured
19 by -- you know, kind of like lines of coverage, so
20 they had specialty areas for that.

21 Q And so what was your -- what exactly was
22 the function that you performed at Johnson & Higgins?

23 A Well, again, cycling through those
24 departments, I was doing brokerage for them, internal
25 brokerage, not so much dealing with clients or not so

1 much selling insurance but working on the placement
2 of it with the underwriters and the ongoing
3 administration.

4 Q Can you tell me about your education.

5 A Yes. I went to high school down in
6 Galveston. From there, I went to the University of
7 Texas. I have a bachelor's degree in economics, and
8 I also attended the University of Texas Graduate
9 School of Business.

10 Q Did you get a graduate degree?

11 A No.

12 Q What is a chartered property and casualty
13 underwriter?

14 A It's a designation -- it's an industry
15 designation for property and casualty insurance
16 underwriters. It consists of ten exams. You know,
17 you kind of go through a process, and ultimately you
18 get the designation.

19 Q Do you hold the chartered property and
20 casualty underwriter designation?

21 A Yes.

22 Q And what's an associate in risk management?

23 A It's the same type of designation. It's
24 more focused on risk management than on general
25 insurance operations. And it consists of three

1 exams.

2 Q And do you hold that designation?

3 A Yes.

4 Q Do you hold any insurance-related licenses?

5 A Yes. They're all Texas licenses, because
6 that's where I'm -- that's where I operate. I have a
7 Texas agent's license for property and casualty. I
8 have an agent's license for life and health. I have
9 a risk manager's license. I have a claims adjuster's
10 license. And I think that's it.

11 Q Are all those licenses currently in effect?

12 A Yes.

13 MR. ALBRIGHT: Your Honor, if I may, I
14 would like to ask Mr. McNeel to retrieve -- and I'm
15 happy to help him -- the binder out of the window
16 with Exhibit 16-P in it.

17 THE COURT: Yes.

18 MR. ALBRIGHT: Should I help him?

19 THE COURT: Yes.

20 MR. ALBRIGHT: 16-J. I'm sorry.

21 (Pause.)

22 BY MR. ALBRIGHT:

23 Q Mr. McNeel, do you have a copy of Exhibit
24 16-J in front of you there?

25 A Yes.

1 Q Are you familiar with Exhibit 16-J?

2 A Yes.

3 Q Were you involved in preparing Exhibit 16-
4 J?

5 A Yes.

6 Q Can you tell me a little bit about your
7 involvement in preparing Exhibit 16-J.

8 A Well, I was -- first of all, I guess, I
9 started with a site visit, where we, you know, went
10 to Idaho and, you know, toured the facility. We --
11 they sent us some preliminary information, so we
12 weren't going in blind, but, you know, we toured the
13 facility, evaluated the risks. I mean, it was very
14 similar to what I would do as an insurance broker, to
15 go and tour a site to --

16 Q Okay. So, now, you said you --
17 unfortunately, just having a conversation here that's
18 going into this record, so I think we need to be a
19 little more specific with names.

20 A Okay.

21 Q So you said you did a site visit. Is that
22 right?

23 A Yes.

24 Q And do you recall when that site visit
25 occurred?

1 A Well, actually it's on the front here.

2 It's August 13 of 2008.

3 Q August 13, 2008?

4 A Yes.

5 Q Okay. And so where did you go on this site
6 visit?

7 A We went to Osburn, Idaho.

8 Q And was there a particular company that you
9 visited with in Osburn, Idaho?

10 A Yes. Peak Mechanical.

11 Q Peak Mechanical?

12 A Peak Mechanical & Components, Inc.

13 Q Okay. And so you went to Osburn, Idaho,
14 and what did you do while you were there?

15 A We -- again, we toured the facility. They
16 had multiple facilities.

17 Q Now, just stop right there. What facility
18 did you tour?

19 A We started out in their main facility,
20 which was alongside of, you know, a highway. I don't
21 remember the address, but --

22 Q And you say, they. You're talking about
23 Peak Mechanical, one of their facilities?

24 A Yes.

25 Q And what was the facility that you toured?

1 A It was their operations. They stored their
2 inventory. They did their -- it's like machine shop
3 work. They did their cleaning of equipment that they
4 were rehabbing, you know.

5 Q Well, Mr. McNeel, if you would turn to --
6 it's marked RSV-0006050 in Exhibit 16-J.

7 A Yes.

8 Q Do you see those pictures there?

9 A Yes.

10 Q Okay. Did you tour these two -- there are
11 -- it looks like a picture of two buildings here.

12 A Yes. It's actually one building, but
13 that's a little bit different angles.

14 Q And so did you see this building on the
15 site visit?

16 A Yes.

17 Q And if you'd turn the page to 6051, did you
18 tour these?

19 A Yes.

20 Q You saw these items in the -- that are
21 depicted on 6051.

22 A That's right.

23 Q And if you go to 6052 --

24 A I got it. Yes.

25 Q Did you take these pictures?

1 A Yes, I did.

2 Q And 6053?

3 A Yes.

4 Q These are things that you saw on the site
5 visit?

6 A Yes.

7 Q And 6054?

8 A Yes.

9 Q And 6055?

10 A Yes.

11 Q If you look at -- turn the page to 6058.

12 A Yes.

13 Q These are some of Peak's facilities that
14 you saw on this trip?

15 A Yes. This is a different facility, but
16 it's an operation that they -- as you can see, they
17 worked with trucks that they were refitting to go
18 down into the mines.

19 Q And so there's a number of pictures, and
20 they go through the pages marked 6060.

21 A Yes.

22 Q And you took those pictures.

23 A Yes.

24 Q Do you recall how long you were at Osburn,
25 Idaho, on this trip?

1 A In terms of how many hours, I'm not sure,
2 but it was most of the day. I would say probably six
3 to eight hours.

4 Q Okay. Now --

5 MR. ALBRIGHT: Your Honor, if I may, I
6 would also like to ask -- or I'd like to put in front
7 of Mr. McNeel the book with Exhibit 34-J in it. May
8 I --

9 THE COURT: Yes.

10 (Pause.)

11 BY MR. ALBRIGHT:

12 Q Mr. McNeel, do you have a copy of Exhibit
13 34-J there in front of you?

14 A Yes.

15 Q And can you tell me what this Exhibit 34-J
16 is.

17 A These are the various background documents,
18 as the title says. It includes their insurance
19 policies, financial documents.

20 Q There's actually an index on Exhibit 34-J.
21 Correct?

22 A Correct. It's the first page.

23 Q And the index lists the documents that are
24 in Exhibit 34-J.

25 A Yes.

1 Q Why was this put together? Or do you know
2 how it was put together?

3 A Well, I mean, the contents are the
4 documents that we reviewed in going through the
5 feasibility study, some of them prior to the site
6 visit and, you know, some of them dribbled in
7 afterwards.

8 Q And so there's information in this book
9 concerning insurance policies?

10 A Yes.

11 Q Why would you collect that?

12 A Well, because we need to evaluate kind of a
13 broad picture of all of their risks, and then see
14 which risks are currently being covered through the
15 commercial insurance market.

16 Q And why would you need financial data?

17 A Well, financial data is the basis for
18 pricing all of the insurance policies or at least a
19 lot of them. And, you know, I mean, we just need to
20 get that information, just from a practical
21 standpoint. We also like to see kind of the size and
22 scope of the operation.

23 Q So if you're evaluating the risk of a
24 company --

25 A Right.

1 Q -- does its sales have any relevance to
2 that kind of an evaluation?

3 MR. MARKLEY: Your Honor, I think we're
4 slipping into the potential expert part of this
5 witness. I don't think that's a fact question, so I
6 object as to the premature question that may or may
7 not come later on if this witness is an expert.

8 THE COURT: You can rephrase the question.

9 MR. ALBRIGHT: Okay.

10 BY MR. ALBRIGHT:

11 Q Why would you collect information about a
12 company's sales?

13 A Well, again, it's a -- it's an integral
14 part of the pricing model, and again, we want to take
15 a look at the size and scope of their operations.

16 Q What is the purpose of a captive
17 feasibility study?

18 MR. MARKLEY: I think that's also a
19 question that would lead to whatever the testimony
20 would be about his expert testimony, if he gets to
21 stay that far.

22 MR. ALBRIGHT: Your Honor, maybe I should
23 ask a few more questions before I ask that question.

24 THE COURT: Yes.

25 BY MR. ALBRIGHT:

1 Q Mr. McNeel, were you involved in preparing
2 Exhibit 16-J? 16-J, I shifted gears back to the
3 other exhibit.

4 A Oh, this is the -- yes.

5 Q And tell me what you did in -- what was
6 your role in preparing Exhibit 16-J?

7 A Well, after we returned from the site
8 visit, I compiled my notes and did a rough draft of
9 the -- of this document.

10 Q And what is Exhibit 16-J?

11 A 16-J is the captive feasibility -- or the
12 feasibility study.

13 Q And why were you preparing Exhibit 16-J?
14 What's the purpose of Exhibit 16-J?

15 A The purpose is to evaluate the -- first of
16 all, the need or the factors that would make a
17 captive insurance company something that would be,
18 you know, feasible and something they would want.

19 Q Okay. And so I notice in Exhibit 16-J, if
20 you would -- if you would turn to page 18, now, you
21 drafted Exhibit 16-J.

22 A Yes.

23 Q And I see there you say, "Financial
24 information - Revenue has grown sharply for Peak over
25 the last several years to projected sales in excess

1 of \$9 million for 2008." Why is that statement in
2 this captive feasibility study?

3 A Well, again, we are summarizing the
4 operations of the company, and, I mean, you know, we
5 summarized the facilities, the financial information.
6 That's an important part of the rating, and so, you
7 know, it's an important part of their operations.

8 Q And you say in the next paragraph, you talk
9 about, "Peak is vulnerable to changes in the
10 economics and regulations in the mining industry."

11 A Yes.

12 Q Why would that be in the captive
13 feasibility study?

14 A Well, because that's one of their risks and
15 points to a significant risk that they had.

16 Q But does the \$9 million revenue, does that
17 have anything to do with Peak's risks?

18 A Well, yes. That's -- their revenues are
19 what is on the line if something does happen.

20 Q Now, if you would, would you turn to page
21 6015 of Exhibit 16-J.

22 A Okay.

23 Q And if you look over, there's a column
24 there. Do you see that?

25 A Which column?

1 Q The one on the right.

2 A Okay.

3 Q And there's a reference to pollution in
4 there.

5 A Yes.

6 Q What's -- why do you have pollution listed
7 there?

8 A Because it wasn't covered under their
9 general liability policy.

10 Q And if you look on the same page, there's a
11 reference to the number of employees.

12 MR. MARKLEY: I'm sorry. What page is
13 that?

14 MR. ALBRIGHT: 6014.

15 THE WITNESS: Oh, yes. 6014.

16 BY MR. ALBRIGHT:

17 Q It says, "Peak employees - 17 employees."

18 A Yes.

19 Q And why would you include that in the
20 captive feasibility study?

21 A Well, again, the number of employees is
22 generally a rating basis for some policies. It also
23 lets us see what the scope of their operations are
24 and what types of --

25 Q When you say --

1 A -- what types of risks that they have.

2 Q Okay. When you say, rating basis -- you
3 said, rating basis. What does that mean?

4 MR. MARKLEY: Well, I think that's kind of
5 an expert-type question. I understand he can say
6 what a rating basis is, but -- maybe it's a premature
7 objection, but I think we're going to go down the
8 path of, how does that relate to the determination of
9 this feasibility study in regard to a potential
10 expert opinion. I think it's a premature -- other
11 than asking, what is the basis.

12 THE COURT: I'm going to allow the
13 question.

14 BY MR. ALBRIGHT:

15 Q You used the term "rating basis," and
16 specifically in reference to the number of employees.
17 What do you mean by that?

18 A Insurance policies are rated on certain
19 rating bases, so it might be revenue. It might be
20 property value. It might be number of employees.
21 And, you know, for specialty type coverages, it could
22 be some other statistics as well.

23 Q So for the layman, what are you saying,
24 rating basis? What does that translate to? Does it
25 determine the premium?

1 A It does. I mean, it just tells you -- if
2 you have -- let me take an example. If you have a
3 package of ten Lifesavers for a dollar, the rate
4 would be 10 cents. You get ten Lifesavers for a
5 dollar. It's the same kind of thing. It's how much
6 of that risk are you covering.

7 Q Okay. Did -- do you know Mr. Snyder?

8 A Yes.

9 Q How is it that you know Mr. Snyder?

10 A Mr. Snyder worked at Johnson & Higgins at
11 the same time I worked with them, so I've known Bob
12 since 1981. We worked together all the way through
13 the Marsh acquisition. He left and went to Myron
14 Steves. I left and went to CSC.

15 Q Okay. And did Mr. Snyder participate in
16 preparing the captive -- this Exhibit 16-J?

17 A Yes.

18 Q Do you consider him to be a capable
19 insurance professional?

20 MR. MARKLEY: Objection, Your Honor. What
21 he considers him to be --

22 THE COURT: Objection is sustained.

23 BY MR. ALBRIGHT:

24 Q Mr. McNeel, do you know whether Capstone
25 charged a fee for preparing the captive feasibility

1 study?

2 A Yes.

3 Q Do you recall -- do you know about how much
4 that would have been?

5 A I don't recall the exact number. It was
6 probably 15- to 20,000, something like that.

7 Q 15- to \$20,000?

8 A Yes.

9 MR. ALBRIGHT: Now, Your Honor, may I put
10 the book with Exhibit 94-J in it in front of Mr.
11 McNeel?

12 THE COURT: Yes. If you can maybe help
13 assist in --

14 MR. ALBRIGHT: May I approach?

15 THE COURT: Yes.

16 (Pause.)

17 THE WITNESS: Okay.

18 BY MR. ALBRIGHT:

19 Q And I would just ask you to take a look at
20 Exhibit 94-J. Do you have it in front of you there?

21 A Yes.

22 Q Have you read Exhibit -- take a minute and
23 read it. Not out loud, but read it to yourself.

24 A (Perusing document.) Okay.

25 Q Do you agree with the statements in Exhibit

1 94-J?

2 MR. MARKLEY: Objection, Your Honor.

3 Whether he agrees with it or not, the document speaks
4 for itself, but this is not a witness that needs to
5 come in and testify whether he agrees with documents
6 that are in evidence. It's irrelevant.

7 MR. ALBRIGHT: Your Honor, it's relevant,
8 because I'm next going to get into how the premiums
9 in these insurance policies are set, and Mr. McNeel
10 is involved in that.

11 THE COURT: I think you can ask him those
12 questions without the question you just asked, so I'm
13 going to sustain the objection.

14 MR. ALBRIGHT: Okay. Is the Court's ruling
15 that I can't ask Mr. McNeel whether he believes the
16 statements in Exhibit 94-J are accurate Can I ask
17 him that question?

18 MR. MARKLEY: I think it's the same
19 objection, and the document speaks for itself. The
20 parties have stipulated to this document. It's
21 irrelevant what this gentleman thinks about it. I'm
22 not sure where we're going with this.

23 Well, I think I know where we're going with
24 it, and I think we're getting eventually to the
25 question of trying to have Mr. McNeel testify as an

1 expert witness under the guise of being a fact
2 witness.

3 THE COURT: And the Court just -- the
4 document speaks for itself, but I think as -- since
5 this letter was addressed to the witness, I think you
6 can ask him a question about the letter.

7 BY MR. ALBRIGHT:

8 Q Mr. McNeel, do you believe that the
9 statements in Exhibit 94-J are accurate?

10 A Yes.

11 Q And who is Mid-Continent General Agency,
12 Incorporated?

13 A Mid-Continent General Agency, Incorporated,
14 is a managing general underwriter. They -- on a
15 contract basis, they do underwriting for other
16 companies, and -- I mean, that's pretty much who they
17 are.

18 Q Are they a reputable company, in your
19 estimation?

20 MR. MARKLEY: I have to object to that.
21 There's no foundation. They may well be the best in
22 the world, but I don't think there's any foundation
23 for him to testify about whether they're reputable.
24 Again, we're getting close to the expert kind of
25 question again.

1 MR. ALBRIGHT: Your Honor, somebody at Mid-
2 Continent wrote Mr. McNeel a letter, and I'm just
3 asking him questions about the company that the
4 letter came from.

5 THE COURT: The witness may answer the
6 question.

7 BY MR. ALBRIGHT:

8 Q Did you consider them to be a reputable
9 company?

10 A Yes.

11 Q Did you consider them to be a capable
12 company?

13 A Yes.

14 Q Did you consider them to be a capable
15 company with regard to the subject matter that's set
16 forth in this letter?

17 A Yes.

18 MR. MARKLEY: I still move to strike that,
19 because, again, the subject matter in this letter
20 relates to the determination of how premiums are
21 calculated and so forth and so on and the viability
22 of insurance.

23 And, again, we get into the question of
24 this witness testifying as a fact witness, as to
25 whether this is an opposed to the substance of the

1 letter and whether it can be used somehow to buttress
2 the supposed expert opinion he would have in this
3 regard.

4 MR. ALBRIGHT: Your Honor, Mr. McNeel is
5 both a fact witness and an expert witness. Mr.
6 McNeel was involved in performing the captive
7 feasibility study that led to the creation of
8 Petitioner. Mr. McNeel was involved in preparing the
9 policies that Petitioner issued, the insurance
10 policies. Mr. McNeel was involved in doing the
11 underwriting work that resulted in the premiums that
12 are set forth in the policies.

13 We have to have Mr. -- we want to present
14 Mr. McNeel's testimony because it explains how these
15 premiums were set. Those are matters of fact.

16 THE COURT: I'm going to allow the witness
17 to answer the question.

18 MR. MARKLEY: Could you read back the
19 question. I'm sorry. I don't recall it.

20 THE REPORTER: (Shakes head.)

21 MR. MARKLEY: You can't. Okay. Never
22 mind.

23 THE COURT: I think -- do you need the
24 question asked again?

25 THE WITNESS: Yes, please.

1 MR. ALBRIGHT: Your Honor, I've forgotten
2 the question also.

3 THE COURT: I have, too. If you could ask
4 --

5 MR. ALBRIGHT: I'll just start -- I'll
6 start with a new question.

7 BY MR. ALBRIGHT:

8 Q Mr. McNeel, were you involved in
9 determining the premiums that are reflected in
10 Reserve Casualty Corporation's insurance policies for
11 2008?

12 A I'll underline the word "involved." I
13 didn't determine them, but I was involved in the
14 process.

15 Q You were involved in setting the prices,
16 the premium prices? You were involved.

17 A I was involved. Yes.

18 Q And what about for 2009?

19 A Yes.

20 Q And what about for 2010?

21 A Yes.

22 Q And does Exhibit 94-J accurately describe
23 how the premiums that are reflected Reserve Casualty
24 Corporation's insurance policies for 2008 were
25 determined? is that an accurate description?

1 A Yes.

2 Q And if I ask you the same question
3 regarding premiums for 2009, would that description
4 also apply?

5 A Yes.

6 Q And does Exhibit 94-J accurately describe
7 how the premiums that are reflected in Reserve
8 Casualty Corporation's insurance policies were
9 determined for 2010?

10 A Yes.

11 MR. ALBRIGHT: Your Honor, I'd ask
12 permission to have this document marked for
13 Petitioner's -- marked for identification as
14 Petitioner's Exhibit next in order.

15 (Page 326 and following enclosed under
16 separate cover.)

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1 CERTIFICATE OF TRANSCRIBER AND PROOFREADER

2 CASE NAME: Reserve Mechanical Corp, f.k.a. as

3 Reserve Casualty Corp. v. Commissioner

4 DOCKET NO.: 14545-16

5 We, the undersigned, do hereby certify that the
6 foregoing pages, numbers 229 through 325, inclusive,
7 are the true, accurate and complete transcript
8 prepared from the recording made by electronic
9 recording by Leslie Berridge, on April 27, 2017,
10 before the United States Tax Court at its session in
11 Houston, Texas, in accordance with the applicable
12 provisions of the current verbatim reporting contract
13 of the Court, and have verified the accuracy of the
14 transcript by comparing the typewritten transcript
15 against the verbal recording.

16

17 _____

18 Nancy H. King 05/18/2017

19 (Transcriber) (Date)

20

21 _____

22 Laurel H. Stoddard 05/19/2017

23 (Proofreader) (Date)

24

25

<p style="text-align: center;"><u> </u> \$</p> <p>\$20,000 318:7</p> <p>\$200 291:23 292:3</p> <p>\$9 314:1,16</p> <p style="text-align: center;"><u> </u> 0</p> <p>05/18/2017 325:18</p> <p>05/19/2017 325:22</p> <p style="text-align: center;"><u> </u> 1</p> <p>1 256:15,23 263:23 265:19 266:8,9 274:12 275:5,24</p> <p>1(b) 243:23</p> <p>1(c) 251:23</p> <p>10 317:4</p> <p>100 263:16</p> <p>104 235:15 236:19</p> <p>104-P 232:3 235:19,24 236:3,6,10,12,16 250:18 251:23</p> <p>105 241:25</p> <p>105-R 232:4 242:4,6,10,15 243:2,18</p> <p>106-R 232:5 252:13,16,18,24 253:4</p> <p>107-P 232:6 283:18,21,24 284:5,7,9,22,24 285:4 289:25</p> <p>108-P 232:7 289:13,16,18 290:6,10 294:13,23</p> <p>13 307:2,3</p> <p>14545-16 228:5 229:5 233:3 325:4</p> <p>15 318:6,7</p>	<p>16 306:3</p> <p>1600 229:19</p> <p>16-J 305:20,24 306:1,7 308:6 313:2,6,10,11,13 ,14,19,21 314:21 317:16</p> <p>16-P 305:16</p> <p>17 250:16 251:2 315:17</p> <p>18 313:20</p> <p>1981 303:5 317:12</p> <p>1985 303:6</p> <p>1990s 272:16</p> <p>1996 300:18</p> <p>1999 300:18</p> <p style="text-align: center;"><u> </u> 2</p> <p>2 256:9,15 265:16</p> <p>20,000 318:6</p> <p>200 230:6</p> <p>2000 297:25 298:4</p> <p>2000s 272:15</p> <p>2001 263:3</p> <p>2005 298:4</p> <p>2005-40 291:7 292:10,23 293:2</p> <p>2006 297:18 298:5</p> <p>2008 252:12 253:6,22,25 254:3 297:7,10 307:2,3 314:1 323:11,24</p> <p>2009 253:6 254:21 297:7,10 323:18 324:3</p> <p>2010 253:6 254:21 297:7,11 323:20 324:9</p> <p>2017 228:25 229:11 325:9</p>	<p>2021 229:19</p> <p>214-999-3000 229:20</p> <p>229 228:23 325:6</p> <p>234 231:4 234:12</p> <p>235 232:3</p> <p>236 232:3</p> <p>239 231:4</p> <p>242 232:4</p> <p>252 232:5</p> <p>266 231:4</p> <p>27 325:9</p> <p>273 231:4</p> <p>28 228:25 229:11</p> <p>283 232:6</p> <p>284 231:5</p> <p>285 232:6</p> <p>289 232:7</p> <p>295 231:5</p> <p>296 231:6</p> <p style="text-align: center;"><u> </u> 3</p> <p>3 256:9,15</p> <p>300,000 299:23</p> <p>312-368-8243 230:7</p> <p>325 228:23 325:6</p> <p>326 324:15</p> <p>34-J 310:7,13,15,20,2 4</p> <p style="text-align: center;"><u> </u> 4</p> <p>4 228:22 256:2</p> <p style="text-align: center;"><u> </u> 5</p> <p>50 257:6,17 258:11 263:25 266:4,5,8,10</p> <p>500 267:4</p>	<p>515 229:10</p> <p style="text-align: center;"><u> </u> 6</p> <p>6 303:6</p> <p>6014 315:14,15</p> <p>6015 314:21</p> <p>6051 308:17,21</p> <p>6052 308:23</p> <p>6053 309:2</p> <p>6054 309:7</p> <p>6055 309:9</p> <p>6058 309:11</p> <p>6060 309:20</p> <p>60606 230:6</p> <p>6127 296:22</p> <p style="text-align: center;"><u> </u> 7</p> <p>7006 229:9</p> <p>75201 229:20</p> <p>77036 296:22</p> <p style="text-align: center;"><u> </u> 9</p> <p>9 251:23</p> <p>9:18 229:13 233:2</p> <p>90 263:17</p> <p>94-J 318:10,20 319:1,16 320:9 323:22 324:6</p> <p>97 300:18</p> <p>98110 234:14</p> <p style="text-align: center;"><u> </u> A</p> <p>a.m 229:13 233:2</p> <p>ability 250:23</p> <p>able 234:24</p> <p>above-entitled 229:12</p> <p>accepted 235:3 238:6</p> <p>accepting 248:22</p>
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IN THE UNITED STATES TAX COURT

In the Matter of:)
)
RESERVE MECHANICAL CORP., f.k.a.)
RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
v.)
)
COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

Volume: 5
Pages: 326 through 425
Place: Houston, Texas
Date: April 28, 2017

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IN THE UNITED STATES TAX COURT

 In the Matter of:)
)
 RESERVE MECHANICAL CORP., f.k.a.)
 RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
 v.)
)
 COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

Room 7006
 Casey U.S. Courthouse
 515 Rusk Avenue
 Houston, Texas

April 28, 2017

The above-entitled matter resumed for trial, pursuant at 9:18 a.m.

BEFORE: HONORABLE KATHLEEN KERRIGAN
Judge

APPEARANCES:

For the Petitioner:

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 MICHELLE Y. KU, Esquire
 Gardere Wynne
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C O N T E N T S

WITNESSES:	DIRECT	CROSS	REDIRECT	RECROSS	VOIR DIRE
For Petitioner:					
S. Lance					
McNeel, Jr.	330	372	405		
Esperanza Mead	408	410			
For Respondent					
None					

	E X H I B I T S		
	EXHIBITS:	IDENTIFIED	RECEIVED
1			
2			
3	109-P	330	341
4	110-P	344	345
5	111-P	348	350
6	112-P	357	366
7	113-P	408	409

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1 P R O C E E D I N G S

2 THE COURT: Yes. If you'd give
3 Respondent's counsel a copy of the document also --

4 MR. ALBRIGHT: Yes, Your Honor. I'm
5 handing a copy to Mr. Markley. May I approach?

6 THE COURT: You may approach.

7 MR. ALBRIGHT: (Handing document.)

8 THE CLERK: Document titled, Indication
9 underwriters at Lloyd's of London is marked for
10 identification as Exhibit 109-P.

11 (The document referred to was marked for
12 identification as Petitioner's Exhibit
13 109-P.)

14 MR. ALBRIGHT: Your Honor, may I provide
15 Mr. McNeel a copy of the document that's been marked
16 for identification as --

17 THE COURT: Yes.

18 MR. ALBRIGHT: -- Exhibit 109-P?

19 DIRECT EXAMINATION (CONTINUED)

20 BY MR. ALBRIGHT:

21 Q (Handing document.) Mr. McNeel, do you
22 have a copy of Exhibit 109-P in front of you?

23 A Yes.

24 Q Can you tell me what Exhibit 109-P is.

25 MR. MARKLEY: Your Honor, before we get

1 through the litany of all those kind of questions, I
2 do not know one way or the other whether this is a
3 document that was provided to Respondents 14 days
4 prior to trial.

5 Number two, I do not know what the proof
6 would be of the authenticity of this document. And I
7 do not know that anybody on this letter is named Mr.
8 McNeel so that he could, in fact, authenticate it.

9 I see it's a letter -- it's apparently for
10 Reserve Casualty from Mid-Continent, and I do not
11 know how Mid-Continent and Lloyd's of London would be
12 involved in a case involving Reserve, Peak, Capstone
13 or PoolRe. So there's several objections that I
14 have, and I would pursue all of them.

15 THE COURT: Well, the first objection, Mr.
16 Albright, was this document exchanged 14 days prior?

17 MR. ALBRIGHT: Yes, it was, Your Honor. It
18 was provided to Mr. Markley. Also I sent a copy of
19 this document with a proposed supplemental
20 stipulation of facts to Mr. Markley and asked that
21 Respondent stipulate to this document. I'm at a loss
22 as to why Respondent believes that this document was
23 not provided in the 14-day exchange rule.

24 MR. MARKLEY: I'm not questioning his
25 credibility. I said I do not know whether it was

1 provided. And, yes, I do know that it was provided
2 for a supplemental stipulation. But it might be
3 easier for me to get rid of that objection if I knew
4 when it, in fact, was provided. I'm not sitting here
5 with my computer in front of me with the ability to
6 look at every single thing I've gotten, so it should
7 be pretty simple to show that.

8 MR. ALBRIGHT: Your Honor, I don't have a
9 copy of the letter -- paper copy with me, but I have
10 a letter here dated April 10, 2017, and the document
11 that we're talking about was provided with that
12 letter dated April 10 in a letter addressed to Mr.
13 Markley.

14 And in addition, I believe that this was a
15 document that I had previously provided him prior to
16 April 10, and I believe it was provided with -- one
17 second.

18 I believe that I provided this -- I know I
19 provided him a copy of this with this letter, with
20 the April 10 letter, which is 14 days prior to trial.

21 MR. MARKLEY: Based upon that
22 representation, I withdraw that part of the
23 objection.

24 THE COURT: Okay. The Court -- I believe
25 there was a relevancy portion to the objection also.

1 MR. MARKLEY: Well, actually it was
2 authenticity, Your Honor.

3 THE COURT: I thought there was both
4 authenticity and relevancy.

5 MR. MARKLEY: That's right. You're
6 correct. Yes. That was both. Of the four, that was
7 at least two of them.

8 THE COURT: The Court believes this
9 document is relevant, but the Court does have a
10 concern about the authenticity of the document. So
11 if you could address -- and I don't know if you were
12 going to do that in your -- if that's what you were
13 going to --

14 MR. ALBRIGHT: Yes, Your Honor. I was
15 going to ask what this document is.

16 THE COURT: You may continue with your
17 questioning.

18 MR. ALBRIGHT: Okay.

19 BY MR. ALBRIGHT:

20 Q Mr. McNeel --

21 A Yes.

22 Q -- do you know what Exhibit 109-P is?

23 A Yes.

24 Q What is Exhibit 109-P?

25 A It's an indication received from Mid-

1 Continent Agency, Inc., that shows the --

2 MR. MARKLEY: Objection to what it shows.

3 That's not a question of whether it's authentic. He
4 would not be permitted prior to the determination of
5 the authenticity to read from what actually is in the
6 document. It's a different question.

7 THE COURT: If you could ask your question
8 again or instruct the witness how to answer, not to
9 read from the document.

10 BY MR. ALBRIGHT:

11 Q So, Mr. McNeel --

12 A Okay.

13 Q -- I believe you said that this document is
14 an indication, and it has the name Mid-Continent
15 General Agency, Inc. How did you -- how do you know
16 what this document is?

17 A I know what this document is, because it
18 was part of our process. This is a communication
19 from Mid-Continent where they have provided us their
20 --

21 MR. MARKLEY: Again, I'm sorry, sir. I
22 didn't mean to object in the middle of what you're
23 saying, but you're starting to tell us what it is.
24 So now I'm down to what the best evidence objection
25 is on top of everything else. Because what it is, it

1 is. It's not in yet, and once it is in, if it's ever
2 in, he doesn't need to read from it. We can see
3 what's in it.

4 BY MR. ALBRIGHT:

5 Q Mr. McNeel --

6 A Yes.

7 Q -- if I could, if we could go back to
8 Exhibit 94-J for a minute --

9 A Okay.

10 Q Do you see the second paragraph there?

11 A Yes.

12 Q It says, "As you know, we have been working
13 with Capstone for a little over seven years, mainly
14 assisting you with the development of premium quotes
15 for your captive insurance company clients." Do you
16 see that?

17 A Yes.

18 Q The document that's contained in Exhibit
19 109-P, does it have anything to do with that
20 paragraph in that letter?

21 A Yes.

22 Q And what does it have to do with that
23 letter?

24 A Well, this is --

25 MR. MARKLEY: Excuse me. I object. That's

1 a back-door way of just getting him to say what's in
2 it.

3 THE COURT: I'm going to allow the
4 question.

5 MR. MARKLEY: All right.

6 THE WITNESS: This is --

7 BY MR. ALBRIGHT:

8 Q Let me put it another way. Did you ever
9 ask Mid-Continent for assistance in determining
10 premium prices?

11 A Yes.

12 Q And did you request assistance from Mid-
13 Continent General Agency, Inc., in pricing the
14 premiums that were set forth in Reserve Casualty
15 Corporation's insurance policies?

16 A Yes.

17 Q And did you do that for 2008?

18 A Yes.

19 Q Did you do that for 2009?

20 A Yes.

21 Q Did you do that for 2010?

22 A Yes.

23 Q And what is Exhibit 108-P?

24 A 108-P --

25 THE COURT: It's 109.

1 MR. ALBRIGHT: I'm sorry.

2 BY MR. ALBRIGHT:

3 Q 109-P.

4 A 109-P is the result of that. This is their
5 response back, giving us their assessment.

6 Q And how did you use Exhibit 109-P?

7 MR. MARKLEY: Well, I continue -- he cannot
8 really testify about how he used it, because it's not
9 in yet, and there's still not authentication yet.

10 THE COURT: I will sustain that objection,
11 because it's not -- the document is not in yet.

12 MR. ALBRIGHT: Oh, okay, Your Honor. Your
13 Honor, I would offer Exhibit --

14 BY MR. ALBRIGHT:

15 Q Well, first of all, I notice on Exhibit
16 109-P there's a reference to policy period December
17 1, 2008, to January 1, 2009. Do you see that?

18 MR. MARKLEY: Objection. It speaks for
19 itself. He doesn't need to see it or not see it.
20 It's not in yet, so whether he sees it or not is not
21 important.

22 THE COURT: I'm going to allow it, because
23 he's just -- this is part of authenticity.

24 MR. ALBRIGHT: It is, Your Honor.

25 MR. MARKLEY: All right.

1 THE COURT: I'm going to allow it.

2 THE WITNESS: Yes. I see that.

3 BY MR. ALBRIGHT:

4 Q And so this first page of Exhibit 109-P, is
5 this what you received from Mid-Continent General
6 Agency, Inc. --

7 A Yes.

8 Q -- related to premium pricing?

9 A Yes.

10 Q And when you say, you received it, who's
11 you?

12 A Capstone.

13 Q Capstone. And do you know of your own
14 personal knowledge that you received this as the vice
15 president of Capstone from Mid-Continent General
16 Agency, Inc.?

17 A Yes.

18 Q And if I turn the page to page 2, do you
19 see that?

20 A Yes.

21 Q And there's a reference there to policy
22 period, January 1, 2009, to January 1, 2010.

23 A Yes.

24 Q And did you receive this document from Mid-
25 Continent General Agency, Inc.?

1 A Yes.

2 Q And if you turn the page to the third page,
3 there's a similar document here, and it says -- it
4 makes a reference to policy period January 1, 2010,
5 to January 1, 2011.

6 A Yes.

7 Q And did you receive this from Mid-Continent
8 General Agency, Inc.?

9 A Yes.

10 MR. ALBRIGHT: Your Honor, at this time, I
11 would offer Exhibit 109-P into evidence.

12 MR. MARKLEY: Your Honor, I would still
13 continue to object. I don't dispute for a second
14 this gentleman received it, but it still doesn't
15 prove the authenticity of what it was that he
16 received.

17 THE COURT: Do you want to respond before I
18 make my ruling?

19 MR. ALBRIGHT: Your Honor, I don't know
20 what else to say. Mr. McNeel said this is a copy of
21 the document that he received from Mid-Continent
22 General Agency, Inc.

23 MR. MARKLEY: Well, the only thing that I
24 can think of what else he could say is have someone
25 actually come in named Janice Self who sent this in

1 the first place apparently or from Lloyd's of London
2 or Mid-Continent General Agency to identify it as a
3 document that was sent, and that would be something
4 that I wouldn't be spending all this time talking
5 about, other than the fact that the document speaks
6 for itself. It would be that simple.

7 THE COURT: Mr. Albright, if you could just
8 clarify for the record how this document was kept.

9 BY MR. ALBRIGHT:

10 Q Mr. McNeel --

11 A Yes.

12 Q -- this Exhibit 109-P --

13 A Yes.

14 Q There are actually three documents in
15 Exhibit 109-P. Correct?

16 A Yes.

17 Q And there's one for each year, each policy
18 period. Correct?

19 A Yes.

20 Q Did Capstone maintain these documents in
21 their files?

22 A Yes.

23 Q Did they regularly maintain these documents
24 in their files?

25 A Yes.

1 Q And it was their practice to do this with
2 respect to policies, insurance policies, that you
3 were pricing?

4 A Yes.

5 MR. ALBRIGHT: Your Honor, I offer the
6 exhibit into -- Exhibit 109-P into evidence.

7 MR. MARKLEY: I understand why he -- Mr.
8 Albright did that, to try to show it's a business
9 record exception of this company that is Capstone, I
10 believe. But I think what he would have to show is
11 that it's a business record of Mid-Continent in order
12 to effectively show that requirement, to get past the
13 rule.

14 MR. ALBRIGHT: Your Honor, Capstone is
15 involved in setting prices in insurance policies.
16 They went to a third party to obtain information to
17 assist them in setting premium prices. These
18 documents were maintained by Capstone to support the
19 premium prices that are reflected in the policies
20 that were written. This is a business record, Your
21 Honor.

22 THE COURT: 109-P is admitted.

23 (The document referred to, having been
24 previously marked for identification as
25 Petitioner's Exhibit 109-P, was received

1 in evidence.)

2 BY MR. ALBRIGHT:

3 Q Now, do you know whether Mid-Continent
4 would obtain any information from Capstone to prepare
5 these indications that are reflected in Exhibit 109-
6 P?

7 A Yes.

8 Q And can you tell me a little bit about that
9 process. First of all, were you involved in that
10 process?

11 A Yes.

12 Q Personally?

13 A Yes, personally.

14 Q So tell me a little bit about how Mid-
15 Continent would gather information related to the
16 preparation of Exhibits 109-P.

17 A Well, a representative from Mid-Continent
18 would come over to our office. She would spend
19 probably ten days to a couple weeks, I mean, you
20 know, ten calendar days, so it was probably about a
21 couple of weeks. We would make available all of the
22 documents that we had on file, so she would look
23 through the policies, you know, the financial
24 reports, everything that she would normally do with
25 any other account that she was underwriting.

1 Q And did you provide her with the
2 information that you had available?

3 A Yes.

4 Q And then she'd take that information and go
5 back to her office?

6 A Yes.

7 Q And then what would happen?

8 A Well, then she would, you know, present us
9 with this document that shows her pricing.

10 Q And so how did you use -- first of all, do
11 you understand what an indication is? What does that
12 -- does that mean anything to you?

13 A Yes. An indication is to be compared and
14 contrasted with a quote. A quote means, I am
15 offering you insurance coverage at this price. If
16 you say yes, then we have an agreement. An
17 indication, there is no offer or acceptance involved.
18 It's an indication of what the pricing would be.

19 Q Okay.

20 A I don't know if that makes sense, but --

21 Q Okay. Did you use Exhibit 109-P in any
22 way?

23 A Yes.

24 Q And how did you use Exhibit 109-P?

25 A Well, we -- I mean, this is an important

1 part of the process. We compare this with our
2 projections of what the premiums -- our opinion of
3 what the premiums should be.

4 Q Okay. And so -- but --

5 MR. ALBRIGHT: Your Honor, if I may, I
6 would like to have another document marked for
7 identification.

8 THE COURT: Yes. And does Respondent have
9 a copy?

10 MR. ALBRIGHT: I'm going to provide --

11 THE COURT: Okay.

12 MR. ALBRIGHT: -- Respondent with a copy,
13 Respondent's counsel. May I approach, Your Honor?

14 THE COURT: Yes, you may.

15 MR. ALBRIGHT: (Handing document.)

16 THE CLERK: A document entitled, 2010
17 policy rate analysis submitted by Capstone, is marked
18 as Exhibit 110-P.

19 (The document referred to was marked for
20 identification as Petitioner's Exhibit
21 110-P.)

22 MR. ALBRIGHT: Your Honor, may I provide
23 Mr. McNeel a copy of the document --

24 THE COURT: Yes.

25 MR. ALBRIGHT: -- that's been marked for

1 identification as Exhibit 110-P?

2 BY MR. ALBRIGHT:

3 Q (Handing document.) Mr. McNeel, do you
4 have a copy of Exhibit 110-P in front of you?

5 A Yes.

6 Q And do you know what Exhibit 110-P is?

7 A Yes.

8 Q What is it?

9 MR. MARKLEY: I was just going to say, I
10 don't have any of those problems that I raised before
11 with 109 with this, so I don't know whether counsel
12 intends to introduce it or not, but if he did, that
13 would be fine. We would not object.

14 MR. ALBRIGHT: Then I offer it in evidence,
15 Your Honor.

16 THE COURT: All right. Then I'll admit it.
17 110-P is admitted.

18 (The document referred to, having been
19 previously marked for identification as
20 Petitioner's Exhibit 110-P, was received
21 in evidence.)

22 BY MR. ALBRIGHT:

23 Q Mr. McNeel --

24 A Yes.

25 Q -- how is it that you're familiar with

1 Exhibit 110-P?

2 A Well, I mean, it's my work product.

3 Q So is that a roundabout way of saying you
4 prepared it?

5 A Yes.

6 Q So you did prepare Exhibit 110-P.

7 A Yes.

8 Q Now, at a high level, please, what is this?

9 A This is a -- we talked earlier about base
10 rates or guide rates. This is a generation of those
11 rates for each of the common policies that Capstone
12 has managed over the years. What I did -- and,
13 again, I'm trying to stay at a high level.

14 What I did was took the premiums that
15 relate back in the past and -- for each policy Some
16 of them had a large number of policies. Some of them
17 had a smaller number. And what I did was average
18 them. I kind of sliced them and diced them in
19 different ways.

20 I started out -- so in order to do this,
21 you have to look at them on each individual policy.
22 You have to back into a standard limit, so --

23 Q Now, stop right there for a minute. You
24 say you have to back into a standard limit. What
25 kind of limit are you talking about?

1 A The discussion that I had about rates, how
2 you have to, you know, scale an insurance policy, the
3 same thing goes for limits. So a million dollar
4 policy is going to have a lower premium than a half-
5 million dollar policy.

6 Q A million dollar policy's going to have a
7 lower premium --

8 A A different premium.

9 Q It's going to have a different premium than
10 what?

11 A Than a half-million dollar policy or a \$2
12 million policy.

13 Q Okay.

14 A So we need to get the -- if we're going to
15 use a rate, we need to have it as a rate per -- you
16 know, per the different limits.

17 Q So are you saying that you would take all
18 these policies with the different limits in them,
19 loss limits, and you try to come up -- you're trying
20 to come up with a single rate. Is that what you're
21 trying to do?

22 A That's right.

23 Q Okay.

24 MR. ALBRIGHT: Your Honor, may I have this
25 document marked for identification as Petitioner's

1 Exhibit next in order.

2 THE COURT: Yes, you may.

3 MR. ALBRIGHT: (Handing document.)

4 THE CLERK: A graph that says, Increased
5 limit factors, is marked as Exhibit 111-P.

6 (The document referred to was marked for
7 identification as Petitioner's Exhibit
8 111-P.)

9 MR. ALBRIGHT: Your Honor, may I provide
10 Mr. McNeel with a copy of the document that's been
11 marked for identification as Petitioner's Exhibit
12 111-P for identification?

13 THE COURT: Yes.

14 BY MR. ALBRIGHT:

15 Q (Handing document.) Mr. McNeel, do you
16 have a copy of Exhibit 111-P in front of you?

17 A Yes.

18 Q Can you tell me who prepared Exhibit 111-P.

19 A I did.

20 Q And what is Exhibit 111-P?

21 A It's a table of increased limits factors.

22 Q And so why did you prepare Exhibit 111-P?

23 A Well, again, if you're starting at 250,000,
24 you have to have some way of getting it up to a half-
25 million, a million, 2 million, whatever the number

1 is. These are factors that you would multiply by the
2 premium at 250.

3 Q To come up with a --

4 A With a premium at a million, say.

5 Q Okay.

6 MR. MARKLEY: I think I -- I understand the
7 foundation that this gentleman prepared this. Is
8 this a document that was sent to us on or about April
9 10 or before, or was this something that's new? I
10 guess, this -- is this also something that was
11 presented for a potential stipulation? I'm not sure
12 that matters, but --

13 MR. ALBRIGHT: Yes, Your Honor. This
14 document was exchanged under the 14-day rule. And I
15 can look it up if we need to.

16 MR. MARKLEY: No. I'll trust you that it
17 was, if you say it was. And I guess this witness
18 prepared it?

19 THE WITNESS: Yes.

20 MR. ALBRIGHT: He just said he did.

21 MR. MARKLEY: Okay. He didn't offer it
22 yet, so I may or may not object.

23 BY MR. ALBRIGHT:

24 Q Would you have used Exhibit 111-P in
25 preparing Exhibit 110-P?

1 A Yes.

2 Q So if we could for a moment then, could we
3 turn to Exhibit 110-P.

4 MR. ALBRIGHT: Well, first of all, Your
5 Honor, I offer 111-P into evidence.

6 MR. MARKLEY: I'm not -- all right. I
7 guess I can cross-examine on this. I would -- I
8 don't object at this time, Your Honor.

9 THE COURT: 111-P is admitted.

10 (The document referred to, having been
11 previously marked for identification as
12 Petitioner's Exhibit 111-P, was received
13 in evidence.)

14 BY MR. ALBRIGHT:

15 Q Now, Mr. McNeel --

16 A Yes.

17 Q -- turning to Exhibit 110-P.

18 A Okay.

19 Q So I notice over here you have on the left-
20 hand column, you have a column headed, Coverage.

21 A Yes.

22 Q And so what would be included in that
23 column?

24 A Well, the different policy types.

25 Q The different policy types. Is that what

1 you said?

2 A Yes.

3 Q And then you have in the next column, you
4 have a column headed, Overall base rate average.

5 A Yes.

6 Q Now, remember that you're talking -- if
7 you're talking to me, you're talking to a sixth-
8 grader, so can you explain to me what the overall
9 base rate average. How did you get that number?

10 A Okay. So for each policy, there are a
11 variety of data points, for each of the different
12 policies, for each of the different years in the
13 past. What we did was -- I mean, that -- and then we
14 backed them into a \$250,000 standard limit. At that
15 point, that's just a simple average of all those
16 rates.

17 Q Just a simple average. Okay.

18 A Yes.

19 Q And so then in the next column, I see you
20 have a column headed, it looks like, Categories.

21 A Right.

22 Q Okay. And tell me what those categories
23 are. If you could, focus on directors and officers
24 liability down there, the third line item.

25 A Okay. So the directors and officers

1 liability, the categories ranged from a million to 10
2 million in revenue, from 11 million to 25 million in
3 revenue, and greater than 26 million.

4 Q Okay. Now, stop right there for a second.
5 You have those revenue ranges. Those are revenue
6 ranges for what?

7 A For the insured for Peak.

8 Q For the insured under the policy that
9 you're --

10 A Yes.

11 Q -- that you're trying to come up with --
12 that you're including in this spreadsheet.

13 A Right.

14 Q Okay. Then at the next column, you have,
15 base rate average. Do you see that?

16 A Yes.

17 Q So for the 1 million to \$25 million
18 revenue, you have 1.352. What does that mean?

19 A That's the average rate for that layer. So
20 the first average rate was for the entire population.
21 Then we stratified it by these layers, and we came up
22 with a different rate for each one of those layers.

23 Q Okay. And so when you say, 1.352, what do
24 you mean, 1.352? What is 1.352? I know it's an
25 average of some kind, but put it in --

1 A That's the base rate for a client that has
2 premiums from 1 million to 10 million, so that's the
3 average rate for the smaller group of clients.

4 MR. MARKLEY: I'm sorry. Are we on the
5 same line? Because as the directors and officers
6 liability, that first line I see, is 1.436, and I see
7 1.352 as the cyber risk. Are we on the same page?

8 MR. ALBRIGHT: You know, I think my eyes
9 shifted to the wrong line. I apologize. Thank you.

10 BY MR. ALBRIGHT:

11 Q I believe the number we should be looking -
12 - and I should be asking you about and intended to
13 ask you about is the 1.436.

14 A That's right.

15 Q Okay. So base rate average, 1.436, so --
16 what does that mean vis-a-vis the 1 million to \$10
17 million revenue range? Is that something you would
18 use to estimate a policy premium?

19 A Yes. You know, in general, as you -- as
20 the size of the insured increases, the rate -- not
21 the premium, but the rate -- decreases. There's more
22 predictability.

23 Q So if you were going to use the 1.436 --
24 let's say you had a company with \$10 million of
25 revenue. How would you use the 1.436? Does that

1 give you a policy amount -- premium amount?

2 A No. There's a calculation. So 1.436 times
3 10 million divided by a thousand, because that's the
4 way the rate is structured will give you the premium.

5 Q Okay.

6 A Will give you the premium at 250,000. Then
7 times the increased limits factor would you get the
8 premium times -- at the million-dollar level.

9 Q I see. So -- and then, if you look at the
10 next column, there's a base rate range.

11 A Right.

12 Q And it looks like -- better keep an eye on
13 me here -- .558 to 2.661.

14 A Right.

15 Q And what does that mean?

16 A That's the range that -- in all the data,
17 that's the low point and the high point.

18 Q Okay. And then in the next column, I see
19 IRPM. What does IRPM mean?

20 A IRPM is an acronym that stands for
21 individual risk premium modifier.

22 Q Okay. And I see a number there, 1.872. Is
23 that a number that you would use to maybe come up
24 with a premium?

25 A That's the information that we would use.

1 I mean, the last two columns are really
2 informational. That gives us data or gives me data
3 on -- based on this range, what the average, I guess
4 you could call it, like the average deviation or
5 something like that. It's an imputed IRPM for this
6 group of --

7 Q Yes. But what -- again, what does that --
8 tell -- explain it in terms that the man on the
9 street can understand.

10 A Okay. So in all of these rating formulas,
11 you're going to have a certain degree of IRPM that
12 you can apply as an underwriter. It can be a little
13 bit. You can nudge the premium up a little bit, or
14 you can make some pretty significant changes to the
15 premium. That IRPM is representative of that, you
16 know, kind of judgment part of the rating process.

17 Q And so you -- did you use these factors in
18 making premium estimates in 2010?

19 A Yes.

20 Q Okay. And, now, if we could back up a
21 second, I believe you said that the premium
22 information that you had, that you used to construct
23 this, came -- where did that come from?

24 A It came from the site visit.

25 Q No, no, no. I'm talking about Exhibit 110-

1 P. Where did all these -- you did some calculations
2 here, but all these numbers that you have here, you
3 got -- you started from somewhere.

4 A Oh, the previous quotes or previous
5 indications.

6 Q The previous indications.

7 A Right.

8 Q And when you say, previous indications,
9 you're talking about -- do you still have Exhibit
10 109-P there?

11 A Yes.

12 Q You would use -- you're saying you used the
13 previous indications like this indication here for
14 all of the back years?

15 A Yes.

16 Q Okay. To your knowledge, if you had any
17 captive insurance company that Capstone managed, was
18 it your practice to get a pricing indication from a
19 company like Mid-Continent?

20 A Yes.

21 Q And would that -- in your files, you would
22 maintain those indications for --

23 A Yes. Absolutely.

24 MR. ALBRIGHT: Your Honor, if I could, I
25 would ask to mark this document as Petitioner's

1 Exhibit next in order --

2 THE COURT: Yes.

3 MR. ALBRIGHT: -- for identification. May
4 I approach?

5 THE COURT: Yes.

6 MR. ALBRIGHT: (Handing document.)

7 THE CLERK: A table titled, Reserve
8 Casualty Corp. estimated sales, is marked as Exhibit
9 112-P.

10 (The document referred to was marked for
11 identification as Petitioner's Exhibit
12 112-P.)

13 MR. ALBRIGHT: Your Honor, may I provide
14 Mr. McNeel a copy of Exhibit 112-P?

15 THE COURT: Yes.

16 BY MR. ALBRIGHT:

17 Q (Handing document.) Mr. McNeel, do you
18 have a copy of Exhibit 112-P in front of you?

19 A Yes.

20 Q Do you know who prepared the documents that
21 are contained in Exhibit 112-P?

22 A Yes. I did.

23 Q And, Mr. McNeel, if you notice, there's --
24 it says -- there's a -- the words, Rating work sheet,
25 are on there. Do you see that?

1 A Yes.

2 Q And then there's a year on the first page,
3 2008.

4 A Yes.

5 Q And then if you turn to the second page,
6 there's a similar document, and it says 2009 on it.

7 A That's right.

8 Q And then if you turn to the third page,
9 there's a similar document, but it says, 2010, on it.

10 A That's right.

11 Q Now, when the documents that are contained
12 in Exhibit 112-P were prepared, were they individual
13 documents? In other words, when you -- the 2008
14 document didn't have the 2009 document attached to
15 it, did it?

16 A No.

17 Q Or the 2010 document.

18 A No.

19 Q This is just a copy of these three
20 documents --

21 A That's right.

22 Q -- Exhibit 112-P.

23 A Right.

24 Q And why did you prepare Exhibit 112-P or
25 each of the documents that are contained in Exhibit

1 112-P?

2 A Well, this -- I mean, this is the
3 culmination of what we've been discussing, so you
4 have a limit for each of the policies, the exposure
5 basis as shown in the next column. They are all
6 based on revenues, except for employment practices
7 liability, which is based on the number of employees.
8 The rate is in the next column.

9 The increased limits factor is in the fifth
10 column. If you'll notice, the million-dollar level
11 is at 3.4. The \$500,000 level is at 1.9. Then the
12 premium is calculated in the next column. There's a
13 pro rata factor that is applied to that premium, and
14 then that gives you the final premium in the last
15 column.

16 MR. MARKLEY: Your Honor, I may have to
17 object, because I don't know if this is considered to
18 be a summary document. I understand that this
19 witness prepared it, but is this a summary document
20 that is being introduced -- well, maybe it hasn't
21 been introduced yet, but is being under consideration
22 to be questioned regarding something that would
23 potentially comply with the 1006 rule of evidence?
24 And if it is, I don't know what the underlying
25 documents would be that would be supporting this.

1 Assuming they're in or not, I'm really not sure. So
2 I object as to whether or not this is a summary
3 document without support.

4 THE COURT: All right. I believe the
5 document has not -- the document has not yet been
6 offered.

7 MR. MARKLEY: And the reason I -- he
8 started reading from it, so --

9 BY MR. ALBRIGHT:

10 Q Now, Mr. McNeel, the first page of Exhibit
11 112-P, when would it have been -- when would you have
12 prepared it? Do you know?

13 A Oh, probably in August sometime, I guess.

14 Q August of what?

15 A August or September, I mean, after the site
16 visit.

17 Q So is it fair to say that this would have
18 been prepared before the insurance policies were
19 written?

20 A Yes.

21 Q Okay. So what are you trying to do -- you
22 prepared this. What are you trying to do in this
23 document, Exhibit 112-P?

24 A We're trying to assess the risk, look at
25 the premiums that we would recommend, and, you know,

1 I mean, it's very -- it's essentially a rate sheet
2 that would be used in most insurance companies.

3 Q It's a rate sheet.

4 A A pricing sheet. Yes.

5 Q A pricing sheet.

6 A Yes.

7 Q Okay. And did you regularly prepare these
8 kinds of pricing sheet when you were at Capstone?

9 A Yes.

10 Q In 2008, '9 and '10?

11 A Yes.

12 Q Okay. And the one -- the next page, the
13 one that has 2009 on it, when would it have been
14 prepared?

15 A Probably in --

16 Q Well, was it before or after the policy was
17 written?

18 A Well, it's before. This probably would
19 have been sometime in December.

20 Q December of what?

21 A Of 2008.

22 Q Okay. And if I asked you the same question
23 about the one that has 2010 on it --

24 A Probably a little earlier. Maybe November
25 of 2009.

1 Q Okay.

2 MR. ALBRIGHT: Your Honor, I would offer
3 Exhibit 112-P into evidence.

4 MR. MARKLEY: I'm not objecting to it on
5 the basis of it being a business record. I'm
6 objecting to it under whether or not it's a summary
7 under 1006 that there is documents that support this
8 already in the record or otherwise not available to
9 be in the record because they're so voluminous. So
10 it may qualify as a business record that he keeps,
11 but it may not qualify to come into court because of
12 the contradiction with 1006.

13 THE COURT: Mr. Albright, do you want to
14 respond?

15 MR. ALBRIGHT: Your Honor, this is not a
16 summary being offered under 1006. This is a document
17 that was -- that is a business -- that are business
18 records of Capstone that were prepared in connection
19 with the determination of premiums that are set forth
20 in the insurance policies that were issued by Reserve
21 Casualty Corp. It's not a summary. It's a
22 calculation. I'm happy to ask a few more questions
23 to make that clear.

24 THE COURT: I just want it to be clear that
25 the columns in the calculation, that these numbers

1 weren't pulled from something that's not into
2 evidence.

3 MR. ALBRIGHT: Okay. So may I ask Mr.
4 McNeel a few questions?

5 THE COURT: Yes, you may.

6 BY MR. ALBRIGHT:

7 Q So, Mr. McNeel, looking at the first page
8 of Exhibit 112-P --

9 A Yes.

10 Q -- there is -- it says, Rating work sheet
11 2008, at the top. Do you see that?

12 A Yes.

13 Q There's also -- it says, Estimated sales,
14 \$9 million.

15 A Yes.

16 Q What does that represent? Where'd that
17 come from?

18 A That came from the feasibility study for
19 one thing. That's the -- that's what was shown in
20 that operations summary. And then, you know --

21 Q So hang on a second. Let's be clear. Is
22 that \$9 million number, does that come from Exhibit
23 16-P or from the information book which was Exhibit
24 34-J?

25 A Well, I think -- I mean, I can go through

1 and find it here, but I know that it's in the
2 feasibility study.

3 Q You know, it's in the feasibility study.

4 A Yes.

5 Q Okay. So I see there it says, Employees,
6 17. Do you see that?

7 A Yes.

8 Q Where did that come from?

9 A Well, again, that's their number of
10 employees, and that's what's shown in the feasibility
11 study?

12 Q You said, it's their employees. Who's
13 their?

14 A Peak's employees.

15 Q Now, if I look down here, I see a column
16 headed, Policy form.

17 A Yes.

18 Q What are -- what's listed under that column
19 headed, Policy form?

20 A Various policies. Do you want me to read
21 them?

22 Q No. But, I mean, various policies of what?
23 What do you mean, various policies?

24 A Policies that relate to their operations.

25 Q Their operations, you're saying their is --

1 A Peak's operations.

2 Q -- Peak's operations. Okay. And then if I
3 look at the second column, I see a column that's
4 headed, Limit. What does that mean?

5 A That's the limit of insurance for those
6 specific policies.

7 Q Okay. And then the next column, I see,
8 Exposure. Where did that number come from?

9 A Based on the policy type, it's either the
10 revenue or the number of employees.

11 Q And then the next column, I see, Rate.
12 Where did that come from?

13 A That came from 110-P.

14 Q Let me just -- pardon me, but let me follow
15 along here. And so did Exhibit 109-P have anything
16 to do with the numbers that are in Exhibit 112-P?

17 A No.

18 Q Okay. So the next item, did I ask you
19 about the ILF? Where did that come from? What is
20 ILF?

21 A Increased limits factor. It's 111-P.

22 Q That came from where?

23 A 111-P.

24 Q Okay. And then the premium, how did you
25 get the premium?

1 A That's a calculation.

2 Q And then you say, pro rata percentage.
3 Where did that come from?

4 A That is a -- that's a factor to acknowledge
5 the fact that the policy period is a short policy
6 period, not a full annual term.

7 Q Okay. And then I see PR premium. What
8 does that mean?

9 A The pro rata premium.

10 Q And how did you get that number?

11 A That's the premium times the pro rata
12 factor equals the pro rata property.

13 MR. ALBRIGHT: Your Honor, I would again
14 offer Exhibit 112-P into evidence.

15 MR. MARKLEY: I do not any longer have an
16 objection, Your Honor.

17 THE COURT: 112-P is admitted.

18 (The document referred to, having been
19 previously marked for identification as
20 Petitioner's Exhibit 112-P, was received
21 in evidence.)

22 MR. ALBRIGHT: Your Honor, if I could --
23 yes.

24 (Pause.)

25 THE WITNESS: If you were discussing a bio

1 break, I'm all in favor of it.

2 MR. MARKLEY: He must be a mind-reader.

3 MR. ALBRIGHT: That's fine with me, Your
4 Honor.

5 MR. MARKLEY: It's fine with me, too,
6 because that's what we were talking about, how long
7 Mr. Albright might be going.

8 THE COURT: Okay. We'll go off the record
9 for a second.

10 (Discussion held off the record.)

11 THE COURT: The Court is in recess until
12 1:30.

13 MR. MARKLEY: Thank you, Your Honor.

14 THE CLERK: All rise.

15 (Whereupon, at 12:39 p.m., the trial in
16 the above-entitled matter was recessed, to
17 reconvene at 1:30 p.m., this same day,
18 Friday, April 28, 2017.)

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1 A F T E R N O O N S E S S I O N

2 THE CLERK: All rise.

3 You may be seated.

4 BY MR. ALBRIGHT:

5 Q Mr. McNeel --

6 A Yes.

7 MR. ALBRIGHT: Your Honor, I would ask
8 permission to provide Mr. McNeel with a copy of
9 Exhibit 96-J or at least the book with Exhibit 96-J
10 in it.

11 THE COURT: Yes. And I think he might
12 still have that book in front of him.

13 MR. ALBRIGHT: May I come up and see?

14 THE COURT: Yes. You may check.

15 (Pause.)

16 BY MR. ALBRIGHT:

17 Q Mr. McNeel, are you familiar with Exhibit
18 96-J?

19 A Yes.

20 Q And you'll notice that the subject line is,
21 Pricing of risk underwritten through PoolRe Insurance
22 Corp. stop loss and quota share reinsurance
23 structure.

24 A Yes.

25 Q Do you know -- were you involved in

1 deciding or -- deciding what the -- let me see; how
2 do I say this? Are you familiar with the 81.5/18.5
3 percent premium split?

4 A Yes.

5 Q And there was a premium paid by the direct
6 insureds under the direct written policies --

7 A Yes.

8 Q -- of Reserve. And then there's also a
9 premium paid to PoolRe --

10 A Yes.

11 Q -- under the -- would it be the -- under
12 the stop loss and quota share reinsurance structure.
13 Do you know, was it Exhibit -- do you know whether
14 Exhibit 96-J had any -- was used by Capstone
15 Associated Services, Limited, regarding that split?

16 A Yes.

17 Q And in 2008 and 2009, was that letter used?

18 A Yes.

19 Q To set that split?

20 A Yes.

21 Q Okay. And if you would, would you turn to
22 Exhibit 95-J. It should be the next one down, or the
23 one before, 95-J.

24 A Correct.

25 Q Are you familiar with this Exhibit 95-J?

1 A Let's see. (Perusing document.) Yes.

2 Q And do you see that Exhibit 95-J makes a
3 reference to a report dated October 20, 2009?

4 A Yes.

5 Q And do you know, did the split in the --
6 this 85.1/18.5 premium allocation that was made, did
7 that change in 2010?

8 A Yes, it did.

9 Q And do you know how it changed?

10 A Yes. The new split was 19.9 percent for
11 PoolRe.

12 Q And do you know why it changed?

13 A It changed as part of an ongoing review of,
14 you know, what -- how we could improve the program
15 and, you know --

16 Q Did anything happen to the attachment
17 points under the policies? Do you recall?

18 A Yes. The attachment points changed under
19 the 2008, 2009 formula. It was -- there were two
20 attachment points. One was 100 percent of the total
21 annual premiums, and then the other attachment point,
22 it was multiple points. It was losses in excess of -
23 - one loss in excess of 100,000, two losses in excess
24 of 60,000, I believe, three losses in excess of 45- -
25 - I don't remember the exact numbers, but --

1 Q And it changed in 2010?

2 A Yes.

3 Q And the split, this letter -- who is --

4 sorry --

5 MR. MARKLEY: I'm sorry. Which letter did

6 you -- 96 or --

7 MR. ALBRIGHT: 95-J.

8 BY MR. ALBRIGHT:

9 Q -- Steven Glicksman?

10 A Yes.

11 Q Do you know Mr. Glicksman?

12 A Yes.

13 Q What does Mr. Glicksman do?

14 A He's an actuary.

15 Q And so this change that was made in 2010

16 that you just referred to --

17 A Correct.

18 Q -- did Mr. Glicksman provide Capstone

19 advice about the appropriate split?

20 A Yes.

21 Q And that was contained in the October 20,

22 2009, letter?

23 A Yes.

24 Q Okay.

25 MR. ALBRIGHT: Your Honor, we did submit an

1 expert report for Mr. McNeel, but we don't plan to
2 offer it at this point. So pass the witness.

3 MR. MARKLEY: Okay. Thank you. If I may
4 just have one or two seconds to --

5 THE COURT: Yes.

6 MR. MARKLEY: -- put all these documents
7 somewhere where I can find them.

8 (Pause.)

9 CROSS-EXAMINATION

10 BY MR. MARKLEY:

11 Q Well, Mr. McNeel, I'm Roger Markley. I'm
12 one of the attorneys on the IRS side, so I'll be
13 asking you some questions. Okay?

14 A Okay.

15 Q And just some sort of preliminary type
16 questions about your role in this case and actually
17 also your role in the trial. Prior to you coming to
18 court today, did you have an opportunity to review
19 documents and look at various matters, for example,
20 some of the things maybe that you were asked about by
21 Mr. Albright today or other documents in general?

22 A Yes.

23 Q You need to keep your voice up a little bit
24 --

25 A Yes.

1 Q -- because it's got to be recorded. I can
2 -- not the greatest ear either. And how long would
3 you say you reviewed the documents, whatever it was
4 that you reviewed, hours-wise?

5 A Hours? I'm not sure --

6 Q More or less.

7 A -- I can think in terms of hours. I don't
8 know. Maybe 20 to 30 hours, something like that.

9 Q Okay. And did you have an opportunity to
10 talk to anyone about what your testimony would be
11 today?

12 A You know, I filled out the report, you
13 know.

14 Q Well, what I mean -- I'm not sure you 100
15 percent understand my question. What I meant is,
16 before you came into court this morning to testify,
17 did you have an opportunity to talk to someone, other
18 than just, you know, to Mr. Albright about what you
19 were going to be testifying about, for example,
20 somebody at Capstone, something like that?

21 A No.

22 Q So then you did not talk to anybody at all
23 at any Capstone or PoolRe or any other entity about
24 the substance of your testimony today?

25 A No.

1 Q Okay. All right. And I assume you're not
2 aware of any -- of the testimony that was given in
3 court yesterday. No one told you about that, I
4 assume.

5 A No.

6 Q Okay. You're presently an employee of
7 Capstone. Is that correct?

8 A Yes.

9 Q And -- you keep that voice up.

10 A Shaking my head doesn't --

11 Q That's true, too. Most important person
12 right there, and the Judge. So The Feldman Firm, are
13 you familiar with The Feldman Law Firm?

14 A Yes.

15 Q And obviously you're familiar with
16 Capstone.

17 A Yes.

18 Q Anywhere located near each other?

19 A We're in the same building.

20 Q Okay. And do you have much of a dealing on
21 a day-to-day basis or any kind of basis with The
22 Feldman Law Firm in your Capstone capacity?

23 A Yes.

24 Q Would you say often? Regularly?

25 A Maybe -- I don't know -- on a Capstone

1 level, maybe a couple times a month, something like
2 that.

3 Q So would you ever meet with Mr. Feldman or
4 discuss anything with Mr. Feldman?

5 A Yes.

6 Q And would it be about captive insurance
7 companies in general?

8 A Yes.

9 Q Did you ever talk to Mr. Feldman about
10 anything to do with the Reserve company, the
11 insurance policies that Peak had with Reserve?

12 A I mean, I just don't know. At some point I
13 may have. I mean, certainly when we were in the
14 process, we would have discussed it, but --

15 Q And that would have been 2008, 2009?

16 A Yes.

17 Q Okay. And Mr. Albright had asked you about
18 some of these supplemental activities, you know, when
19 they changed the rates and things of that nature.

20 A Exactly.

21 Q Would you have had any conversations with
22 Mr. Feldman about that, changing of the rate?

23 A Yes.

24 Q Okay. And do you know what his thought
25 process was on that, as far as you know?

1 A I mean, it -- I don't know about a thought
2 process. We discussed that -- you know, we
3 discussed, you know, pros and cons, just sort of a
4 general decision-making process.

5 Q As far as what premiums that Peak was going
6 to pay for policies that it had with Reserve, who
7 would you say had the most influence on determining
8 what that premium amount would be?

9 A Can you repeat that?

10 Q yes. In terms of the -- in this 2008, '9
11 and '10 period --

12 A Right.

13 Q -- and you have Peak being -- Peak and
14 those other two entities being insured by Reserve --

15 A Right.

16 Q -- who was the most important, most
17 influential, significant person in determining what
18 the premium rates would be for those policies?

19 A Well, the most significant would be the
20 owners of Peak and the owners of Reserve.

21 Q And would it be true, as far as you know,
22 that the owners of Peak were essentially the same
23 people as the owners of Reserve?

24 A Yes.

25 Q Okay. Did Capstone have any significance

1 in that determination of the premiums?

2 A We gave our advice, not the determination
3 of them.

4 Q And without spending the next hour or two
5 going through all these documents again, would the
6 advice that you gave be in large part based upon the
7 type of work you did in, you know, formulating the
8 premium amounts and the documents that Mr. Albright
9 talked about earlier?

10 A Sure.

11 Q So would it be fair to say that a
12 culmination of the advice that you gave, meaning
13 Capstone and/or you gave regarding the premium
14 amounts would still have to be approved by Mr.
15 Zumbaum and his other partner? Is that right?

16 A Yes.

17 Q Okay. Did they question the numbers that
18 you gave them as the potential premium amounts? Did
19 they say, Why would we do this? Did they say
20 anything like that?

21 A Honestly, I just can't remember.

22 Q Okay. Did they ever put up a fight, any
23 kind of difficulty about it, as far as you know?

24 A I mean, if they had put up a fight, I
25 probably would remember it. I just don't remember

1 anything, you know, any kind of particular
2 conversation.

3 Q Yes. So you went out to that on-site in
4 '08, I think, the feasibility study, August 13, 2008.
5 Is that right?

6 A Yes.

7 Q That's on 16-J, if you need to --

8 A Yes.

9 Q -- look at it. So who went with you?

10 A Stewart Feldman.

11 Q So you and Mr. Feldman, and I believe you
12 said you were there about maybe working on it, six or
13 eight hours, something like that.

14 A Yes.

15 Q And you went to the various site locations
16 or the primary site location of Peak Company.

17 A Yes.

18 Q Did you go to the other site locations or
19 the other locations of the other entities, like
20 RocQuest or -- what was the other one? -- ZW?

21 A Actually they are -- my understanding is
22 one is a property company, so they own the property.
23 And I don't recall what the other one was. No, we
24 didn't.

25 Q Okay. There's a term that may drive some

1 of us crazy on TV about bundling, when you watch it
2 on TV. Were these policies bundled between Peak, ZW,
3 and RocQuest in terms of a policy, in terms of a
4 premium amount?

5 A The best analogy I can use is in the
6 commercial insurance industry. As an agent when I
7 would go out, I would identify every -- you know,
8 everybody in the group, everyone that's combinable.
9 That's an insurance term. You can't combine
10 unaffiliated companies. And we would want to put
11 those in the same policy, because we don't -- we want
12 to minimize the amount of gaps and things between
13 different companies in the same group.

14 Q So did you -- you know, in your capacity as
15 working out there and your long-term capacity being
16 in the insurance business, you knew that the -- Mr.
17 Zumbaum and Mr. Weikel were the primary persons
18 involved with all those three businesses that I
19 mentioned.

20 A Yes.

21 Q Okay. But you knew that they were
22 technically separate businesses, did you not?

23 A Yes.

24 Q So they weren't subs for -- one was not a
25 sub of another.

1 A No. They were separate.

2 Q Okay. We've had a lot of discussion about
3 the policies that are in issue here. Did you take a
4 look independently to see whether or not ZW and
5 RocQuest needed the same type of policy coverage that
6 Peak did?

7 A No. And that wouldn't be a traditional
8 type of approach. As an agent, I would never leave a
9 subsidiary or a part of a group out of a policy.
10 That would be asking for an E&O claim someday --

11 Q Uh-huh.

12 A -- against me.

13 Q So you -- when you were out in Idaho, did
14 someone put together a rough draft of the feasibility
15 study?

16 A Yes.

17 Q And was that you primarily?

18 A Primarily, yes.

19 Q Okay. Did Mr. Feldman have any input in
20 that rough draft?

21 A Not that I recall.

22 Q Okay. Well, after you got -- well, maybe
23 before or after you finished your on-site inspection
24 and review, did you and Mr. Feldman discuss what
25 would go into your draft of the feasibility study?

1 A I don't recall a separate discussion. You
2 know, we flew back. If my memory serves me right,
3 I'm sure that the topic came up.

4 Q Okay. All right. So it would not have
5 been unusual to have that kind of conversation.

6 A Yes, yes. No, it wouldn't.

7 Q How would you have considered your status
8 in Capstone vis-a-vis Mr. Feldman's status in regard
9 to the totality of the insurance business for which
10 you were working?

11 A I'm not sure I understand.

12 Q Okay. Who was higher or lower in the
13 status of -- between Mr. Feldman and yourself when
14 you were doing the feasibility study?

15 A Do you mean, who do I report to?

16 Q Well, you could do it that way, too.

17 A I report to Stewart, of course.

18 Q Okay.

19 A Do you mean who is the primary insurance
20 professional who understands what all of the issues
21 are? That would be me.

22 Q That would be you. Okay. Well, either
23 way, it answers a different question, and that's
24 fine. So PoolRe and Capstone, are you familiar with
25 that -- I'm not sure if it's PoolRe or PoolRe. I

1 don't know if I ever get it right, but --

2 A I call it PoolRe. Everyone else in
3 Capstone calls it PoolRe.

4 Q Okay.

5 A So we agree on something.

6 Q Yes. You and I -- well, we may agree on
7 more than one thing, but -- yes. Okay. So what is
8 the relationship between PoolRe and Capstone, in your
9 best way of describing it?

10 A Capstone provides underwriting services to
11 PoolRe.

12 Q All right. And how would you describe
13 PoolRe? What kind of an entity are they? Do you
14 know where they're located? What do they do?

15 A They're a licensed insurance company. They
16 are -- at the time, I believe, they were a British
17 Virgin Islands domicile, and somewhere along the line
18 that changed to Anguilla, I believe. But I'm not
19 sure exactly.

20 Q Okay. And do they -- do you know anything
21 about their reinsurance type activity? Are you
22 familiar with what they do in that regard?

23 A Sure.

24 Q And can you explain what you understand
25 they do.

1 A Well, they -- okay. So on a direct basis,
2 they underwrite a portion of each of the policies.
3 They underwriter a stop loss portion. And so they
4 have this book of business, and that is ceded to all
5 of the member captives.

6 Q Okay. So -- and this is actually one of
7 the most recent things that Mr. Albright asked you
8 about. At one point, the percentage that was being
9 paid to PoolRe was, I believe, 18-1/2 percent. Is
10 that correct?

11 A Yes.

12 Q And then it went up to 19.something.

13 A 19.9. Yes.

14 Q Okay. And I'll get to that in a second.
15 Have you ever testified on behalf of Capstone or
16 PoolRe before in any kind of trial, litigation,
17 arbitration or anything like that?

18 A Yes.

19 Q Okay. And where did you testify, and when?
20 Do you recall?

21 A Let's see. There was one that was in
22 Delaware. I don't remember the -- I guess it was the
23 capital, whatever that is.

24 Q Dover maybe?

25 A No. It wasn't Dover.

1 Q Wilmington?

2 A Wilmington, yes. Let's see. There was
3 another one in Houston. There were two more that
4 were in Houston, all arbitrations.

5 Q Okay. So then this would be the third or
6 how many testifying -- well, let me put it -- let me
7 rephrase that. In your capacity as a Capstone
8 employee, have you ever testified in any other type
9 of trial or hearing?

10 A No.

11 Q Than the ones you just mentioned.

12 A Right.

13 Q You had mentioned that you had worked
14 together with Mr. Snyder on the report.

15 A Yes.

16 Q Okay. Did you write -- when you wrote your
17 draft, did he participate in the draft, or did he
18 kind of edit it?

19 A He edited it.

20 Q Okay. Have you seen -- you've seen the
21 feasibility study -- right? -- at 16-J.

22 A Yes.

23 Q You might still have it up there. I assume
24 you noticed that on page 3, he is the only one that
25 signed it. Do you see that? Page 3 of that

1 feasibility study. Take a look. It should only be -

2 - oh, is it in that book there?

3 A Oh, it must be a different book. 16-J --

4 Q Well, let me do it a different way. Did
5 you sign the feasibility study?

6 A No.

7 Q Okay. That's an easier way to do it. And
8 why is that, that you did not sign it?

9 A Well, I drafted it. I participated in the
10 site visit. There's no question that Capstone was
11 definitely a party to the feasibility study.

12 Q Okay.

13 A I think it had our logo on it as well.

14 Q It had your logo on it. Yes.

15 Q So as far as your testimony here today,
16 you're testifying as a Capstone employee, and you're
17 not being paid anything extra and any other kind of
18 fee, other than your salary and your bonus money, I
19 think, that you had mentioned.

20 A Yes.

21 Q Okay. Going back to your -- you know, your
22 work history Mr. Albright asked you several hours
23 ago, did you ever in your work history in any kind of
24 insurance capacity, in whatever capacity it was, did
25 you ever deal with any type of a company that's

1 primarily kind of the work that Peak did in the
2 mining business before, if you recall?

3 A Let me think. I worked with a lot of oil
4 and gas companies, control of oil well drilling
5 contractors, that sort of thing.

6 Q Yes. And I would assume -- would it be
7 correct to assume that that would be a lot more money
8 involved with that type of business, or not?

9 A You know, it -- they go from Exxon down to,
10 you know, small drilling contractors.

11 Q Okay. But anything in the part of the
12 country where Peak is involved in actual mining?

13 A No.

14 Q Okay. Did you ever deal with any type of
15 companies in your insurance capacity in the past that
16 had the type of, I'll call it, pollution issues that
17 came up with the Peak Company?

18 A Certainly the oil and gas business is a
19 significant pollution exposure. Dealing with
20 refineries is the same kind of exposure.

21 Q All right. How about anything that had to
22 do -- any company that had any issues regarding like
23 being in the middle of an EPA Superfund site? Every
24 dealt with that before?

25 A Nothing that I can recall.

1 Q Okay. Did you ever deal with any companies
2 that had needs for the type of policies that Peak
3 had, you know, in terms of the insurance policies
4 that you discussed with the Peak owners and then
5 eventually were set up into premiums where Reserve
6 would be the insurer? There's about between ten and
7 13 --

8 A Yes.

9 Q -- depending upon the year.

10 A Yes. I mean, certainly throughout my
11 tenure at Capstone, I talked about that with clients
12 a lot.

13 Q Okay. So would this be an accurate
14 statement, that in your capacity working with
15 Capstone, you had -- and I don't want to say an
16 absolute set, but you had a more or less set type of
17 policies that you would talk about with potential
18 companies that would be setting up insurance captive
19 arrangements?

20 A I would say that we had policies that were
21 common to a lot of different clients. We also had
22 policies that were manuscripted specifically for a
23 client.

24 Q Yes. I think I might have heard that term
25 "manuscripted" before. Is that -- does that mean

1 essentially that something is particularized as a
2 type of policy that's out of the ordinary, let's say,
3 Allstate or State Farm kind of insurance policy?

4 A Yes. Or actually it could be something
5 that is rather in the norm. If a client has a
6 particular need or if there is a -- I'll give you an
7 example. Johnson & Higgins didn't like the standard
8 property insurance forms that were out there. Their
9 feeling was, we can do better for our clients. So
10 they had their own manuscript property form.

11 And when they went to an insurance company,
12 they said, We want you to use our form, and, you
13 know, you have to develop your own pricing, but we
14 want our form. Every other broker did the same
15 thing, so it wasn't that uncommon.

16 Q The types of policies that Peak had in this
17 particular situation, '08, '09 and '10, were they the
18 type of policies that theoretically PoolRe would be
19 involved in regarding reinsurance?

20 A Could you repeat that.

21 Q Yes. So, you know, you're familiar with
22 the type of policies that Peak had for '08, '09 and
23 '10.

24 A Yes.

25 Q Okay. Are those the type of policies that

1 a lot of the companies that were involved in the
2 PoolRe arrangement were also insuring those type of
3 risks, if you know?

4 A Yes. I mean --

5 Q How about liability, pollution liability?
6 Do you know?

7 A Yes. There were a number that had
8 pollution liability.

9 Q Okay. Do you know if any of them had
10 pollution liability type coverage where that
11 particular company, other than Peak, was in the
12 middle of an EPA site such as Peak was in?

13 A No. I don't think so.

14 Q You don't think so. Do you have any
15 knowledge of whether or not companies who were in the
16 PoolRe arrangement would have had any issues with
17 being in a pool where such a potential problem would
18 exist from an EPA type Superfund site to Peak?

19 A I don't think so.

20 Q And considering the fact of what -- well,
21 you don't know what was -- okay. Never mind. If you
22 have an -- I have an insurance agent for my
23 insurance, you know, house and car, and you probably
24 do, too.

25 A Sure.

1 Q How would you compare that to what Capstone
2 did in this case regarding Peak and -- I don't mean -
3 - yes, I mean Capstone. What was Capstone's
4 relationship to Peak and Reserve in any way similar
5 to what an insurance agent would be in a, I'll call
6 it, regular car insurance policy, fire policy?

7 A No.

8 Q It was not the same?

9 A It was not the same.

10 Q Okay. So you were out looking at potential
11 -- in that feasibility study, about potential risk.
12 Is that correct?

13 A Yes.

14 Q Okay. Now, of the potential risks that you
15 came up with, did you have any information, whether,
16 you know, from documentation or the owners of Peak
17 telling you or your independent investigation, that
18 they had ever suffered the kind of losses from some
19 sort of a problem, from sort of a claim, that were --
20 would have been the types covered by the policies
21 that Reserve enacted with the --

22 MR. ALBRIGHT: Objection, Your Honor.

23 That's a terribly confusing question.

24 MR. MARKLEY: Well, I'll ask it a different
25 way if I can.

1 BY MR. MARKLEY:

2 Q Did you know what the risks potentially
3 were to Peak as stated to you?

4 A Yes. I mean, we discussed it.

5 Q Okay. Did you know whether or not the
6 risks that were stated to you were actually enacted
7 as being the basis for policies that Reserve
8 eventually gave to Peak?

9 MR. ALBRIGHT: Objection, Your Honor.
10 That's a very confusing question.

11 THE COURT: If you could clarify the
12 question --

13 MR. MARKLEY: All right. I thought I had,
14 but I'll try again.

15 BY MR. MARKLEY:

16 Q When you went out for your feasibility
17 study, did anyone from Peak or any representative
18 from Peak tell you that they had specific losses that
19 if they had been policies as such that were set up by
20 Reserve would have been covered for --

21 MR. ALBRIGHT: Objection, Your Honor.
22 Again, very confusing. I'm not sure I know what he
23 asked.

24 THE COURT: If you could try and clarify
25 the question, and I know -- and he is testifying as a

1 fact witness, too, so --

2 MR. MARKLEY: Well, I -- okay. Yes, he is
3 testifying as a fact, and I wasn't trying to get into
4 a -- but I'll try once gain.

5 BY MR. MARKLEY:

6 Q Were you aware of any actual losses
7 suffered by Peak prior to your study, feasibility
8 study, that you went and engaged in in 2008?

9 A Yes.

10 Q And what were those losses?

11 A Well, they had a weight of snow loss --

12 Q Right.

13 Q -- a year before. Maybe it was that year.
14 I mean, you know, that was one loss. You know, I'm
15 not aware of any other losses.

16 A Okay.

17 Q I guess I should have asked it that way the
18 first time. Now --

19 MR. MARKLEY: Excuse me a second, Your
20 Honor.

21 (Pause.)

22 BY MR. MARKLEY:

23 Q Okay. So we have 109 and 110. Do you
24 still have those up there? I don't know if they're
25 in that book. They might have been a separate --

1 A Yes. They might be separate --

2 Q Have you got them?

3 THE COURT: Yes. 109 and 110 are looseleaf.

4 They're not in the books.

5 BY MR. MARKLEY:

6 Q Yes. Mine are just little sheets really.

7 A Okay.

8 Q So 109 has that underwriters, Lloyd's of
9 London, you see on that. 109, take a look at that
10 one, please.

11 A Okay.

12 Q Do you see that? So those are the --
13 that's a document that talks about the potential cost
14 for a premium for those types of coverage. Is that
15 correct?

16 A Yes.

17 Q Do you have any idea -- and I don't know if
18 you've had an opportunity to look at this or
19 determine this. Do you know what the total amount of
20 premiums are that if you would add them all up that
21 would be indicated on 109, for that first page which
22 was --

23 A For this?

24 Q Huh?

25 A For this?

1 Q Yes.

2 A No.

3 Q Okay. So would it be your belief that
4 whatever the amount of premiums would be would be the
5 total amount of premiums they would have to pay, that
6 is, Peak?

7 A No, not necessarily. I mean, these are
8 different columns, and, you know, it just depends on
9 which column the coverage fell into.

10 Q Okay. Is there any -- so then would it be
11 accurate to say that you'd have to look at each
12 column to figure out what the total amount of
13 premiums that Peak would have to pay for each of the
14 years in question, '08 for one form, '09 for the
15 other, and '10 for the third year?

16 A Yes.

17 Q Okay.

18 A Well, again, given the fact that these are
19 a set of recommendations and indications, they may
20 not end up being the exact number. I don't know. I
21 haven't done that calculation, but that doesn't
22 necessarily mean that these premiums are the end of
23 the road, the final premiums that are being charged.

24 Q Okay. And going to 110, if you have that
25 relatively small piece of paper there, document --

1 tell me when you get there. It looks like this.

2 It's minuscule.

3 A Okay. Here it is.

4 Q Yes. I want to just ask you basically
5 this. Would it would be correct to say -- if we came
6 away with something from this, would it be that as to
7 each type of policy coverage, that these other
8 numbers, going over to the right-hand side, you know,
9 categories, base rate average and so forth, would be
10 based upon the revenue amount collected by the
11 company in question, in other words, the insured
12 company?

13 A For all except employment practices.

14 Q For all except employment practices?

15 A Yes.

16 Q So like when Mr. Albright was going
17 through, for example, directors and officers
18 liability, he went through the first line, and 1
19 million through 10 million revenue under categories
20 and then that 1.436 number, would that be the type of
21 company that would be -- would involve Peak Company -
22 -Yes.

23 Q -- Peak Corporation?

24 A Yes.

25 Q Okay. So do you know that Peak had

1 approximately \$9 million in revenue?

2 A That was their projection.

3 Q That was their projection. Okay. So then
4 the amount of revenue would be a factor in the
5 determination of what the premium would be?

6 A Yes.

7 Q Would the potential for loss be a factor?

8 A Yes. I mean, in a -- probably not in a
9 direct sense, but in a -- you know, in a global
10 sense, sure.

11 Q Okay. What does that mean, global sense?

12 A The potential for loss is a potential. I
13 mean, you know, it's not -- you can't compare this
14 person's premium and that person's premium and this
15 person's loss and that person's loss and have them
16 match up.

17 Q Would you the fact losses in the past, for
18 example the snowfall crushing the roof, would that be
19 a factor to determine what the premium would be?

20 A That's taken into account. That's taken
21 into account in terms of underwriting.

22 Q Okay. And would the types of losses that
23 have been suffered in the past by Peak, like the
24 snowfall thing, would that be taken into account for
25 what premiums would be applicable?

1 A Again, it's not that easy. That's why we
2 don't have computers rating policies.

3 Q Is it a combination of activities that
4 would come together?

5 A It's an analysis that is done by
6 experienced, qualified underwriters who look at all
7 sorts of things. And, again, I don't want to bore
8 you with a bunch of examples, but I've never had a
9 homeowner's loss. I'm guessing you haven't either.
10 I've had an automobile loss 15 years ago when my son
11 was a teenager. I haven't had anything since. And
12 other than that, if you looked at my loss
13 information, you'd say, Why are we even writing this;
14 why not charge you nothing. I mean, you have no
15 losses; you have no need.

16 Q Okay. So let me spin off from there. So
17 in this particular instance where there was -- if the
18 only indication to you in regard to Peak was the
19 snowfall issue that broke the roof, why would there
20 have been any need to have policies for these other
21 aspects, for example, pollution --

22 A Yes. That's exactly --

23 Q Excuse me a second. Go ahead.

24 A No, go ahead.

25 Q No, no, no. Were you going to say, That's

1 exactly right, what I was saying.

2 A No. I was going to say, That's exactly
3 right, what I was saying.

4 Q Okay. Which is what?

5 A Which is past losses are not a slam dunk
6 indicator of future losses.

7 Q Okay. And so you're saying future losses
8 that have no basis in past losses are just as good as
9 past losses for calculation?

10 A Yes -- well, not for calculation. There's
11 nothing to calculate. But I don't -- I'm not locked
12 into past losses. What I'm locked on is, what is the
13 future loss potential.

14 Q And do you look at --

15 A And that's the ultimate job description of
16 an underwriter. If all I were doing was rating, I
17 would have a rating job, which is very important in a
18 large insurance company, but it's a clerical job.

19 Q Would it be accurate that -- well, are you
20 familiar with what type of requirement the Anguillan
21 law has as to how much insurance premiums can be
22 received in an Anguillan company before it becomes
23 potentially subject to United States tax? Do you
24 know?

25 A I don't believe there's an Anguillan law to

1 that effect.

2 Q Do you know if there's any American law to
3 that effect?

4 A Yes, yes.

5 Q Okay. So would it be correct that --

6 A Let me put it this way. I'm familiar with
7 it, but I'm certainly not a tax attorney or anything
8 like that. I don't want to --

9 Q No. I'm not asking you as a tax attorney.
10 I'm just asking if you're familiar with the law. So
11 would it be correct when policies such as Peak were
12 designed, they needed to be designed so that the
13 premium amounts that were paid per year for the
14 policies, whatever -- whether there were one or 20,
15 would have to be under \$600,000, so that they're not
16 taxable in the United States? Do you know that or
17 not?

18 MR. ALBRIGHT: Your Honor, objection. I'm
19 not sure that asking Mr. McNeel tax questions is --
20 has any relevance.

21 MR. MARKLEY: Well, what I'm asking him is
22 -- I'll ask it a different way.

23 THE COURT: And since he isn't -- and
24 reminding you, just since he is a fact witness, so --

25 MR. MARKLEY: Okay.

1 BY MR. MARKLEY:

2 Q When you were assisting and putting
3 together the policies in question, were you aware
4 that the premiums could never exceed \$600,000?

5 A No.

6 Q You were not aware of that.

7 A No. Not at all.

8 Q Okay. So do you know if anyone else within
9 the Capstone company was aware of that?

10 A I'm not sure anyone went into it with the
11 stated intention that the policies, whatever we come
12 up with in the feasibility study, are going to be
13 under a certain amount. I mean, that's just -- I
14 mean, that's just not part of the process.

15 Let me try to clarify --

16 Q Excuse me just one second.

17 (Respondent counsel conferring.)

18 BY MR. MARKLEY:

19 Q I'm sorry. Go ahead.

20 A Go ahead. I --

21 Q No, no. You were answering my question. I
22 didn't think I had one, but go ahead.

23 A No. We --

24 MR. ALBRIGHT: Your Honor, I would ask that
25 the question be repeated. I don't remember what it

1 was myself.

2 MR. MARKLEY: I didn't think I had a
3 question. That was my point.

4 MR. ALBRIGHT: Oh.

5 BY MR. MARKLEY:

6 Q Mr. McNeel, did you want to amplify
7 something that you had said to me before? Because
8 nobody on this side seems to know what it was.

9 A I lost it myself.

10 MR. ALBRIGHT: In response to what, Your
11 Honor? I --

12 THE COURT: We'll just move to the next
13 question.

14 MR. MARKLEY: I don't have a question
15 pending at the moment, but all right.

16 BY MR. MARKLEY:

17 Q The -- okay. The lawyers lie that says,
18 Just one more question, so I won't say, Just one more
19 question, but hopefully not too many more. 34-J,
20 which is the study -- it's kind of like the
21 documentation that you had before you actually put
22 together the feasibility study, it's that real big
23 fat one there.

24 A Oh, yes.

25 Q Yes. We're not on those skinny guys

1 anymore. You can put -- I'm not going to be asking
2 you anything. So when you put together your
3 feasibility study, you and Mr. Snyder and perhaps Mr.
4 Feldman, those, as you testified to, that was the
5 basis for -- part of the basis for the feasibility
6 study determination.

7 A Yes.

8 Q Do you know when the final feasibility
9 study was actually issued?

10 A I think it was like August of '09.

11 Q And -- but you actually were out there in
12 2008. Is that right?

13 A Yes.

14 Q Okay. Do you have 94-J up there? It looks
15 to me like one piece of paper, but unfortunately,
16 it's in the middle of that morass.

17 A Okay.

18 Q Okay. And --

19 A Wait, wait, wait, wait. I was at 90.
20 That's 8951?

21 Q 8951, yes, on the far side with the RSV in
22 front, but 94-J.

23 A Okay.

24 Q Now, you had mentioned that this was the
25 type of document or this was the document that was

1 the basis for your participation in the feasibility
2 study. Or how did this quite come into play in
3 regarding your work in the Peak feasibility study?

4 A This is the -- in terms of Mid-Continent
5 issuing those indications --

6 Q Yes.

7 A -- this is their process for doing that.

8 Q Okay. So when did you -- when do you
9 believe that Mid-Continent issued their indications
10 that were used by you in the feasibility study for
11 what turned out to be the policies that Peak had with
12 Reserve?

13 A I don't understand.

14 Q Take a look at the date of the letter 94-J,
15 April 28, 2009.

16 A Right.

17 Q Okay. This is dated April 28, 2009. When
18 was your feasibility study in place in Idaho for
19 Peak?

20 A August -- I mean, it was in place -- the
21 feasibility study was drafted a few weeks after the
22 site visit.

23 Q Okay. So the feasibility study was drafted
24 a few weeks after the site visit, which was in August
25 or so of 2008?

1 A Right.

2 Q So would it be correct, then, that 94-J,
3 dated April 28, 2009, could not have possibly been
4 used in that feasibility study?

5 A Well, this is documenting an ongoing
6 relationship, an ongoing set of criteria that they
7 used. This isn't the basis for anything that we did.
8 This is an acknowledgment, a description of their
9 processes.

10 Q Okay. In light of the fact --

11 A In fact, I think it even says -- refers to
12 the long-term relationship that we've had.

13 Q So what you're saying then, that this isn't
14 really the basis specifically for anything that you
15 did in 2008.

16 A No. I'm saying -- well, this document, but
17 the long-time relationship that Capstone, even before
18 I was there, had with Mid-Continent is described in
19 this document.

20 Q Were there any other documents that
21 actually existed prior to doing the feasibility study
22 that enunciated this type of policy that you say was
23 around for a long period of time?

24 A I'm not aware of any.

25 Q Okay. All right.

1 MR. MARKLEY: Thank you, Your Honor. Thank
2 you, Mr. McNeel.

3 REDIRECT EXAMINATION

4 BY MR. ALBRIGHT:

5 Q Mr. McNeel, Mr. Markley asked you in his
6 cross-examination whether you were aware -- or I
7 believe you said you were not aware of any losses
8 that Peak had, other than the roof -- the weather-
9 related event. Was it that you were not aware of any
10 losses, or is it that you did not -- do not remember
11 whether they told you about other losses?

12 MR. MARKLEY: Your Honor, he's putting
13 words in his mouth. He already had the answer. This
14 is redirect. It's leading.

15 THE COURT: If you could just rephrase the
16 question --

17 MR. ALBRIGHT: Okay.

18 BY MR. ALBRIGHT:

19 Q Mr. McNeel, you said that you -- I believe
20 you said -- I thought I understood you to say that
21 you were not aware of any losses that Peak had prior
22 to the time that you did the feasibility study, other
23 than the weather-related loss. Was that your
24 testimony?

25 A Yes.

1 Q Okay.

2 MR. ALBRIGHT: No further questions, Your
3 Honor.

4 MR. MARKLEY: I have no follow-up on that.

5 THE COURT: All right. You may step down.

6 THE WITNESS: For good, or just for now?

7 THE COURT: Unless Respondent --

8 MR. MARKLEY: No. This witness had not
9 been subpoenaed by Respondent, and as I understand
10 it, then he -- Mr. McNeel will not be testifying as
11 an expert. Right? I think you said that.

12 MR. ALBRIGHT: We've not offered him as an
13 expert witness at this point.

14 THE WITNESS: All right. Thank you.

15 THE COURT: At this point. You may step
16 down for now.

17 THE WITNESS: I mean, I just wanted to know
18 if I could go home or if I should stay around.

19 MR. ALBRIGHT: We have no plans to ask any
20 further questions of Mr. McNeel today. As far as
21 we're concerned, he can go home.

22 (Whereupon, the witness was excused.)

23 THE COURT: All right. And just to switch
24 things up, we'll take a five-minute recess. Thank
25 you.

1 THE CLERK: All rise.

2 (Whereupon, a short recess was taken.)

3 THE CLERK: All rise.

4 Please be seated.

5 MR. ALBRIGHT: Petitioner calls Esperanza
6 Mead.

7 THE CLERK: Please raise your right hand.

8 Whereupon,

9 ESPERANZA MEAD

10 having been first duly sworn, was called as
11 a witness herein, and was examined and testified as
12 follows:

13 THE CLERK: Can you please state your name
14 and address for the record.

15 THE WITNESS: My name is Esperanza Mead,
16 and my address is -- work or --

17 THE CLERK: You can do work address.

18 THE WITNESS: -- 175 Southwest 7th Street,
19 Suite 2201, Miami, Florida 33130.

20 THE CLERK: Thank you. You may be seated.

21 MR. HARRIMAN: Your Honor, to help expedite
22 matters, Respondent has no objection to the Court --
23 or no objection to Ms. Mead's qualifications as an
24 actuary.

25 THE COURT: So the Court will accept her as

1 an expert witness.

2 MR. ALBRIGHT: Your Honor, may I have a
3 copy of Ms. Mead's report marked for identification
4 as Petitioner's Exhibit next in order?

5 THE COURT: Yes.

6 MR. ALBRIGHT: May I approach, Your Honor?

7 THE COURT: Yes.

8 MR. ALBRIGHT: (Handing document.)

9 THE CLERK: The expert report of Esperanza
10 Mead has been marked for identification as Exhibit
11 113-P.

12 (The document referred to was marked for
13 identification as Petitioner's Exhibit
14 113-P.)

15 MR. ALBRIGHT: Your Honor, may I provide a
16 copy of the document -- or the report that's been
17 marked for identification as Petitioner's Exhibit
18 113-P for identification, may I provide that to --

19 THE COURT: Yes.

20 MR. ALBRIGHT: -- Ms. Mead?

21 DIRECT EXAMINATION

22 BY MR. ALBRIGHT:

23 Q (Handing document.) Ms. Mead, do you have
24 a copy of Exhibit 113-P in front of you?

25 A Yes, I do.

1 Q Can you tell me what Exhibit 113-P is.

2 A Overall, this report is to show the
3 findings regarding eight of the coverages that
4 Reserve Casualty Corp. has, to review the adequacy
5 and give my opinion, whether the rates that were in
6 place back for policy year 2008, 2009, and 2010,
7 whether they were reasonable or not.

8 Q And is this a copy of your report?

9 A Yes.

10 Q 113-P?

11 A Yes.

12 Q And is your signature on page 2?

13 A Yes.

14 MR. ALBRIGHT: Your Honor, I would offer
15 Exhibit 113-P into evidence.

16 MR. HARRIMAN: No objection, Your Honor.

17 THE COURT: 113-P is admitted.

18 (The document referred to, having been
19 previously marked for identification as
20 Petitioner's Exhibit 113-P, was received
21 in evidence.)

22 BY MR. ALBRIGHT:

23 Q And in reviewing -- in the work that you
24 did, did you come to a conclusion?

25 A In my opinion, the eight coverages that I

1 reviewed for Reserve Casualty Corp. for the years in
2 question, the rates were reasonable.

3 MR. ALBRIGHT: Pass the witness, Your
4 Honor.

5 CROSS-EXAMINATION

6 BY MR. HARRIMAN:

7 Q Good afternoon, Ms. Mead.

8 A Good afternoon.

9 Q My name's Tom Harriman. I'm an attorney
10 for Respondent, and so I just have a couple of
11 questions regarding the expert report that was just
12 filed.

13 A Sure.

14 Q Let's start off on page 11. Now, you
15 stated in your report on this page that the
16 historical loss experience of Petitioner has no
17 credibility. Is that correct?

18 A Credibility in the actuarial terms, what it
19 means is there is no volume of claim activity. In
20 the actuarial world, that's what we refer to
21 credibility.

22 Q So that means that there was no historical
23 loss data for the Petitioner?

24 A Yes. It would be no claims or low claim
25 activity for it to be low credibility.

1 Q But in this situation is it low claim or no
2 claims?

3 A For the Reserve, for the years in question,
4 there were no claims.

5 Q So no losses during those years.

6 A Correct.

7 Q And because of the missing historical loss
8 experience, your report looked at the aggregate of
9 all the Capstone associated captives. Is that
10 correct?

11 A That is correct.

12 Q And that was the aggregate for all the
13 Capstone captives, as we'll refer to them throughout
14 this as Capstone associated captives is a mouthful.
15 For the Capstone captives, that was for the policy
16 years 2011 to 2015. Would that be a correct
17 statement?

18 A For -- yes. The analysis was performed for
19 all captives for Capstone, to be able to build more
20 credibility, because we have more experience there.

21 Q But when you were looking at the Capstone
22 in the aggregate level, it was for policy years that
23 were in effect 2011 to 2015. Right?

24 A Yes. You have four rate indication
25 exhibits. In the actuarial profession, we go back

1 five years, so we started from 2011 to 2015.

2 Q So you weren't looking at Capstone data
3 from 2008 to 2010 on the aggregate level.

4 A Correct.

5 Q All right. Now, you also stated that the
6 historical loss data for the Capstone captives for
7 the policy years 2011 to 2015 had low credibility.

8 A For all aggregate or for Reserve?

9 Q For the aggregate.

10 A No, because 2008 and 2009, I didn't have
11 that information.

12 Q Oh, it was for 2011 to 2015, again
13 examining at the aggregate level.

14 A The five years.

15 Q Uh-huh.

16 A Those, we looked at it, and there are some
17 claim activities, so they had more credibility than
18 when we're looking at just Reserve Casualty Corp.

19 Q But you still called it as low credibility.
20 Correct?

21 A It has lower claim activity, and it's
22 expected for this type of coverage.

23 Q But in your expert report, it stated that
24 it was low credibility.

25 A Yes. Low credibility.

1 Q Uh-huh. And, again, it's a low credibility
2 that you're giving it because of the missing loss
3 data, or there's minimal losses being claimed.

4 Correct?

5 A The claim activity is low.

6 Q So your report relies mostly on expected
7 loss ratios and evaluating the Petitioner's premiums.

8 A Yes. I used the 75 percent loss ratio,
9 expected loss ratio, as a complement to the
10 credibility to the actual experience.

11 Q Now, I'm not an actuary, so expected loss
12 ratio, I'm lost on it. Just for clarity, is that
13 essentially the percentage of claims that's going to
14 be paid versus the premiums received, or what would
15 be the best way if you're describing expected loss
16 ratio?

17 A The best way to describe it is if you had
18 \$100 in premium, the portion of the expected losses.
19 So in other words, in this example, it would be \$75
20 out of the hundred that is expected to cover the
21 losses.

22 Q That's funny. That's the exact same
23 hypothetical I had posed next, so even with the 175,
24 so that clarifies it. I do want to discuss now the
25 sources of data you relied upon in compiling your

1 report. It's on pages 9 and 10. What data did you
2 review from Petitioner?

3 A I reviewed all the data disclosed on page 9
4 and 10.

5 Q All right. And amongst the data you
6 disclosed on pages 9 and 10, was any of it from
7 Petitioner or the owners of Petitioner, Norman
8 Zumbaum or Corey Weikel?

9 A The -- I included here the actual source of
10 the data, and most of the data source was provided by
11 Capstone for me to perform the peer reviews, as well
12 as some of the information is coming from the
13 actuarial risk management, which Capstone again were
14 the one provided that report to me.

15 Q Okay. So would you say then -- would it be
16 a fair statement that all your sources of data are
17 from Capstone, the actuarial factor, and The Feldman
18 law Firm? And I see another thing on here, the
19 Consumer Price Index. Is that a complete list of
20 your sources of data?

21 A Correct.

22 Q So you didn't review any information from
23 Mid-Continent?

24 A No.

25 Q And, again, you didn't review any data from

1 Reserve, the Petitioner in this case.

2 A All the information was provided to me by
3 Capstone.

4 Q All right. Now, I do want to discuss the
5 exhibits that you have attached to your report.

6 Let's start on Exhibit 3A.2. It's labeled, Captive
7 analysis cyber risk package insurance policy. Let me
8 know when you're on that page.

9 A Which exhibit is?

10 Q It's labeled 3A.2.

11 A Okay. Expense exhibit.

12 Q Yes. The expected loss ratio page.

13 A Okay.

14 Q All right. So this is for cyber risk.

15 A Yes.

16 Q Now, there's a few numbers on here I want
17 to just walk through. The first one is the expected
18 loss ratio, what we discussed earlier. That's 75
19 percent.

20 A Yes.

21 Q All right. And you arrived at that based
22 on, it looks like, these three other numbers above.
23 So let's start with this 20 percent you cite to. Can
24 you explain how you arrived or where this 20 percent
25 number is coming from?

1 A The item number 1 is LAE, which stands for
2 loss adjustment expenses. It is a load that is
3 normally included in the actual losses to include
4 essentially legal expenses, any expenses outside the
5 actual losses. And that 20 percent is not part of
6 this expected loss ratio. 75 is actually added to
7 the -- loaded to the actual losses.

8 Q Okay. So are you saying that we should be
9 focusing on the second number and the third number?

10 A The 75 is 100 percent. Out of the \$100
11 premium, \$8 is for the expenses. \$17 is for profit,
12 and the remaining is for the expected losses.

13 Q All right. So let's start with that 8
14 percent number for expenses. What does that entail?

15 A The 8 percent expenses was provided to me
16 by Capstone, and that is essentially overhead to run
17 the captive operation.

18 Q Did you verify this 8 percent number?

19 A I did not verify the 8 percent number.
20 However, in my opinion, that number should be higher
21 than the 8 percent.

22 Q And why is that? On what basis?

23 A On the basis of my experience with
24 insurance. For all the other insurance carriers that
25 I have worked with in my 22 years of experience, that

1 number is on the low end.

2 Q All right. And then turning to number 3,
3 this one is labeled as your judgment. That's at 17
4 percent.

5 A Correct.

6 Q So what makes up that 17 percent number?

7 A Essentially as a captive, the captive has
8 to run on its own besides the normal operations, so
9 there needs to be some type of profit involved in
10 there. In other words, we want to make sure that the
11 captive is self-sufficient, so there is essentially a
12 margin there.

13 Because the -- what I consider the expected
14 loss ratio in the industry for this type of coverage
15 is 75 percent and I believe the expense is low that
16 was included there was on the low end, I judgmentally
17 selected the 17 percent profit load in there.

18 Q So the 17 percent is based solely on your
19 judgment.

20 A Correct.

21 Q And with the 8 percent provided by Capstone
22 and the 17 percent from solely your judgment, that's
23 how you arrived at the 75 percent expected loss
24 ratio?

25 A Essentially the 75 percent is what I expect

1 for this type of business to run, based on my
2 experience in the industry for this type of coverage.

3 Q Okay. And that's for this type of coverage
4 for cyber risk.

5 A Correct.

6 Q Okay. So I want to now turn your attention
7 to what's been marked as Exhibit -- attached to your
8 report, 3D.2.

9 A Correct.

10 Q Now, this is for intellectual property
11 package insurance policy. Correct?

12 A You said 3D.2?

13 Q 3D.2.

14 A Okay.

15 Q All right. And that's the page that's
16 labeled, Intellectual property package insurance
17 policy.

18 A Uh-huh.

19 Q Now, it's the same numbers again. It's 20
20 percent, 8 percent, 17 percent, and the expected loss
21 ratio is 75 percent.

22 A That is correct.

23 Q And so that's the exact same as the cyber
24 risk.

25 A Correct.

1 Q So you're applying the same numbers and
2 risks -- or the same expenses and your profit margin
3 to the exact -- to a completely different policy?

4 A Yes.

5 Q All right. And would you say that it would
6 be fair to say that these numbers are used repeatedly
7 for each policy you reviewed?

8 A Yes.

9 Q So for each and every policy, it's the same
10 percent of expenses.

11 A Correct.

12 Q And it's your same judgment percentage that
13 you use across all policies, regardless of what the
14 coverage is.

15 A Correct.

16 Q Okay. Now, going back to your actual
17 report -- and luckily we'll have page numbers this
18 time -- it's going to be pages 14 and 15. I just
19 have a few questions here.

20 All right. Are you there?

21 A Yes.

22 Q Great. So the first thing I notice on this
23 is you have a column that's labeled,
24 Revenue/employees. What does that column mean?

25 A It is the range of where Reserve falls into

1 for the revenues. In other words, they have revenues
2 between 1 million to 10.9 million, and that's
3 essentially where they fall into, and there is a base
4 rate related to that revenue tier.

5 Q Okay. So it would be fair to say that this
6 is the starting point for determining the premium.

7 A Correct.

8 Q All right. So -- and the range is 1
9 million to 10.9 million?

10 A Correct.

11 Q All right. And I notice that we have two
12 rows here. One's labeled, All captives, and one's
13 labeled, Reserve Casualty Corp. Let's look at the
14 cyber risk one, just as a way of example.

15 A Uh-huh.

16 Q So it looks like what we're doing is
17 comparing all of the captives between 2010 and 2015
18 to the 2008 premium. Would that be correct?

19 A Yes. The -- what it has is it's comparing
20 -- you can see that the basic rate is the same. The
21 increased limit factor is the same, whether you're
22 looking at all captives versus Reserve Casualty Corp.
23 for that particular year, the only difference between
24 the two being the experience modifier, because that
25 is applied more at an individual level.

1 Q But it all starts at the same starting
2 point of basically what's the gross revenue a company
3 has.

4 A Correct.

5 Q So let's run through cyber risk quick as a
6 hypothetical. So let's say we have a company, we'll
7 say, a computer programming company --

8 A Uh-huh.

9 Q -- and it has \$10 million in revenue. it
10 would still fit into this chart right here.

11 A Yes.

12 Q But then, let's say, we have a bakery, and
13 it makes a million dollars. It would still fit into
14 this chart here.

15 A Correct.

16 Q They would have the same starting point.

17 A Correct.

18 Q Even though they're in vastly different
19 industries.

20 A Correct.

21 Q And they have vastly different revenues.

22 A Yes.

23 Q And now just turning to the one labeled,
24 Employment practices liability, there we don't have a
25 1 million to \$10 million range anymore. It's 1 to

1 25. Would that be for the number of employees?

2 A Correct.

3 Q So, again, just walking through a
4 hypothetical, if we had a company with 25 employees
5 and we had a company with one employee, they would
6 still use this rating system.

7 A That is the range. Yes.

8 Q That would be the starting point.

9 A That is the range that is used. Correct.

10 Q Even though they're vastly different
11 numbers for the number of employees involved, one
12 employee versus 25 employees. It's the same system.

13 A I wouldn't say they're vastly different,
14 but they -- it is within the range, and, yes, it
15 would be just the same.

16 Q So it sounds like the revenue and the
17 number of employees would be the main factors in
18 determining the premium rate under the system.

19 A it's based on -- for most of the coverages,
20 with the exception of employment practice liability,
21 it's using the revenue to be able to price it, so
22 different tiers.

23 Q So with the exception again of the employee
24 practices, for these policies you reviewed, it looks
25 like it's seven if we're excluding the employment

1 practices. For the seven here, revenue is the main
2 factor for setting a premium.

3 A That is one of the factors that is setting
4 the premium. There's also obviously the differences
5 in coverages. That's a different rate, and as well
6 has the limit, in this case being the 1 million in
7 most cases, so we do adjust for the increased limit
8 factors as well. So there are various factors.
9 That's just one.

10 Q Uh-huh. But it's all using the same
11 starting point of gross revenue.

12 A Correct.

13 Q All right. Now, on page 17, it discusses
14 just your compensation, and I see your hourly rate
15 and the amount of time you've spent. But who is
16 compensating you for your time today and for this
17 report?

18 A I got paid by the law firm, and I already
19 received the check.

20 Q Oh, can you clarify which law firm.

21 A From Feldman.

22 Q All right. And going to, I believe it is,
23 your signature page number 2, it discusses your
24 previous actuarial work and review. Who was that
25 previous actuarial work that is referred to in the

1 second paragraph?

2 A Actuarial Risk Management.

3 Q That's what you reviewed, but did somebody
4 request that you review the reports from Actuarial
5 Risk Management?

6 A Yes. Actuarial Risk Management initially
7 did an actual review of these coverages. They did a
8 complete analysis, and I was asked by Capstone to
9 perform a peer review of all those coverages.

10 Q And when was that peer review conducted?

11 A It was done in 2016 and 2017, earlier this
12 year.

13 Q So since 2015, you've been engaged by
14 Capstone?

15 A I was engaged, I believe it was, at the end
16 of 2015.

17 Q So from the end of 2015 to the present,
18 you've been engaged by Capstone?

19 A Yes.

20 (Page 426 and following enclosed under
21 separate cover.)

22

23

24

25

1 CERTIFICATE OF TRANSCRIBER AND PROOFREADER

2 CASE NAME: Reserve Mechanical Corp, f.k.a. as

3 Reserve Casualty Corp. v. Commissioner

4 DOCKET NO.: 14545-16

5 We, the undersigned, do hereby certify that the
6 foregoing pages, numbers 326 through 425, inclusive,
7 are the true, accurate and complete transcript
8 prepared from the recording made by electronic
9 recording by Leslie Berridge, on April 27, 2017,
10 before the United States Tax Court at its session in
11 Houston, Texas, in accordance with the applicable
12 provisions of the current verbatim reporting contract
13 of the Court, and have verified the accuracy of the
14 transcript by comparing the typewritten transcript
15 against the verbal recording.

16

17 _____

18 Nancy H. King 05/18/2017

19 (Transcriber) (Date)

20

21 _____

22 Laurel H. Stoddard 05/19/2017

23 (Proofreader) (Date)

24

25

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IN THE UNITED STATES TAX COURT

In the Matter of:)
)
RESERVE MECHANICAL CORP., f.k.a.)
RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
v.)
)
COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

Volume: 6
Pages: 426 through 501
Place: Houston, Texas
Date: April 28, 2017

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IN THE UNITED STATES TAX COURT

 In the Matter of:)
)
 RESERVE MECHANICAL CORP., f.k.a.)
 RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
 v.)
)
 COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

Room 7006
Casey U.S. Courthouse
515 Rusk Avenue
Houston, Texas

April 28, 2017

The above-entitled matter resumed for
trial, pursuant at 9:18 a.m.

BEFORE: HONORABLE KATHLEEN KERRIGAN
Judge

APPEARANCES:

For the Petitioner:

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MICHELLE Y. KU, Esquire
Gardere Wynne
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214-999-3000

1 APPEARANCES: (continued)

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C O N T E N T S

WITNESSES:	DIRECT	CROSS	REDIRECT	RECROSS	VOIR DIRE
For Petitioner:					
Esperanza Mead				434	
			435		
Gary T. Fagg	437	439			
Michael Solomon	447	468	485		
For Respondent					
None					

1

E X H I B I T S

2

EXHIBITS:

IDENTIFIED

RECEIVED

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114-P

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115-R & 116-R

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117-P

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1 P R O C E E D I N G S

2 MR. HARRIMAN: Your Honor, if I may have
3 just one moment --

4 THE COURT: Yes.

5 (Pause.)

6 MR. HARRIMAN: Your Honor, I have no
7 further questions at this time.

8 THE COURT: All right. I'm just going to
9 ask a couple of questions before, and then you can
10 both -- so that way, you'll both have opportunity to
11 follow up on my questions.

12 On page 14 of your report, if you could --
13 I just want you to explain. In response to
14 Respondent's question, you mentioned how the numbers
15 were the same here in certain columns, but it was the
16 experience modifier that made the difference. And
17 could you just explain why and kind of maybe use --
18 maybe since we used cyber risk package, just walk
19 through that line and give an example of that.

20 THE WITNESS: Sure. So basically the
21 pricing for Capstone, the way it's structured, is
22 based on the revenue tiers, so in this case, for
23 Reserve Casualty Corp., it is in the 1 million to
24 10.9 million. And it also, with that, it brings the
25 basic rate of 1.687 for that particular tier.

1 And because of that, because the selected
2 aggregate limit is 1 million, we have to bring in the
3 increased limit factor that corresponded with the 1
4 million, so that's where the 3.4 comes from. So in
5 other words, if the limit was half a million, it
6 would be lower factor. But because it's 1 million,
7 it's the 3.4.

8 And then after that, we just multiply the
9 two, the basic limit times the increased limit
10 factor, to come up with what we have there as the
11 basic rate times the increased limit factor of 5.736.
12 But if you notice, the current unlimited rate, which
13 is really the actual rate as it relates to the
14 revenue level, is 3.149. So the fact that it's lower
15 is because at the individual captive, they provide a
16 experience multiplier discount that brings the rate
17 down, and that is done at the individual level.

18 THE COURT: So did you review the
19 experience modifier, and if you could just kind of
20 explain what is usually taken into consideration to
21 get the experience modifier.

22 THE WITNESS: Experience modifiers are
23 usually done in commercial business for -- in
24 general. There's a generic, as far as having a
25 particular business, having more risk controls in

1 place than other ones, so there's usually a credit
2 given to different areas.

3 Also, if they have no claim activities in
4 the past several years, they also give a discount, so
5 this is very common in the commercial market, to be
6 able to give essentially credits or debits as it
7 relates to that.

8 But if you notice, what's important in my
9 opinion is that the current unlimited rate for all
10 captives is 5.528, meaning that it is higher than
11 what you see the rate charged for that same coverage
12 for Reserve Casualty Corp. is 3.149.

13 THE COURT: Okay. And on the experience
14 modifier, if I move down to -- say, we skip down to
15 directors and officer insurance policy.

16 THE WITNESS: Uh-huh.

17 THE COURT: So for each different type of
18 insurance line, the experience modifier is usually
19 different?

20 THE WITNESS: Yes. It depends on what the
21 criteria they have for that particular coverage. And
22 that's done usually by the underwriter.

23 THE COURT: On page 12 of your report --
24 and this also relates back to when we were talking
25 about 3A.2, but I think you can just -- on page 12,

1 it says, "Capstone provided actual factor with an
2 expense ratio of 8." And I believe when you talked
3 about the cyber risk, that 8 percent, you mentioned
4 that you thought that that was the overhead, and you
5 thought that number should be higher.

6 THE WITNESS: Yes, because in the insurance
7 industry, from what I know, not just captives but
8 just regular insurance, the expected expenses are
9 much higher than 8 percent.

10 THE COURT: And so this 8 percent -- I
11 believe you answered this. I just want to be clear.
12 This 8 percent estimate was given for all the eight
13 different insurance you reviewed.

14 THE WITNESS: Correct.

15 THE COURT: Okay.

16 THE WITNESS: Sometimes they don't separate
17 it by coverage.

18 THE COURT: That was --

19 THE WITNESS: And that is normal.

20 THE COURT: That was all my questions.

21 THE WITNESS: Sure.

22 MR. ALBRIGHT: No questions, Your Honor.

23 (Pause.)

24 MR. HARRIMAN: Your Honor, if I may, I just
25 have a few questions, based on what just transpired.

1 RECROSS-EXAMINATION

2 BY MR. HARRIMAN:

3 Q So going back to tables 14 and 15, let's
4 discuss the experience modifier just a little bit
5 more. If I heard you correctly when you were
6 speaking with the Judge, you stated that the
7 experience modifier comes from the underwriter.

8 A The experience modifier is, in my opinion,
9 it's normally the underwriter does provide debits and
10 credits, based on the individual captive of how they
11 perform.

12 Q So where is the experience modifier number
13 coming from in your report? What's the source for
14 it?

15 A My report is actually just adopting -- I
16 have the actual total premium charge. Right?

17 Q Uh-huh.

18 A And that, divided by the revenue, is what
19 we have here as a total, and then the actual what we
20 have in table are basic rates, as well as the
21 increased limit factor, so it's essentially imbedded
22 in it. That's the experience modifier here. In
23 other words, I backed into it.

24 Q So you didn't come up with this experience
25 modifier.

1 A No. It is backed into it.

2 Q So -- and did you review the underlying
3 documentation that would have given you what the
4 experience modifier would have been, had the policy
5 been unwritten in 2008?

6 A My opinion has been on the total premium
7 charge, which is the current unlimited rate. That
8 is the opinion that I'm issuing.

9 Q And in issuing that opinion, you didn't
10 review any of the underlying underwriting
11 documentation for 2008, 2009, and 2010.

12 A My opinion for each of the individual
13 captives, with the exception of Reserve Casualty
14 Corp., it's not at the individual level, at the
15 aggregate level.

16 Q So you didn't review the documentation --
17 the underwriting documentation for Reserve.

18 A For the experience modifier, the
19 documentation, no.

20 Q Thank you.

21 MR. HARRIMAN: No further questions.

22 REDIRECT EXAMINATION

23 BY MR. ALBRIGHT:

24 Q Ms. Mead, is there anything that you did in
25 your report that would be outside the normal

1 practices as an actuary in your experience?

2 A No. Everything that I did was according to
3 the Actuarial Standards of Practice and what I feel
4 comfortable with.

5 Q And the information that you relied on, you
6 believe it's okay for you to rely on that information
7 as an actuary?

8 A Yes, because I believe, as far as in my
9 mind, experience modifier is just a derivation of it.
10 What I'm really interested on finding out is total
11 premium being charged. Is it adequate or not? And
12 that's essentially what matters to me.

13 Q So have there been any questions that would
14 cause you to change what you've said in your report
15 as it is in Exhibit 113-P?

16 A There's nothing that I would -- that I know
17 of till now that I would make a change. Everything
18 that I have is what I mean to have.

19 MR. ALBRIGHT: No further questions, Your
20 Honor.

21 MR. HARRIMAN: No further questions.

22 THE COURT: You may step down. Thank you.

23 MR. ALBRIGHT: And, Your Honor, just to be
24 clear, Ms. Mead is free to go, to return to Miami. I
25 believe she wanted to get home tonight.

1 THE COURT: Yes.

2 (Whereupon, the witness was excused.)

3 THE COURT: We'll just go off the record
4 for a second.

5 (Whereupon, a short recess was taken.)

6 MR. ALBRIGHT: Petitioner calls Gary Fagg.

7 THE CLERK: Please raise your right hand.

8 Whereupon,

9 GARY THOMAS FAGG

10 having been first duly sworn, was called as
11 a witness herein, and was examined and testified as
12 follows:

13 THE CLERK: Can you please state your name
14 and address for the record.

15 THE WITNESS: Gary Thomas Fagg. Stonebridge
16 Drive, Colleyville, Texas.

17 THE CLERK: Thank you. You may be seated.

18 DIRECT EXAMINATION

19 BY MR. ALBRIGHT:

20 Q Good afternoon, Mr. Fagg.

21 A Good afternoon.

22 Q Mr. Fagg --

23 MR. ALBRIGHT: Your Honor, I wanted to ask
24 Mr. Fagg just a very -- couple of very brief
25 questions as a fact witness and then move right into

1 the expert portion of his testimony.

2 THE COURT: If after you ask the brief
3 questions about the fact witness, I'm going to let
4 Respondent ask if they have any questions as a fact
5 witness, and then we can move into the expert
6 witness.

7 MR. ALBRIGHT: Yes, Your Honor.

8 THE COURT: Okay.

9 BY MR. ALBRIGHT:

10 Q Mr. Fagg, are you familiar with Credit
11 Reassurance, Limited?

12 A Yes.

13 Q And how is it that you're familiar with
14 Credit Reassurance, Limited?

15 A I am the sole owner of the company.

16 Q And what kind of business is Credit
17 Reassurance, Limited, in?

18 A It is the business of assuming and
19 retroceiving of insurance risk of various products,
20 but principally products related to the financing of
21 -- the finance business, such as credit life, credit
22 disallow, credit unemployment, gap, vehicle service
23 contracts, and other risks.

24 Q And do you know whether Credit Reassurance,
25 Limited, cedes any risk to PoolRe Insurance

1 Corporation?

2 A It does.

3 MR. ALBRIGHT: Your Honor, that completes
4 the factual portion of questions that I wanted to ask
5 Mr. Fagg.

6 THE COURT: Okay.

7 CROSS-EXAMINATION

8 BY MS. KHAN:

9 Q Mr. Fagg, I just have a few brief questions
10 to ask you as well. Credit Reassurance, Limited, you
11 stated that you're the sole owner.

12 A Yes.

13 Q Were you the sole owner in 2008?

14 A Yes.

15 Q In 2009 and '10?

16 A I have always been the sole owner.

17 Q All right. And when was Credit
18 Reassurance, Limited, formed?

19 A Maybe 1990.

20 Q And you briefly described the business,
21 specifically the operations of CreditRE. How many
22 employees does that involve? How many employees in
23 the business?

24 A We really don't have employees. The
25 officers are myself and my wife, Constance Fagg, and

1 if there was consulting work that was done or
2 additional management of the company that needed
3 expertise, that would have been performed by
4 employees of my general corporation, CreditRE.

5 Q And so with respect to the findings of
6 businesses or specifically the business that was
7 ceded to you from PoolRe, did you have any actuaries
8 on staff, or did you engage actuaries to help with
9 evaluating the reinsurance premiums would have been
10 ceded to PoolRe?

11 A The business at hand is ceded from
12 CreditRE, Limited, to PoolRe.

13 Q All right.

14 A So the -- first of all, I am an actuary, a
15 fellow in the Society of Actuaries, which is the life
16 insurance side of it. For many years, I practiced in
17 lines of business that spanned both life and --
18 property and casualty insurance.

19 In addition, my consulting firm also had
20 other actuaries, at least one of which over the last
21 ten to 15 years, has been property and casualty
22 actuary, so we had both life actuaries and the P&C
23 actuaries on the staff.

24 Q Okay. During 2008, '9, and '10, did Credit
25 Reassurance, Limited, have a relationship with the

1 Capstone Associates Services, Limited, company?

2 A Well, it -- I don't think we had a
3 relationship with Capstone.

4 Q Did you have a relationship with Feldman
5 Law Firm during those years, 2008, '9 and '10?

6 A In particularly those years -- you know, I
7 just finished a 40-year career, and -- finishing a
8 40-year career, and so to go back to those specific
9 years, I'm not sure. We did have some interaction
10 with Capstone, but I can't tell you the specific ones
11 during that time period.

12 Q Okay. All right. So then I'd like to
13 direct your attention to Exhibit 52-J.

14 MS. KHAN: Your Honor, may I approach the
15 witness to hand him 52-J?

16 THE COURT: Yes.

17 BY MS. KHAN:

18 Q (Handing document.) Are you there, Mr.
19 Fagg?

20 A Yes. What --

21 Q 52-J.

22 A 52 -- yes.

23 Q All right. 52-J is the Credit Coinsurance
24 contract for 2008. I'm going to refer to that as
25 2008 contract going forward. Are you familiar with

1 that document?

2 A I have reviewed this as a part of the
3 preparation for this trial.

4 Q All right. Did you have a role in
5 preparing the 2008 contract?

6 A Only indirectly. Credit Reassurance had
7 reinsured the risk to PoolRe, and I drafted that
8 contract, and this contract here is remarkably
9 similar to the contract that CreditRE Limited issued
10 to PoolRe.

11 Q Okay. Mr. Fagg, I'd like to direct your
12 attention to Article 2 in the contract, and
13 specifically this is with respect to the credit
14 coinsurance contract where the reinsurance premiums
15 that were going to be paid to the company, which here
16 would be PoolRe, and then eventually to the
17 reinsurer, which would be Reserve, shall be the
18 reinsurer's pro rata share of the earned premiums
19 during the accounting period.

20 Did you have a role with respect to
21 determining pro rata share of an earned premium or
22 the reinsurance premium as described under Article 2
23 in the contract here?

24 A I, of course, determined the earned
25 premiums in total that were ceded to PoolRe. I had

1 no knowledge or any activity relative to the
2 retrocession to Reserve.

3 Q Next I'd like to direct your attention to
4 Article 3 of that contract. This is with respect to
5 incurred claims. On -- with respect to 2008, are you
6 familiar with the incurred claims that would have
7 been incurred by CreditRE that would have passed to
8 PoolRe?

9 A Yes.

10 Q Okay. Can you describe or elaborate on
11 what those claims would generally entail?

12 A So, first of all, these are claims that
13 CreditRE, Limited, assumed from another company and
14 their pro rata share of the claims that went with the
15 risk that was ceded by that company to CreditRe,
16 Limited, and so I'm familiar with them in the sense
17 of I know them in terms of dollars. But I was not
18 directly involved in the adjudication of those claims
19 or any of that.

20 Q Okay. So then on -- I'd like to direct
21 your attention to Attachment A of the contract. And
22 so it's the second paragraph of the contract --

23 A Yes.

24 Q -- Mr. Fagg. The -- for 2008, there were
25 contracts that were -- there were risks that were

1 transferred from Linden Property Insurance Company,
2 and then subsequently issued and assumed by Credit
3 Reassurance Corporation. Are you familiar with what
4 those risks would have been assumed by Linden
5 Property Insurance Company were?

6 A Vehicle service contracts.

7 Q Okay. With respect to the vehicle service
8 contracts, are you familiar with any incurred claims
9 that would have been related to those vehicle service
10 contracts for taxable year 2008?

11 A Well, I certainly experienced them. They
12 were the claims that were charged to CreditRe,
13 Limited by the party that ceded the business to
14 CreditRe, Limited.

15 Q Okay. And were those claims then passed
16 down to PoolRe?

17 A A pro rata share of them. Yes.

18 Q Okay. And were you involved in the
19 calculation of the pro rata share that would have
20 been transferred to PoolRe?

21 A Only the share. Yes.

22 Q And how was that share determined?

23 A Well, in general, CreditRe, Limited, had
24 more risks than it preferred to retain, and in
25 discussion with PoolRe, basically asked them how much

1 of that they would be willing to accept.

2 Q Now, this attachment, Mr. Fagg, at the top
3 there in the heading, this was an attachment to the
4 2008 contract that was effective November 26, 2008.
5 Do you see that?

6 A Yes.

7 Q Now, this was a contract that went from
8 Linden Property to then CreditRe and from CreditRE to
9 PoolRe, and under the terms of this contract and was
10 allocated out to Reserve Company, Petitioner in this
11 case. Is that correct?

12 A Yes. But they weren't -- I mean, the risk
13 went from CreditRe, Limited, to PoolRe. They then
14 made the choice to retrocede it to various people,
15 and they could have been at dates that weren't -- I
16 mean, they may have had business that I ceded to
17 them, that they didn't retrocede at all.

18 For instance, the date, November 28, 2008,
19 has no meaning to me. That was -- that would be a
20 portion of the risk that they had on that date that
21 they had received from CreditRE, Limited.

22 Q All right. So -- but with respect to
23 reinsuring those risks in November 26, 2008, you
24 would have had to have been an insurance company that
25 was licensed to reinsure those risks. Am I right?

1 A To PoolRe. Yes.

2 Q Yes. All right. So then I'd like to
3 direct your attention now to Exhibit 10-J.

4 MS. KHAN: Your Honor, may I approach the
5 witness?

6 MR. ALBRIGHT: Your Honor, I'd just like to
7 note for the record, we're going way beyond the scope
8 of direct here.

9 THE COURT: Do you want to respond to that
10 objection, because I was --

11 MS. KHAN: Your Honor, Mr. Fagg is being --
12 has been called as a witness in this case with
13 respect to the contracts at issue, the reinsurance
14 contracts at issue in the case. And so with respect
15 to that, I am, you know -- I'm asking questions with
16 respect to the reinsurance policies and premiums that
17 were asked, that he was going for to answer.

18 MR. ALBRIGHT: Your Honor, I didn't
19 actually ask Mr. Fagg any questions about what PoolRe
20 reinsured to Reserve in my direct examination.

21 MS. KHAN: One of the lines of businesses
22 of CreditRE Corporation or Credit Reinsurance
23 Corporation for which Mr. Fagg is the sole owner, is
24 the line of business of findings, and that was opened
25 up on direct, that he has findings in business.

1 I can wait to ask the questions later, Your
2 Honor. That's okay. But he's also offered as an
3 expert.

4 THE COURT: Yes. Right. Your first --
5 these last few questions, we started going -- I do
6 see the connection, but we did start going beyond the
7 scope of the direct.

8 MS. KHAN: All right. Then I have no
9 further questions, Your Honor. I'll just wait.

10 THE COURT: Okay.

11 MR. ALBRIGHT: And, Your Honor, I have no
12 redirect on the factual portion, fact testimony.

13 THE COURT: Okay.

14 MR. ALBRIGHT: I'm now ready to proceed
15 with the expert part of his testimony.

16 THE COURT: All right.

17 DIRECT EXAMINATION

18 BY MR. ALBRIGHT:

19 Q How long have you been involved in the
20 insurance industry?

21 A I first worked as a summer student in 1967
22 at a actuarial consulting firm.

23 Q And your education, what was your education
24 before you started working for the actuarial firm?

25 A Well, that was after high school. I then

1 went to University of North Carolina and have a
2 degree in economics.

3 Q And do you recall when you graduated?

4 A In 1972.

5 Q And so when did you become an actuarial?

6 A Well, there's no appointed time that you
7 become one. I began to take -- to be an actuary, to
8 be a credentialed actuary, you take a series of ten
9 professional exams. I began to take those during
10 college. I took the first two or three before I
11 graduated, and then started taking those professional
12 exams basically right after I graduated, and took
13 about four to five years to complete the series of
14 exams that -- to be come a fellow of the Society of
15 Actuaries.

16 Q And so have done a lot of actuarial work in
17 your career?

18 A Well, I have either been doing actuarial
19 work or been teaching seminars about the actuarial
20 work that I do. That was a great deal, and I've done
21 a tremendous amount of expert testimony also, but all
22 of it relating to the -- this credit-related type
23 insurance and some other types of -- allied portions
24 of those type of risks.

25 MR. ALBRIGHT: Your Honor, if the Court

1 would indulge me, it might be easier to go over Mr.
2 Fagg's experience that qualifies him to testify as an
3 expert if I were to mark his report. His resume is
4 extensive, and I think it would be a lot easier if he
5 had his resume in front of him, and we could go over
6 this quickly.

7 MS. KHAN: Your Honor, Respondent does not
8 object to the qualifications of Mr. Fagg in this
9 case.

10 THE COURT: Okay. Well, that even changes
11 that, so Mr. Fagg is recognized as an expert witness.

12 MR. ALBRIGHT: Your Honor, I'd ask
13 permission to mark a copy of Mr. Fagg's report as
14 Petitioner's Exhibit next in order for
15 identification.

16 THE COURT: You may have it -- you may
17 offer it at this time.

18 MR. ALBRIGHT: (Handing document.)

19 THE CLERK: The expert report of Gary Fagg
20 is marked for identification as Exhibit 114-P.

21 (The document referred to was marked for
22 identification as Petitioner's Exhibit
23 114-P.)

24 MR. ALBRIGHT: Your Honor, may I provide
25 Mr. Fagg with a copy of the exhibit that has been

1 marked for identification as Petitioner's Exhibit
2 114-P?

3 THE COURT: Yes.

4 BY MR. ALBRIGHT:

5 Q (Handing document.) Mr. Fagg, do you have
6 a copy of Exhibit 114-P in front of you?

7 A I do.

8 Q And can you identify what Exhibit 114-P is.

9 A It is an expert report that I prepared
10 fairly recently, relating to the products that are
11 under discussion here.

12 MR. ALBRIGHT: Your Honor, I'd offer
13 Exhibit 114-P into evidence. Petitioner offers it
14 into evidence.

15 MS. KHAN: Your Honor, we have no
16 objection.

17 THE COURT: 114-P is admitted.

18 (The document referred to, having been
19 previously marked for identification as
20 Petitioner's Exhibit 114-P, was received
21 in evidence.)

22 BY MR. ALBRIGHT:

23 Q Mr. Fagg, can you tell me just briefly what
24 you did -- what you were asked to do and what your
25 conclusions were. I know it's in your report, but if

1 you could just summarize it, please.

2 A Well, I was asked to discuss the coverages
3 that were a part of the reinsurance between CreditRE,
4 Limited, and PoolRe, and to discuss the way that risk
5 flows through the various entities that are parties
6 to that contract and how the advantage -- and then
7 somewhat to discuss the advantages that it -- PoolRe
8 would have in accepting those risks, a portion of
9 those risks.

10 Q And did you come to any conclusions?

11 A Well, I felt it was a good idea for them.
12 I describe here how it arises out of a noninsurance
13 transaction, but then ultimately gets insured and
14 reinsured, and how the risk transfer moves among the
15 parties, and then come to the three opinions that are
16 listed on page 3.

17 Q Okay.

18 A Should I go ahead and discuss them or --

19 Q Well, your opinions are set forth on page 3
20 of your report?

21 A Yes.

22 Q Mr. Fagg, is there anything about your
23 report that needs to be corrected or changed, based
24 on anything that you've learned since you prepared
25 the report?

1 A No.

2 MR. ALBRIGHT: Your Honor, I pass the
3 witness.

4 CROSS-EXAMINATION

5 BY MS. KHAN:

6 Q Mr. Fagg --

7 A Yes.

8 Q -- can we go back -- is the credit
9 insurance -- coinsurance contract you just discussed
10 about in your direct examination, is this one of the
11 documents that you relied on, Exhibit 52-J, in
12 preparing your report?

13 A Well, it essentially is the same -- yes.

14 Q Yes. Okay. So I'd like to direct your
15 attention again to the attachment, Attachment A to
16 the contract.

17 THE COURT: And you're on 52-J?

18 MS. KHAN: Yes, Your Honor.

19 THE WITNESS: I have 52-J again.

20 BY MS. KHAN:

21 Q So I'd like to direct your attention to the
22 header there. This was a contract. The 2008
23 contract was effective November 26, 2008. Do you see
24 that in the header in Attachment A to the contract?

25 A Oh, Attachment A. (Perusing document.) I

1 see that attachment. Yes.

2 Q And do you see the date? It's November 26,
3 2008. Is that correct?

4 A Yes.

5 Q All right. Do you know when Reserve was
6 given an insurance license on -- to operate as an
7 insurance company?

8 A I have no knowledge of Reserve, its
9 formation or its operation.

10 Q Okay. I'd like to direct your attention to
11 Exhibit 10-J in the case.

12 A Okay. I have -- I see that.

13 Q Okay. What is identified -- isn't it true
14 that the insurance license from Financial Services
15 Commissioner of Anguilla was given to Reserve on
16 December 3, 2008? Is that correct?

17 A Correct.

18 Q So as of November 26, 2008, Reserve did not
19 maintain an insurance license. Is that correct?

20 A It's Anguilla. I'm not sure what -- given
21 this 3rd day of December. I don't -- it may mean
22 that's the effective date. I don't know that that's
23 -- I don't know what "given this 3rd day of December"
24 means.

25 Q Well, the document is a license from

1 Anguilla, identifying a December 3, 2008, date as the
2 -- from Financial Services Commission of Anguilla to
3 Reserve. Is that correct?

4 A Well, on the top it just says, "Reserve
5 Casualty Corp. is hereby licensed to carry on general
6 insurance" -- "foreign insurance business but not
7 long-term foreign insurance business subject to the
8 provisions of the law" -- period. And then it says,
9 "Given this 3rd day of December." And I don't know
10 if that just means the day they signed it, or that
11 was the effective date of the license or what. It
12 just says -- I don't know the full interpretation of
13 the word "given."

14 Q Well, do you know if Reserve had a license
15 that was given by Anguilla, by the Financial Services
16 Commission, as of November 26, 2008?

17 A I have no knowledge of Reserve's license or
18 operation.

19 Q I'd like to direct your attention to page 3
20 of your report. wherein you state that, "The vehicle
21 service contracts reinsured by Reserve are numerous,
22 small, unrelated risks, thousands of individual
23 vehicles that provide risk distribution as a stand-
24 alone risk pool." Do you see that?

25 A Yes.

1 Q And you further state that -- okay. Now,
2 in preparing your report on -- you relied on a number
3 of documents.

4 MS. KHAN: And at this time, I'd like to
5 have two documents marked for identification, Your
6 Honor. May I approach?

7 THE COURT: You may approach.

8 MS. KHAN: (Handing documents.)

9 THE CLERK: Document entitled,
10 Supplementary materials, table of contents, is marked
11 for identification as Exhibit 115-R.

12 (The document referred to was marked for
13 identification as Respondent's Exhibit
14 115-R.)

15 THE CLERK: Document entitled, Policy
16 summaries, is marked for identification as Exhibit
17 116-R.

18 (The document referred to was marked for
19 identification as Respondent's Exhibit
20 116-R.)

21 MS. KHAN: Your Honor, let the record
22 reflect that I'm handing 115 and 116-R to
23 Petitioner's counsel. (Handing documents.)

24 MS. KHAN: Your Honor, may I approach the
25 witness?

1 THE COURT: Yes.

2 BY MS. KHAN:

3 Q (Handing documents.) Now, Mr. Fagg, in
4 preparing your report and forming your opinion, I've
5 handed you what's been identified as Exhibit 115-R.
6 And this is the table of contents that was attached
7 to your report. Is that correct? Of the documents
8 that you relied on in your report. Do you want to
9 take a moment to look?

10 A (Perusing document.) Okay. I don't
11 remember that page exactly, but okay. Yes.

12 Q Yes, it is? And then also attached to your
13 report was 116 -- what's been identified as 116-R,
14 and it is policy summaries. Do you see that?

15 A Yes.

16 Q Can you tell me who prepared the policy
17 summaries for the documents that you relied on in
18 your report?

19 A They were provided to me.

20 Q Who provided those documents to you?

21 A Capstone.

22 Q Capstone --

23 A Well, I mean -- yes. Capstone.

24 Q And then with respect to the table of
25 contents, you relied on some cases, the pleadings in

1 the case, the credit reinsurance contract that we
2 just looked at, the insurance licenses, as well as
3 materials that were prepared and a summary of the
4 policies that were prepared by Capstone. Is that
5 correct?

6 MR. ALBRIGHT: Objection, Your Honor. I
7 don't believe that Mr. Fagg has said that he relied
8 on any material -- of these materials yet.

9 THE WITNESS: I may have used the word
10 "reviewed."

11 BY MS. KHAN:

12 Q Okay. Well, did you review these documents
13 in preparation of your report?

14 A I reviewed them. Yes.

15 Q Now, on page 2 of your report, you
16 discussed at the bottom that, "One such series of
17 reinsurance transactions result in certain vehicle
18 service contracts being reinsured by PoolRe under the
19 PoolRe-Reserve program." Do you see that?

20 A Yes.

21 Q Can you elaborate on what the PoolRe-
22 Reserve program is.

23 A Well, that would be the reinsurance treaty
24 between PoolRe --

25 Q I'm sorry, Mr. Fagg.

1 A The reinsurance treaty between PoolRe and
2 Reserve.

3 Q Did you look at any of the -- outside of
4 the -- any of the specific service contracts that
5 PoolRe had ceded to Reserve in 2008? Were those any
6 of the documents that you looked at?

7 A I only have samples of such documents. I
8 didn't review specific ones.

9 Q And those samples were provided to you by
10 who?

11 A By the company that ceded business to
12 CreditRE, Limited.

13 Q Okay. What's the name of that company?

14 A Well, there is a pathway. Credit
15 Reassurance, Limited, assumed the business from Aria
16 (SAC), a Bermuda reinsurance company, and Aria had
17 assumed that business from the U.S. direct writers
18 such as Linden.

19 Q Okay. Some -- in preparing your report,
20 you also reviewed insurance binders, Reserve's
21 insurance binders. Are you familiar with that? Do
22 you remember? For the direct written policies in the
23 case.

24 A I reviewed some materials. I guess I would
25 characterize them as binders.

1 Q Okay. Did you review any reinsurance --
2 any binders that would have reflected the reinsurance
3 assumed by Reserve --

4 A No.

5 Q -- in this case?

6 A No.

7 Q Did you -- for 2008, did you review a
8 reinsurance binder?

9 A No.

10 Q For 2009, did you review a reinsurance
11 binder of the partnership --

12 A Relating to these risks?

13 Q Yes.

14 A No.

15 Q And then in 2010, did you look at any
16 reinsurance binders with respect to the risk that was
17 transferred from the service vehicle contracts from
18 CreditRE to PoolRe and then to Reserve?

19 A Well, I mean, I did see the reinsurance
20 treaty.

21 Q Right. But with respect to Reserve's
22 reinsurance binders, did you review any reinsurance
23 binders for 2010 for Reserve?

24 A I'm not sure what you're characterizing as
25 a binder.

1 Q Okay. So let me -- I have a document that
2 can refresh your memory. Would that help?

3 A We'll find out.

4 Q Okay. So Exhibit 35-J --

5 MS. KHAN: May I approach, Your Honor?

6 THE COURT: Yes. I think the binders are
7 right here.

8 (Pause.)

9 BY MS. KHAN:

10 Q Are you there, Mr. Fagg?

11 A Yes.

12 Q Okay. So 35-J is the 2008 direct written
13 policy schedule for Reserve, which is part of an
14 insurance binder. Do you see that?

15 A Yes.

16 Q Okay. Are you aware of whether Reserve
17 prepared -- it states, "Excludes reinsurance
18 assumed." Are you aware if a binder such as this was
19 prepared for the reinsurance -- reinsurance premiums
20 of the case?

21 A I have no knowledge of this binder or how
22 it's used.

23 MS. KHAN: Your Honor, at this point, I
24 have no further questions of Mr. Fagg.

25 THE COURT: Okay. I have one -- hopefully

1 just one question, Mr. Fagg. On your expert report
2 on page 3 and in your testimony, I'm just trying to
3 follow and make sure I understand the terminology
4 correctly. When you talked about the vehicle service
5 contracts and that the company Aria, they were ceded
6 to CreditRE, and then they went from CreditRE to
7 PoolRe and from PoolRe, they went to Reserve.

8 THE WITNESS: Correct.

9 THE COURT: And I just -- when you're using
10 the word "ceded," I'm just wondering. Do the
11 premiums that were paid to the company that got the
12 insurance from Aria made its premium payments through
13 the vehicle service contracts, did the premiums flow
14 all the way up and through to Reserve each time it
15 ceded?

16 THE WITNESS: It is an accounting
17 transaction that's reported on a quarterly basis.
18 It's not like dollars are being ceded every week, but
19 transactions are reported quarterly, and it says,
20 Here are the new premiums that were written; here's
21 the -- and below that, you get the premiums that have
22 been previously written that were earned this
23 accounting period. And that is what constitutes the
24 premium for the quarter.

25 THE COURT: Okay. And as a follow-up

1 question, if one -- and it's in your report. You say
2 how vehicle service contracts are distinct, and
3 there's numerous small, unrelated risks. And if one
4 of these vehicle contract policies, for some reason
5 they had a claim --

6 THE WITNESS: Oh, they will.

7 THE COURT: If they had a claim, who do
8 they call when they first have the claim? Do they
9 call CreditRE, and then it's followed up, or is it
10 just -- or is the claim split? Or when you're using
11 the term "ceded," I thought everything was passed
12 along. So if you could explain that to me.

13 THE WITNESS: The transactions that we are
14 talking about that started with Aria of Bermuda to
15 CreditRE, that's still just the tail end. The actual
16 insurance is by a company that's referred to here as
17 Linden, and Linden is a large A-rated property and
18 casualty insurance company. That would be the people
19 that actually paid the claim.

20 THE COURT: So would it be just the
21 reinsurance portions? I'm just throwing out a number
22 for an example, so the first -- so would Linden pick
23 up the first million, and then if it was over --
24 anything beyond a certain amount, saying if it's a
25 million, just using it as a hypothetical, then

1 Linden, would they use anything above that -- that is
2 owed above that amount. If it was a certain level,
3 would it just -- only if it's high enough does it go
4 through? I'm not sure exactly what you meant by the
5 tail.

6 THE WITNESS: Oh, well, first of all, that
7 would be -- what you described would be described as
8 excess insurance.

9 THE COURT: Okay.

10 THE WITNESS: This is what would be
11 described as first-dollar insurance, that the claims
12 that are counted are a pro rata portion of every
13 dollar of claim that was actually paid.

14 THE COURT: So if -- in my example, if
15 Linden -- if one of these vehicle contracts, Linden -
16 - a million claim would go -- then Linden would go
17 back and -- I'm just taking -- and then they would
18 pay 60 cents on the dollar, and the rest of it would
19 go through to the others to the amount on the dollar.
20 So then are the premiums split the way the payments
21 are split on the dollar?

22 THE WITNESS: The -- whatever split there
23 is on the premium is the same split that would be
24 applied to the claims.

25 ; THE COURT: So is this -- so if we're

1 using my hypothetical that one of these vehicle
2 contracts first goes to Linden, then they go to
3 CreditRE. So each -- all the way through, CreditRE,
4 PoolRe, and then we get to Reserve, they all have
5 like a split. They all have a percent -- they all
6 have some aspect of the dollar.

7 THE WITNESS: If I could do it with my
8 hands --

9 THE COURT: Okay.

10 THE WITNESS: Here's Linden with
11 everything, and that actually goes to Aria in its
12 entirety. CreditRE, Limited, takes maybe 30 percent
13 of it. PoolRe then takes some percentage like 5
14 percent of the 30 that CreditRE, Limited, took. So
15 it's -- but everything is a pro rata share of the
16 original transaction.

17 THE COURT: I just want to make sure I
18 understand this. So when the claim comes in, does
19 Linden pay out the whole thing, and then it goes to
20 CreditRE for 30, and then does PoolRe pay back to
21 CreditRE, or is everybody going back to Linden, or do
22 they just go back to the one previous to them in the
23 chain?

24 THE WITNESS: Linden pays the consumer, and
25 --

1 THE COURT: Yep.

2 THE WITNESS: -- then basically sends a
3 bill to Aria that sends a bill to -- a portion of
4 that bill to CreditRE, and a portion of that bill
5 gets billed to --

6 THE COURT: Okay. All right.

7 THE WITNESS: -- PoolRe.

8 THE COURT: So I just wanted to be sure how
9 it was split. So it's the one who pays the claim
10 goes back to each, instead of each -- okay. That was
11 my only -- I wanted to clarify that.

12 MR. ALBRIGHT: No questions, Your Honor.

13 MS. KHAN: I have no further questions,
14 Your Honor.

15 THE COURT: All right. You may step down.

16 THE WITNESS: Thank you.

17 (Whereupon, the witness was excused.)

18 THE COURT: We'll go off the record for a
19 minute.

20 (Whereupon, a short recess was taken.)

21 THE COURT: All right. You may proceed.

22 MS. KHAN: Your Honor, just one
23 housekeeping matter. I failed to move Exhibits 115-R
24 and 116-R into the record, and Mr. Albright has
25 indicated that he wouldn't have any objection to

1 that.

2 MR. ALBRIGHT: That's correct, Your Honor.

3 THE COURT: Those exhibits are admitted.

4 MS. KHAN: Thank you, Your Honor.

5 (The documents referred to, having been
6 previously marked for identification as
7 Respondent Exhibits 115-R and 116-R, were
8 received in evidence.)

9 MR. ALBRIGHT: Ready for the next witness?

10 THE COURT: Yes.

11 MR. ALBRIGHT: Petitioner calls Michael

12 Solomon.

13 THE CLERK: Please raise your right hand.

14 Whereupon,

15 MICHAEL SOLOMON

16 having been first duly sworn, was called as
17 a witness herein, and was examined and testified as
18 follows:

19 THE CLERK: Will you please state your name
20 and address for the record.

21 THE WITNESS: Michael Solomon, 7 --

22 THE CLERK: Do you have a work address?

23 THE WITNESS: Yes, I do. My work address
24 is 111 Veterans Square, Media, Pennsylvania.

25 THE CLERK: Thank you. You may be seated.

1 MR. HARRIMAN: Your Honor, as a preliminary
2 matter, Respondent has no objection to qualifying Mr.
3 Solomon -- has no objections to his qualifications as
4 an actuary.

5 THE COURT: All right. So Mr. Solomon is
6 qualified as a witness, expert witness.

7 MR. ALBRIGHT: Your Honor, may I ask that
8 this document be marked --

9 THE COURT: Yes.

10 MR. ALBRIGHT: -- for identification as
11 Petitioner's Exhibit next in order?

12 THE COURT: Yes.

13 THE CLERK: The expert report of Michael
14 Solomon is marked for identification as Exhibit 117-
15 P.

16 (The document referred to was marked for
17 identification as Petitioner's Exhibit
18 117-P.)

19 MR. ALBRIGHT: Your Honor, may I provide
20 Mr. Solomon --

21 THE COURT: Yes.

22 MR. ALBRIGHT: -- with a copy of his
23 report? (Handing document.)

24 I would propose to give Mr. Solomon the award for the
25 heaviest report.

1 THE WITNESS: I apologize.

2 DIRECT EXAMINATION

3 BY MR. ALBRIGHT:

4 Q Mr. Solomon, do you have a copy of your
5 report in front of you there?

6 A Yes, I do.

7 Q And it's marked Exhibit 117-P.

8 A Correct.

9 Q And there are two volumes?

10 A Correct.

11 Q And can you tell me what Exhibit 117-P is.

12 A It is my actuarial review of the -- to the
13 reasonability of the premiums for selected policies
14 issued by Reserve Mech for years including 2008, 2009
15 and 2010.

16 MR. ALBRIGHT: Your Honor, I would offer
17 Exhibit 117-P into evidence.

18 MR. HARRIMAN: No objection, Your Honor.

19 THE COURT: 117-P is admitted.

20 (The document referred to, having been
21 previously marked for identification as
22 Petitioner's Exhibit 117-P, was received
23 in evidence.)

24 MR. ALBRIGHT: And I pass the witness.

25 MR. HARRIMAN: Lucky it can support this

1 much weight.

2 CROSS-EXAMINATION

3 BY MR. HARRIMAN:

4 Q Good afternoon, Mr. Solomon. My name's Tom
5 Harriman. I am an attorney for Respondent. Get
6 comfy. I have a question about each and every single
7 page of your report. I'm just -- that was a joke.
8 I'm just -- but we will start off with the sources of
9 data you relied upon in formulating your report.

10 You used documents that you referred to as
11 TAA manuals. Is that correct?

12 A Correct.

13 Q And what are TAA manuals?

14 A The company I worked for is called The
15 Actuarial Advantage, Inc., or TAA for short. My
16 colleagues produced rating manuals for Capstone
17 during 2016 and 2017, to produce premiums for several
18 lines of business, and I relied on those rating
19 manuals to calculate premiums, indicated premiums for
20 Reserve Mech.

21 Q Now, you mentioned that your colleagues
22 prepared these manuals. So you didn't prepare the
23 TAA manuals that you used in your report?

24 A Correct. I did not prepare the manuals.

25 Q And the TAA manuals, they were created at

1 the request of Capstone Associated Services.

2 A That's my understanding. I wasn't
3 completely in touch with the back and forth between
4 who asked who, but I assume that's what happened.
5 Capstone engaged my firm to produce the manuals. I
6 assume that's what happened.

7 Q Now, I want to draw your attention to page
8 10 of your report. It's in the section -- section --
9 I believe, section 6, reliances and limitations, so
10 let me know when you're on that page.

11 A Actually the -- just give me one minute.

12 Q Take your time.

13 A (Complying.)

14 Q All right. Are you on page 10?

15 A Yes.

16 Q Now, on page 10, it's discussing the TAA
17 rating manuals. So it says here that the rating
18 manuals were developed for new businesses.

19 A New business. Correct.

20 Q So the idea behind the manuals is they
21 would be used for new businesses or new policies
22 under the Capstone program.

23 A Correct.

24 Q So they weren't -- the TAA manuals weren't
25 created to be applied to previously issued policies.

1 A Correct.

2 Q And when you applied the TAA manuals to the
3 policies for Reserve in 2008, 2009, and 2010, you
4 applied those manuals without any adjustment.

5 A Correct.

6 Q So that means you just looked at the TAA
7 manual for a certain policy, and you just compared
8 it, without taking into effect time, value or
9 anything like that, or inflation or any other
10 factors.

11 A Correct. I did think about that. I was
12 aware that I was making that assumption, and I did
13 consider it reasonable to use the TAA rating manual
14 with this. There are reasons for that, if you want
15 me to go into that.

16 Q Oh, no, thank you. I do have another
17 question, though, regarding what you went into on
18 page 10. It says that you didn't review the
19 methodology used by Reserve in determining the
20 premiums they charged for the policies in 2008, '9
21 and '10.

22 A Correct.

23 Q So you didn't review any underwriting
24 documentation from Reserve.

25 A Can you define "underwriting

1 documentation," by which I mean -- well, define what
2 you mean by that.

3 Q Well, in your line of work, when somebody
4 says, underwriting documentation, what would you take
5 that definition to mean?

6 A Well, it can mean a whole host of things.
7 For instance, I reviewed the policy terms and
8 conditions as part of my analysis. I would
9 understand that to be understanding materials, and I
10 did review that.

11 Q so you reviewed the policies at issue.

12 A I reviewed the policies that were issued.
13 Correct.

14 Q So, again, going back to your -- we're
15 trying to understand the definition of underwriting
16 materials. What would you take that to mean, beyond
17 policies?

18 A Well, underwriting materials could mean a
19 whole host of things. It could mean notes that were
20 by the underwriters during when they looked at the
21 property. it could mean -- well, notes and --

22 Q So did you review any notes from the
23 underwriter?

24 A I did not review notes from the underwriter
25 at that stage. No.

1 Q All right.

2 A I also received revenue figures, of which I
3 would imagine would be defined as underwriting
4 material in the sense that an underwriter would, I
5 assume, want to look at those revenue figures in
6 order to determine whether -- what the premium should
7 be.

8 Q All right. So you reviewed revenue figures
9 and the policies.

10 A I reviewed revenue figures, the policies --

11 Q And, of course, the other documents listed
12 in your reference manual, in your report for
13 documents relied upon.

14 A Correct.

15 Q Okay. And so the same sort of question
16 regarding PoolRe. You have a statement in here. You
17 didn't review the methodology used by PoolRe in
18 developing their premiums. Correct?

19 A Correct.

20 Q All right. So essentially for Reserve's
21 premiums that they charged in 2008, 2009, and 2010,
22 you relied on information Capstone provided to you.

23 A There was material provided by Capstone. I
24 don't recall exactly who provided the documents for
25 Reserve Mech. I don't remember if that was Capstone

1 or the law firm. I don't remember -- for instance,
2 somebody told me that the revenue was X million. 9
3 million, I recall. I don't remember if that was
4 Capstone or Reserve Mech on the spot.

5 Q Now, you said the documentations came from
6 Capstone or the law firm. Who is the law firm in
7 that situation?

8 A The Feldman Law Firm.

9 Q All right. So Feldman Law Firm or Capstone
10 were the primary sources of information in creating
11 your report here?

12 A Correct.

13 Q And, of course, the TAA manuals --

14 A TAA rating manuals. Correct.

15 Q Uh-huh. Now, for the manuals themselves,
16 now, they're attached as the appendixes to your
17 report. Let's start at Appendix A --

18 A Okay.

19 Q -- for special risk liability.
20 Specifically, it'll be page 3 of Appendix A is where
21 I want to start. Unfortunately, these aren't Bates-
22 numbered, so let me know when you're on that page.

23 A (Complying.)

24 Q All right. Are you on page 3 of Appendix
25 A?

1 A Yes. I think so.

2 Q All right. So I want to draw your
3 attention to -- all right. So just confirming again
4 here on the middle of page 3, these are the
5 individuals who wrote this manual. Correct?

6 A Correct.

7 Q All right. And, again, you were not
8 involved in compiling this manual.

9 A Correct.

10 Q All right. Now, in section 4 of the
11 Appendix A, it states here again that for creating
12 this manual, there was no review of Capstone's
13 methodology for developing the premium rates.

14 A Page --

15 Q Page 6. It's section 4 of Appendix A.

16 A Which paragraph am I looking at, please?

17 Q It'll be the first paragraph, the second
18 sentence, regarding the review of Capstone
19 methodology for developing premium rates.

20 A Okay.

21 Q Was there a review of Capstone's
22 methodology for developing premium rates regarding
23 special risk tax liability?

24 A Based on this sentence -- and, again, I did
25 not -- this is not my manual, in the sense that I

1 didn't write it. But based on this, they did not
2 review the methodology used by Capstone.

3 Q And would it be fair to say that this would
4 apply to the remaining appendixes, B, C, D, E and F?

5 A I assume so. I can check each one, if you
6 wish, but if it says it, then I assume it's true.

7 Q All right. Now, turning to section 6 of
8 Appendix A, observations, it'll be page 8.

9 A Okay.

10 Q Now, it states that there was no audit or
11 verification of the information from Capstone. Is
12 that correct?

13 A Can you -- which paragraph are you
14 referring to, please?

15 Q The paragraph I'm referring to is one, two,
16 three -- the fourth paragraph.

17 A Okay. Uh-huh.

18 Q Where it states -- so there was no audit of
19 the data provided by Capstone?

20 A Correct. That's what it says.

21 Q Uh-huh. Now, if there was no audit of the
22 data, it'd be possible that there were errors in it.

23 A Correct. I mean, they -- somebody -- I
24 don't remember whom, but, for instance, I remember
25 showing the revenue was approximately 9 million. If

1 the revenue was actually 90,000, that would have
2 affected my results.

3 Q So without verification, there could be
4 errors, and if there are errors, would you say that
5 would have a material impact on your report? In the
6 example you just gave, where you said, Somebody told
7 it was 9 million for the revenue, but if it was
8 actually 900,000 [sic], that would have a material
9 impact.

10 A All actuarial studies I've seen in my
11 career have a statement to the effect that the data
12 was received by a person. If that data was
13 incorrect, that would have an effect on the results,
14 so --

15 Q And you wouldn't know if there was an error
16 unless you audited or independently verified the
17 information.

18 A I disagree that's true. In many cases, you
19 rely that it is being audited by others.

20 Q So your reliance on the state of the
21 correctness from Capstone and whatever process they
22 had for reviewing data.

23 A I rely on the data being correct without
24 audit. I agree that if the data was materially
25 wrong, that would have a material impact on the

1 results.

2 Q And, again, this is regarding Appendix A,
3 but you would agree that that same principle would
4 apply to Appendix B, C, D, E and F. Correct?

5 A I would also like to state that since I'm
6 not as familiar, I'll say, with these reports, since
7 I didn't create them, I --

8 Q You're not familiar with the reports you
9 used to rely to make your report?

10 A I am -- I'm familiar with the report. I
11 wanted to complete my sentence and say that I
12 couldn't say with -- I could estimate based on the
13 report, but I don't want to say with certainty that a
14 material -- if there was a material mistake in
15 certain data, that would not necessarily mean that
16 there was -- that would materially have affected any
17 findings, so it's possible, but it's not certain,
18 even if there was a material error in the data.

19 Q All right. So the possibility of error --
20 again, that possibility can exist as it applies to
21 the appendices for the policies you reviewed. Would
22 that be a correct statement?

23 A That's a correct statement.

24 Q Now, again staying at Appendix A, looking
25 at section 8 that starts on page 11, it's in the

1 first paragraph. I have a question. It says that,
2 "There was not enough credible historical data to
3 arrive actuarial sound premium rates based on
4 Capstone's historical claims experience." Does that
5 essentially mean that there wasn't enough historical
6 data or losses to calculate a premium?

7 A No, it does not mean that. It means that
8 there was -- let me explain this in detail. So there
9 are several ways an actuary can calculate a premium.
10 They can calculate it based on loss data. If they
11 don't believe that the loss data's credible, they can
12 calculate premiums in other ways.

13 So the fact that there isn't loss data does
14 not mean that you can't calculate a premium at all.
15 Actuaries are regularly asked to calculate premiums
16 without loss data.

17 Q But in this situation, there wasn't enough
18 loss data to calculate a premium from it.

19 A There wasn't enough loss data to rely on
20 the data exclusively to come up with a premium
21 without using those losses. Correct.

22 Q All right. And, again, we're in Appendix
23 A, but would this also apply to B, C, D, E and F?

24 A Correct. There was not enough loss data
25 from Capstone -- from the Capstone policies for

1 Reserve Mech to exclusively rely on to calculate an
2 actuarial premium.

3 Q Well, I just want to clarify your statement
4 right there, because I believe you were referring to
5 just Reserve. But for the manuals, it's all of
6 Capstone's captives that you're --

7 A True --

8 Q -- pulling data from.

9 A Correct. Correct. There would be --

10 Q So we're not just dealing with just one
11 company for three years. This is -- when these
12 manuals were created, it was all of Capstone's
13 captives, and from all of Capstone's captives, there
14 wasn't enough loss data to be used as a sole basis
15 for calculating premium.

16 A Correct.

17 Q And that would apply for all the appendices
18 regarding the policies you reviewed.

19 A Correct.

20 Q All right. Now, let's turn to Appendix B.
21 There is one particular thing here I want to discuss.
22 It will be on the first page under, Purpose and
23 scope. Just let me know when you get there.

24 A Okay. I believe I'm there.

25 Q All right. Now, there's a footnote on this

1 page regarding the weather-related business
2 interruption insurance. And so to your
3 understanding, Capstone does not underwrite coverage
4 to clients direct.

5 A (Perusing document.) I can see the
6 footnote.

7 Q And so, again, based on your understanding,
8 Capstone doesn't underwrite coverage to clients
9 directly.

10 A That's what it states.

11 Q And then it also states that, "Coverage,
12 selection and pricing ultimately is approved by the
13 officers and directors of the insurance company." Is
14 that a correct statement?

15 A That's what it states.

16 Q So based on what's in these manuals, it
17 seems that the final say for premiums lies with the
18 directors and officers of the individual captives.

19 A Within Appendix B? I mean, it doesn't -- I
20 don't remember it saying it's under Appendix A.

21 Q Oh, it wasn't in Appendix A, for whatever
22 reason, but for Appendix B it's here. So with your
23 understanding, so the individual pricing for the
24 policy listed in Appendix B, for the premiums, that
25 pricing amount is determined by ultimately the

1 directors and officers of the captive. Would that be
2 correct?

3 A (Perusing document.) That is what it
4 appears to state.

5 Q So with that in mind, if the individual
6 officers of the company set the -- or decided on the
7 premium rate, I guess my question is: For -- when
8 you reviewed the weather-related business
9 interruption, did you contact the directors of
10 Reserve to get information directly from them?

11 A No.

12 Q So you didn't speak with Norman Zumbaum?

13 A No.

14 Q Or Corey Weikel?

15 A No.

16 Q And would that be true for all the policies
17 you reviewed?

18 A That is correct.

19 Q And, again, this footnote -- it's on
20 Appendix B, but would you say it also applies to
21 Appendix C, D, and F?

22 A (Perusing document.) I apologize for
23 taking the time. I'm just trying to find them here
24 to make sure. (Perusing document.) Appendix C, the
25 footnote is there.

1 Q Uh-huh.

2 A The footnote appears the same. Can you
3 remind me of the other appendices?

4 Q Certainly. The next one is D.

5 A D -- I'm assuming that the -- you're saying
6 that the footnote's there. It's there for D. E
7 also, did you say?

8 Q Surprisingly not. The next one's F.

9 A The next one's F. (Perusing document.)
10 It's in Appendix F. And then is that it?

11 Q I believe so. So I know we went on a
12 little bit of a hunt, looking for that footnote, but
13 the reason why I'm bringing it up is it sounds like
14 the final pricing for the premiums lies with the
15 individual owners. So when examining whether or not
16 a premium was priced reasonably, wouldn't it make
17 sense to go and discuss it with the person who had
18 ultimate authority to decide that premium and get the
19 underlying documents and data that they may have in
20 determining their premium pricing?

21 A In my opinion, the way I decided whether or
22 not the premium was reasonable was by applying these
23 manuals. So, for instance, if a director had decided
24 that while an indication from my manuals was X, they
25 decided they were going to pay Y, while they may have

1 the authority to do this, based on that, I would not
2 then be saying that it was or wasn't actuarially
3 sound, based on that selection. I did base that on
4 my own selections from the rating manual.

5 Q So that's from the rating manuals that you
6 attach as your various appendixes. But, again, these
7 were rating manuals designed for new business.
8 Correct?

9 A Correct.

10 Q And they were manuals that were created, I
11 believe, as late as 2005 and on. Is that correct?

12 A The rating manuals --

13 Q Or 2015 and on. I apologize.

14 A I think they're 2015 or later. That's
15 correct. And, I guess, if you're asking me for why
16 I did that, I can speak to that if you wish, why I
17 made that decision.

18 Q Oh, no. I was just clarifying as to these
19 policy manuals were created in 2015 and on, and you
20 applied them to policies in 2008, 2009, and 2010.
21 Correct?

22 A Correct.

23 Q I have no further questions. However, I
24 believe every point you wanted to illustrate on
25 further, Mr. Albright will now address.

1 REDIRECT EXAMINATION

2 BY MR. ALBRIGHT:

3 Q Mr. Solomon, could you go into why you
4 thought it was reasonable to rely on the TAA rating
5 manuals.

6 A Yes, yes. The TAA rating manuals were
7 designed for Capstone's use. When we were asked to
8 opine on the reasonableness of the premiums for 2008,
9 2009, 2010, I believed it was reasonable to rely on
10 these filings for several reasons.

11 The first reason is that it was -- since
12 the amount of -- there was more data available from
13 industry sources than actuaries used in the absence
14 of loss data available to support the rating manual,
15 to support the rating manual as written, rather than
16 trying to find and review documents from the year,
17 say, 2000, 2001, or later. That documentation wasn't
18 there.

19 Secondly and more importantly, the exposure
20 basis used adjusts to a great extent for inflation.
21 The exposure basis is the revenue, and I think from
22 memory, I think all of my -- all of the appendices
23 used revenue as the rating manual, and not as
24 inflation-dependent also. So it'd be very possible
25 in the commercial -- in insurance markets that

1 they'll have a price revenue, and then since revenue
2 is going up, they don't necessarily need to adjust
3 their factors to account for the change over time.

4 Q Did you say that the increasing revenue
5 takes into account inflation? Is that what you said?

6 A Yes, yes. So since the revenue -- since
7 the exposure basis is revenue, there'll be a natural
8 adjustment. The 2015 factors applied to revenue
9 would be used accurately without any material
10 differences for policies written in 2008, 2009, and
11 2010. I could contrast with some other lines where
12 there might be some issues if you would --

13 For instance, if you had an exposure base
14 that was different, that wasn't -- wouldn't be
15 adjusted by inflation, that data purge might not work
16 as well. But in this case, for the lines of business
17 within my scope, I thought it was a reasonable
18 assumption.

19 Q Is having low level of loss data expected
20 when you're dealing with the types of coverages that
21 we're talking about here?

22 A So there were two elements that would lead
23 to having low amounts of loss data. One is the types
24 of coverage written, and another one is the amounts
25 of exposure. While Peak Mechanical has revenue of 9

1 million, so I wouldn't want to classify it as a small
2 company, it would -- a company of that size would not
3 be expected to have the amount of loss or claims data
4 that would be fully credible for a actuarial
5 analysis.

6 Q Mr. Solomon, if you would turn to page 11
7 of your report --

8 A Yes.

9 Q And presumably if we're looking at the same
10 page, there's a heading there that says, Standards of
11 Practice.

12 A Correct.

13 Q What are you saying there at page 11 of
14 your report? And you can just paraphrase it if --
15 without reading it out loud.

16 A I am stating that my work is consistent
17 with actuarial standards of practice. They are the
18 standards of practice that are incumbent on all
19 credentialed actuaries when performing any actuarial
20 analysis.

21 Q And so, I guess, within that, you're saying
22 that relying on the TAA ratings manuals, as you did,
23 is -- that conforms to the actuarial standards of
24 practice.

25 A Yes. The actuarial standards of practice

1 make specific mention of relying on the work of
2 actuaries.

3 Q And with regard to relying on information
4 that was provided by Capstone, for example --

5 A Correct.

6 Q -- would that be consistent -- the way you
7 dealt with that, would that be consistent with the
8 actuarial standards of practice?

9 A Correct. The actuarial standards of
10 practice specifically state that we can rely on data
11 from others and that it can be relied upon without
12 audit. The actuarial standards of practice
13 specifically state that.

14 Q Now, Respondent's counsel cut you off a
15 couple of times when you wanted to answer a question.
16 Was there anything that you would like to say that
17 you haven't had an opportunity to say about your
18 report?

19 A I think, as stated, my report is an
20 actuarial report. It is completely consistent with
21 actuarial standards of practice. I can speak to a
22 conclusion I made, if you wish. I concluded that the
23 premiums were reasonable, within a reasonable range,
24 for each of the policy years, 2008, 2009, 2010, and
25 in aggregate for three policy years.

1 Q Mr. Solomon, if you would turn to Appendix
2 B, which is labeled, Special risk, weather-related
3 business interruption.

4 A Uh-huh.

5 Q Are you there?

6 A I'm on Appendix B. Which page?

7 Q It would be -- I believe it is the first
8 page. It's Roman one, Purpose and Scope. The top of
9 the page says, Actuarial review report, weather-
10 related business interruption insurance.

11 A Okay. Uh-huh.

12 Q Are you there?

13 A Yes.

14 Q And there's a footnote 1 there.

15 A Correct.

16 Q I believe that Respondent's counsel asked
17 you a question about who makes the determination of
18 how much of a premium to charge.

19 A Correct.

20 Q Do you address that issue in footnote 1 of
21 your report?

22 A Correct. Of my report, or of this page?

23 Q Appendix B to your report.

24 A The -- correct. The footnote states that
25 coverage selection pricing ultimately is approved by

1 the officers and directors of the insurance company.

2 Q I'm sorry. Say that again, please.

3 A Yes.

4 Q Yes.

5 MR. ALBRIGHT: Could I have a moment, Your
6 Honor?

7 THE COURT: Yes.

8 (Pause.)

9 BY MR. ALBRIGHT:

10 Q Respondent's counsel also suggested to you
11 that -- or asked you why you didn't contact Norman
12 Zumbaum when you were doing your report.

13 A Correct.

14 Q Would there be any reason for you to do
15 that?

16 A I cannot think of any reason at this moment
17 in time. If I'd have wanted to do that during my
18 analysis and felt it would have helped my analysis or
19 was necessary to my analysis, I would have asked for
20 that contact information during producing my report.
21 I -- if I'd have wanted more information in any case,
22 I would have asked for more information while
23 producing my report.

24 Q Now, was there -- did you receive all of
25 the information that you requested and needed for

1 your analysis in preparing your report?

2 A Correct.

3 MR. ALBRIGHT: Pass the witness, Your
4 Honor.

5 THE COURT: I have a quick question. When
6 I read your report, I thought I understood it, but I
7 just want to clarify it on the record. It mentions
8 the purpose and scope is to -- on the reasonableness
9 of the premiums by Reserve and PoolRe. And then I
10 understand once we get into the appendices -- I think
11 it's A through F -- these -- each appendix, they're
12 reviewing different categories of insurance, and it's
13 looking -- I believe for all those, it's looking at
14 all the Capstone captives.

15 And then I just want a clarification. When
16 you mention on page 5, you're applying TAA's rating
17 manuals, and so I was just clear looking at how the
18 rating manuals -- how it all kind of is put together,
19 and I'll try and make my question a little clear. I
20 just want to make sure I'm understanding.

21 But each appendix, I think, as I said A
22 through F, is looking at Capstone's captives and is
23 looking at -- from actuarial perspective those
24 different insurance lines. Is that correct?

25 THE WITNESS: That's correct.

1 THE COURT: And then -- and so the chart
2 that's using on page 5, I just wanted to be clear I'm
3 understanding how the rating manuals are used.

4 THE WITNESS: So okay. So let me clarify
5 that. TAA produced a rating manual that were meant
6 that was -- a manual, if you will, for Capstone to
7 use for their -- in their work for each rating
8 manual.

9 So if a client came to them, a potential
10 captive, and said, We want to write this line of
11 business under this insurance company, what should we
12 charge as premium, the rating manuals would give a
13 guide for that line of business. And then you would
14 put the inputs in for that specific client. Revenue
15 would be one, I think, for all my lines of business.
16 It would not be the only one. Let me rephrase that.
17 Revenue is for most of them, but there are inputs for
18 all of them.

19 You would then use those inputs to come up
20 with a premium following the rating manual in
21 Appendices A through F. We were then asked to opine
22 on the reasonableness for Capstone -- not for
23 Capstone; I apologize -- for Reserve Mech, so I used
24 the inputs that I needed from Reserve Mech, such as
25 the specific revenue.

1 For instance, I used those as inputs, put
2 them through the rating manual, and used them to
3 calculate what is the actuarial central estimate --

4 THE COURT: So the rating manual that you
5 used is based on Appendixes A through F.

6 THE WITNESS: Correct.

7 THE COURT: And so this rating manual was
8 specifically designed for Capstone. So are you just
9 looking at the premiums of Reserve to see if they're
10 in line with premiums for Capstone and no other
11 premiums outside the Capstone Group?

12 THE WITNESS: Let me -- I don't want to
13 state they're in line with other rates charged by
14 Capstone. They are -- I'm saying that they are in
15 line with what we would suggest be charged by
16 Capstone to a client, to a potential client.

17 THE COURT: Thank you.

18 MR. HARRIMAN: No further questions, Your
19 Honor.

20 MR. ALBRIGHT: No further questions, Your
21 Honor.

22 THE COURT: Okay.

23 MR. ALBRIGHT: Now, I do note that Mr.
24 Solomon has a rebuttal report, but we're planning on
25 bringing him back next week.

1 THE COURT: Okay. So you're planning on
2 bringing him back. Okay.

3 MR. ALBRIGHT: Yes, ma'am.

4 THE COURT: All right. You may step down
5 then.

6 (Whereupon, the witness was excused.)

7 MR. ALBRIGHT: May I have a moment, Your
8 Honor?

9 THE COURT: Yes, you may.

10 (Pause.)

11 MR. ALBRIGHT: Your Honor, do you want us
12 to call another witness?

13 THE COURT: If you have another witness.

14 MR. ALBRIGHT: We do.

15 THE COURT: Okay. I just wasn't -- I
16 wasn't sure. Why don't we take a five-minute recess.

17 THE CLERK: All rise.

18 (Whereupon, a short recess was taken.)

19 THE CLERK: All rise.

20 Please be seated.

21 MR. ALBRIGHT: Your Honor, I apologize for
22 the disorganization on our side of the table, but we
23 thought we were ready to go with Mr. Liptz, but
24 actually we've left the materials related to his
25 testimony back at the office. And so we would

1 propose to stop tonight, and have spoken with
2 Respondent's counsel about it, and I believe that
3 they're okay with it, if the Court's okay with it.

4 MR. SCHEID: We certainly have no objection
5 to the order in which he chooses to call his
6 witnesses.

7 THE COURT: Okay.

8 MR. SCHEID: We do have one scheduling
9 issue that we'd --

10 THE COURT: Yes.

11 MR. SCHEID: -- like to discuss with the
12 Court whenever the appropriate time is.

13 THE COURT: Okay. We can discuss it now.

14 MR. SCHEID: Your Honor, we have -- we
15 anticipate to call a representative from Atlas
16 Insurance in addition to our expert, Donald Riggan,
17 and Revenue Agent Batory. We have arrangements for
18 the representative from Atlas Insurance to be here on
19 Monday.

20 And so to the extent it would be possible,
21 we would propose that we sort of take that witness
22 out of order. We anticipate a very short direct
23 examination of that witness.

24 And so the scheduling we were considering
25 between the parties was to call Liptz first thing on

1 Monday morning, to then have the Atlas representative
2 testify briefly before Petitioner puts Mr. Feldman on
3 and completes their case, just based partly to ensure
4 if we don't fully get through Feldman -- we
5 anticipate that'll be quite a lengthy witness -- the
6 Atlas representative has plans to return home in the
7 evening, Monday evening.

8 MR. ALBRIGHT: Your Honor, if I might ask
9 who the Atlas representative is, I don't know who
10 that is.

11 MR. SCHEID: Martin Eveleigh.

12 MR. ALBRIGHT: And, Your Honor, I don't
13 believe that we will have an issue if there's a
14 witness like that that his schedule needs to be
15 accommodated.

16 THE COURT: Okay. It would go in between
17 your two witnesses and --

18 MR. ALBRIGHT: Correct.

19 THE COURT: And at this point, is it -- you
20 just have the two witnesses remaining on Monday?

21 MR. ALBRIGHT: Well, Your Honor --

22 THE COURT: The rebuttal is --

23 (Pause.)

24 MR. ALBRIGHT: I believe, Your Honor -- I
25 had my -- frankly, my -- I've fallen apart over here

1 this afternoon. I had a note with a list, and I
2 stuck it somewhere, but I believe that sounds right.

3 THE COURT: Okay. Because I wasn't sure if
4 you were going to call the witnesses in your pretrial
5 memo.

6 MR. ALBRIGHT: We have some rebuttal
7 witnesses obviously, but I think -- I believe in our
8 case in chief, we have -- the plan currently would be
9 Mr. Liptz and Mr. Feldman.

10 THE COURT: Okay. All right.

11 MR. SCHEID: And, Your Honor, as I
12 previously indicated, in Respondent's case in chief,
13 we'll call the representative from Atlas first, to
14 the extent we can assert that in Petitioner's case;
15 Donald Riggin second; and Revenue Agent Batory third.

16 THE COURT: Okay. And is it your
17 expectation that we should be able to finish on
18 Tuesday?

19 MR. SCHEID: That is certainly my
20 expectation, Your Honor.

21 THE COURT: Okay. All right. Are there
22 any other matters while we're on the record?

23 MR. SCHEID: No other matters. I guess I
24 should qualify that finishing by Tuesday, based upon
25 the fact that Petitioner will then be calling

1 witnesses in rebuttal, so that may add some time, but
2 we would anticipate being done on Tuesday, Your
3 Honor.

4 THE COURT: Okay.

5 MR. ALBRIGHT: I think that's very likely,
6 Your Honor. I think that things moved along pretty
7 fast today with the witnesses, probably a little
8 faster than I thought they would.

9 THE COURT: Okay. And I don't want to get
10 too ahead of myself, but usually my practice, I
11 usually do not do closing arguments, hear closing
12 arguments when I'm going to order post-trial briefs,
13 and I plan on ordering post-trial briefs in this
14 case, so that's -- if the parties are fine with that.

15 MR. ALBRIGHT: Your Honor, I'm perfectly
16 fine with that.

17 THE COURT: Okay.

18 MR. MARKLEY: Yes. We're fine. Sure.

19 THE COURT: Okay. And I probably will put
20 page limits. I'll see how -- by Tuesday, I probably
21 will put page limits on the briefs, and I can go the
22 standard briefing dates, or if you want to discuss
23 among yourselves timing and dates, too, that's -- I'd
24 hear -- if you came up with an agreement, I'd be
25 willing to consider that also.

1 MR. MARKLEY: And as documents continue to
2 march their way in from both sides without a
3 stipulation, I assume we're still working on a
4 potential stipulation, but I'm not 100 percent sure
5 how much is really left to -- on the second part of
6 it.

7 THE COURT: Right.

8 MR. ALBRIGHT: I --

9 MR. MARKLEY: Apparently not.

10 MR. ALBRIGHT: There could be something
11 left, but I'm not aware right at the moment --

12 MR. MARKLEY: Okay.

13 MR. ALBRIGHT: -- of anything material.

14 THE COURT: Okay. Well, that leads into
15 what was admitted today. So 104-P, 107-P, 109-P,
16 110-P, 111-P, 112-P, 113-P, 114-P, 115-R, 116-R, and
17 117-P.

18 MR. SCHEID: That's consistent with
19 Respondent's record, Your Honor.

20 THE COURT: All right. Since I don't have
21 anything else remaining on my calendar, we can start
22 -- if the parties are agreeable, we can start at 9:00
23 on Monday.

24 MR. ALBRIGHT: That's fine, Your Honor.

25 THE COURT: Okay. The Court is in recess

1 until 9:00 on Monday. Thank you.

2 THE CLERK: All rise.

3 (Whereupon, at 5:12 p.m., the above-
4 entitled matter was concluded.)

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1 CERTIFICATE OF TRANSCRIBER AND PROOFREADER

2 CASE NAME: Reserve Mechanical Corp, f.k.a. as

3 Reserve Casualty Corp. v. Commissioner

4 DOCKET NO.: 14545-16

5 We, the undersigned, do hereby certify that the
6 foregoing pages, numbers 426 through 501, inclusive,
7 are the true, accurate and complete transcript
8 prepared from the recording made by electronic
9 recording by Leslie Berridge, on April 27, 2017,
10 before the United States Tax Court at its session in
11 Houston, Texas, in accordance with the applicable
12 provisions of the current verbatim reporting contract
13 of the Court, and have verified the accuracy of the
14 transcript by comparing the typewritten transcript
15 against the verbal recording.

16

17 _____

18 Nancy H. King 05/18/2017

19 (Transcriber) (Date)

20

21 _____

22 Laurel H. Stoddard 05/19/2017

23 (Proofreader) (Date)

24

25

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IN THE UNITED STATES TAX COURT

In the Matter of:)
)
RESERVE MECHANICAL CORP., f.k.a.)
RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
v.)
)
COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

Volume: 7
Pages: 502 through 596
Place: Houston, Texas
Date: May 1, 2017

1 IN THE UNITED STATES TAX COURT

2

In the Matter of:)
)
 RESERVE MECHANICAL CORP., f.k.a.)
 4 RESERVE CASUALTY CORP.,)
)
 5 Petitioner,) Docket No. 14545-16
)
 6 v.)
)
 7 COMMISSIONER OF INTERNAL REVENUE,)
)
 8 Respondent.)

9 Room 7006
 Casey U.S. Courthouse
 10 515 Rusk Avenue
 Houston, Texas

11 May 1, 2017

12 The above-entitled matter resumed for
13 trial, pursuant to recess, at 9:13 a.m.

14 BEFORE: HONORABLE KATHLEEN KERRIGAN
15 Judge

16 APPEARANCES:

17 For the Petitioner:

18 VAL J. ALBRIGHT, Esquire
 MICHELLE Y. KU, Esquire
 19 Gardere Wynne
 20 2021 McKinney Avenue, Ste. 1600
 Dallas, Texas 75201
 21 214-999-3000

22

23

24

25

1 APPEARANCES: (continued)

2 For the Respondent:

3 G. ROGER MARKLEY, Esquire
4 THOMAS F. HARRIMAN, Esquire
5 NASEEM J. KHAN, Esquire
6 JUSTIN D. SCHEID, Esquire
7 Office of the Chief Counsel
8 Internal Revenue Service
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10 Chicago, Illinois 60606
11 312-368-8243

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C O N T E N T S

WITNESSES:	DIRECT	CROSS	REDIRECT	RECROSS	VOIR DIRE
For Petitioner:					
David Liptz	521	572	585		590
For Respondent					
Martin Eveleigh	507				

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1 P R O C E E D I N G S

2 (9:13 a.m.)

3 THE CLERK: Docket Number 14545-16, Reserve
4 Mechanical Group, formerly known as Reserve Casualty
5 Corp. Please state your appearances.

6 MR. MARKLEY: Good morning, Your Honor.
7 Roger Markley for Respondent.

8 MS. KHAN: Good morning, Your Honor.
9 Naseem Khan for Respondent, Your Honor.

10 MR. HARRIMAN: Good morning, Your Honor.
11 Tom Harriman for Respondent.

12 MR. SCHEID: Justin Scheid for Respondent.

13 MR. ALBRIGHT: Val Albright for Petitioner.
14 Good morning, Your Honor.

15 MS. KU: Michelle Ku for Petitioner. Good
16 morning, Your Honor.

17 THE COURT: Good morning. You may be
18 seated.

19 So it's my understanding Respondent is
20 going to call a witness first.

21 MS. KHAN: Your Honor, we have a witness
22 that needs to leave today, so we worked it out with
23 Mr. Albright to call Mr. Eveleigh, who represents
24 Atlas Management as the first witness in the case
25 today, if it's okay with you.

1 THE COURT: Yes.

2 MS. KHAN: Thank you. At this time,
3 Respondent calls Mr. Eveleigh.

4 Your Honor, Mr. Eveleigh is also
5 represented by Emily Marlowe, who's here with us
6 today.

7 MS. MARLOWE: Good morning, Your Honor.

8 THE COURT: Good morning.

9 THE CLERK: Please raise your right hand.
10 Whereupon,

11 MARTIN EVELEIGH having been first duly
12 sworn, was called as a witness herein, and was
13 examined and testified as follows:

14 THE CLERK: Will you please state your name
15 and address for the record.

16 THE WITNESS: Yes. Martin Eveleigh, 3022
17 Arundel Drive, Charlotte, North Carolina.

18 THE CLERK: Thank you. You may be seated.

19 THE COURT: Could you spell your name for
20 the record.

21 THE WITNESS: Yes. E-V-E-L-E-I-G-H.

22 DIRECT EXAMINATION

23 BY MS. KHAN:

24 Q Good morning, Mr. Eveleigh.

25 A Good morning.

1 Q Mr. Eveleigh, where are you employed?

2 A Atlas Insurance Management.

3 Q And do you have a title with Atlas
4 Insurance Management?

5 A Yes. I'm the chairman and CEO.

6 Q And as chairman and CEO of Atlas Insurance
7 Management, what are your -- what do your
8 responsibilities entail?

9 A The overall direction and strategy of the
10 company, ultimate executive responsibility for
11 everything that we do.

12 Q Okay. During 2008 through 2010, what was
13 your position with Atlas Insurance Management?

14 A I was in the same position.

15 Q Did Capstone Associated Services engage
16 Atlas to perform services for Capstone clients as of
17 December 1, 2006?

18 A Yes.

19 Q Generally, what services did Atlas perform
20 for Capstone as it related to Petitioner in this case
21 for 2008 and 2009?

22 A The -- there was an application for the
23 licensing of this company made late in 2008. Now,
24 the application process involves the provision of
25 certain documents to the regulator in Anguilla, such

1 things as a business plan, financial projections,
2 some forms to be filled in, and personal details of
3 the shareholders and directors of the company.

4 Now, all of those things were prepared by
5 Capstone, provided to Atlas for onward transmission
6 to the regulators. Our role was to make the
7 submission, using what we'd been provided by
8 Capstone. Then going forward, once the company had
9 been licensed and formed, our role really was
10 regulatory liaison and the provision of a local
11 office to the company.

12 Q Thank you. And did Atlas's engagement with
13 Capstone Associated Services change as of June 30,
14 2009?

15 A Yes. Capstone had determined that they
16 wanted, I think, to do their own thing. They were
17 forming their own licensed insurance management
18 company in Anguilla, and so they wanted to take over
19 the role that we had had in addition to whatever else
20 they might have been doing.

21 Q Okay. Now, Mr. Eveleigh, you were
22 subpoenaed to appear today, and you produced records
23 to the Internal Revenue Services. Correct?

24 A Yes.

25 MS. KHAN: Your Honor, I have five

1 documents that I'd like to have marked for
2 identification.

3 THE COURT: You may have those marked, and
4 does Mr. Albright have a copy of those documents?

5 MS. KHAN: I'm going to hand him copies as
6 I go. (Handing documents.) Let the record reflect
7 that I've handed Mr. Albright five copies of the
8 documents.

9 Your Honor, may I approach the clerk to --

10 THE COURT: Yes.

11 MS. KHAN: -- have the documents marked for
12 -- (Handing documents.)

13 MR. ALBRIGHT: Your Honor, Petitioner would
14 like to raise an objection. I know these documents
15 haven't been offered yet, but so we don't make it
16 real awkward, we'd like to raise an objection now to
17 asking Mr. Eveleigh about these documents or possibly
18 introducing them in evidence.

19 These documents were not exchanged at least
20 14 days before the first day of the trial session,
21 and under the Court's standing pretrial order dated
22 November 28, 2016, these documents should not be
23 admitted. And based on objections made by
24 Respondent's counsel during the trial, Petitioner
25 understands that is also Respondent's position.

1 MS. KHAN: Your Honor, this is not
2 Respondent's position. These are documents that were
3 subpoenaed by Mr. Eveleigh. We received the
4 documents on April 19. We immediately exchanged it
5 with Petitioner's representative on April 21.
6 They've been the subject of supplemental stipulation
7 discussions since then.

8 THE COURT: On April 26 when we had the
9 hearing on the various motions pending, and it was my
10 understanding that the subpoenaed documents were
11 returned from Atlas. You received what was requested
12 from the subpoena, and you had those present. You
13 had already given those to Petitioner's counsel.

14 And part of my order was to make sure the
15 documents that you had turned over, you walked
16 through Petitioner's counsel, telling them which -- I
17 think it was 90 documents, if my memory serves me.
18 correctly -- and you were going to walk through
19 Petitioner, telling them which documents came from
20 where.

21 MS. KHAN: We did, Your Honor.

22 THE COURT: And were these documents part
23 of those documents?

24 MS. KHAN: These documents were -- no.
25 There were two sets of documents. There were the

1 Borden documents that we received from the
2 arbitration firm. There were these documents that we
3 received from Atlas Insurance Management that were
4 subject to the subpoena that have been exchanged with
5 Mr. Albright, and we've been negotiating this --
6 we've been trying to negotiate the supplemental stip
7 with Mr. Albright on these documents.

8 MR. ALBRIGHT: Your Honor, may I speak to
9 that?

10 THE COURT: Yes, Mr. Albright.

11 MR. ALBRIGHT: Your Honor, the Respondent
12 subpoena was issued on April 7, 2017, and it was
13 served on April 11, 2017. And Respondent not once,
14 until we asked about the subpoenas that had been
15 served, did not discuss with us the fact that they
16 might have -- that Respondent might have documents
17 that would be delivered after the 14-day period had
18 expired.

19 And under the -- I mean, for Respondent to
20 be able to use this process essentially can
21 circumvent the Court's 14-day document exchange rule
22 by simply issuing a subpoena late in the process.
23 Your Honor, Respondent has known about Atlas
24 Insurance Management since at least as early as
25 February 23, 2009.

1 Atlas Insurance Management was listed as
2 the manager in the 1024 application that was filed
3 with Respondent for tax-exempt status. That
4 application is Exhibit -- it's a stipulated exhibit
5 in this case. It's Exhibit 18-J.

6 MS. KHAN: Your Honor, we didn't discover a
7 U.S. address for Atlas's U.S. address until April,
8 and as soon as we found the address, we issued the
9 subpoenas.

10 THE COURT: Mr. Albright, were these
11 documents -- these documents, were these part of the
12 documents -- it was my understanding when we had the
13 hearing on Wednesday, that documents were turned --
14 that you had already received documents that were
15 subject to a subpoena. Is that correct?

16 A I believe we received the documents on
17 Wednesday --

18 MS. KU: On April 21, we first received the
19 documents. On Wednesday, April 26, is when they told
20 us which documents came from which nonparty.

21 MR. ALBRIGHT: So I correct myself. We
22 received the documents on April 21.

23 MS. KU: And then they identified which
24 documents --

25 MR. ALBRIGHT: And then -- but they were

1 just a group of -- just a collection --

2 THE COURT: Right.

3 THE COURT: Right. But the Court asked
4 them, Respondent's counsel, to go through the
5 documents with you and identify where they came from,
6 and that was done. Correct?

7 MS. KU: On April 26.

8 MR. ALBRIGHT: On April 26, Your Honor.

9 THE COURT: Okay. I'm going to ask the
10 trial clerk to mark the documents for identification
11 purposes only.

12 THE CLERK: So a list of invoices from
13 Atlas Insurance to, Bill to Reserve Casualty Corp. is
14 marked as Exhibit 118-R.

15 (The document referred to was
16 marked for identification as
17 Respondent's Exhibit 118-R.)

18 THE CLERK: A letter dated December 1,
19 2006, from Atlas Insurance management, is marked for
20 identification as Exhibit 119-R.

21 (The document referred to was
22 marked for identification as
23 Respondent's Exhibit 119-R.)

24 THE CLERK: A letter dated October 20,
25 2008, from Capstone Associated Services is marked for

1 identification as Exhibit 120-R.

2 (The document referred to was
3 marked for identification as
4 Respondent's Exhibit 120-R.)

5 THE CLERK: A letter dated June 30, 2009,
6 from Atlas Insurance Management is marked for
7 identification as Exhibit 121-R.

8 (The document referred to was
9 marked for identification as
10 Respondent's Exhibit 121-R.)

11 THE CLERK: And a document entitled,
12 Certificate of Ultimate Beneficial Owner, dated
13 effective the 9th day of July 2009, is marked for
14 identification as Exhibit 122-R.

15 (The document referred to was
16 marked for identification as
17 Respondent's Exhibit 122-R.)

18 MS. KHAN: Your Honor, at this time, may I
19 approach Mr. Eveleigh to give him Exhibits 118-R
20 through 122-R?

21 THE COURT: Yes.

22 BY MS. KHAN:

23 Q (Handing documents.) Mr. Eveleigh, can you
24 identify what is Exhibit 118-R.

25 A Yes. Three invoices and a credit note.

1 Q And invoices are issued to -- from who to -
2 -

3 A From Atlas Insurance Management, Anguilla,
4 to Reserve Casualty Corp.

5 Q And these documents were produced in
6 response to the subpoena --

7 A Yes.

8 Q -- that was served upon you? Okay. Next,
9 can you identify -- are you familiar with Exhibit
10 119-R?

11 A Yes.

12 Q And what is Exhibit 119-R?

13 A It's a letter agreement between Atlas
14 Insurance Management and Capstone Associated Services
15 for the provision of services to Capstone-
16 administered captive insurance companies in Anguilla.

17 Q And were these the documents that you
18 produced to the Respondent subject to the subpoena?

19 A Yes.

20 Q Can you turn to Exhibit 120-R.

21 A Yes.

22 Q Can you identify what Exhibit 120-R is.

23 A Yes. It's a letter enclosing an insurance
24 license application for Reserve Casualty Corp.

25 Q Okay. And is this another document that

1 you produced to the Government, subject to the
2 subpoena?

3 A Yes.

4 Q All right. Can you identify Exhibit 121-R.

5 A Yes. It's a letter amending the previous
6 letter agreement, the one dated in 2006, and that,
7 again, is a letter from Atlas to Capstone Associated
8 Services.

9 Q Okay. And is this a document that you
10 produced to the Government, subject to the subpoena?

11 A Yes, it is.

12 Q Can you identify Exhibit 122-R.

13 A I don't think I have it.

14 Q I have it here. I'm sorry.

15 MS. KHAN: May I approach, Your Honor, with
16 Exhibit 122-R?

17 THE COURT: Yes, you may approach.

18 BY MS. KHAN:

19 Q (Handing document.)

20 A Thank you. (Perusing document.) Yes, I
21 do. I recognize it.

22 Q Okay. What is Exhibit 122-R?

23 A It calls itself a Certificate of Ultimate
24 Beneficial Owner. In effect, it appears to be a
25 board or shareholders resolution to change the

1 service providers in Anguilla, specifically to
2 appoint Capstone Insurance Management, Anguilla, in
3 place of Atlas Insurance Management.

4 Q So, Mr. Eveleigh, can we go back a moment
5 to Exhibit 121-R. I'd like to direct your attention
6 to Exhibit A that's attached to the document.

7 A Yes.

8 Q Are these redactions that were made by you?

9 A Yes.

10 Q Okay. I'd like to also direct now your
11 attention to Exhibit 119-R, directing your attention
12 to Exhibit A that is attached to the document.

13 A Yes.

14 Q Mr. Eveleigh, are these redactions that
15 were made by you?

16 A Yes, they are.

17 MS. KHAN: Your Honor, at this time,
18 Respondent would like to move Exhibits 118 through
19 122-R into the record.

20 MR. ALBRIGHT: Your Honor, same objection
21 as I stated previously. And furthermore, these
22 documents are redacted.

23 THE COURT: Which redactions are you
24 referring to?

25 MR. ALBRIGHT: Your Honor, on 117-R, there

1 are redactions to Exhibit A.

2 THE COURT: Do you mean 118?

3 MR. ALBRIGHT: Yes, Your Honor. 117 and --

4 THE COURT: No. There is no 117 -- 117 was
5 Michael Solomon's expert report.

6 MR. ALBRIGHT: Oh, this is 119-R.

7 THE COURT: 119? (Perusing document.)

8 It's the Court's understanding that the redactions
9 made to that document were made by the witness.

10 MS. KHAN: They were made by the witness,
11 Your Honor.

12 THE COURT: These documents are third-party
13 documents and were subject to the subpoena, and
14 Petitioner was aware that the documents subject to
15 the subpoena were going to be -- the subpoena were
16 going to be returned to the calendar call, and it was
17 addressed. So I'm going to admit these documents.

18 118-R, 119-R, 120-R, 121-R, and 122-R are
19 admitted.

20 (The documents referred to, having been
21 previously marked for identification as
22 Respondent's Exhibits 118-R through 122-
23 R, were received in evidence.)

24 MS. KHAN: Thank you, Your Honor. I have
25 no further questions of Mr. Eveleigh.

1 MR. ALBRIGHT: Your Honor, could I have
2 just a brief moment?

3 THE COURT: Yes.

4 (Pause.)

5 MR. ALBRIGHT: No questions, Your Honor.

6 THE COURT: Okay. You may step down.

7 Thank you.

8 THE WITNESS: Thank you.

9 (Whereupon, the witness was excused.)

10 MS. KHAN: Your Honor, may I collect the
11 documents from --

12 THE COURT: Yes.

13 (Pause.)

14 MR. ALBRIGHT: Your Honor, Petitioner calls
15 David Liptz.

16 THE CLERK: Please raise your right hand.

17 Whereupon,

18 DAVID LIPTZ having been first duly sworn,
19 was called as a witness herein, and was examined and
20 testified as follows:

21 THE CLERK: Can you please state your name
22 and address for the record.

23 THE WITNESS: David Liptz, 2318 Port
24 Carlisle, Newport Beach, California 92660.

25 THE CLERK: Thank you. You may be seated.

1 DIRECT EXAMINATION

2 BY MR. ALBRIGHT:

3 Q Good morning, Mr. Liptz.

4 A Good morning.

5 Q Mr. Liptz, are you employed?

6 A Yes.

7 Q And where are you employed?

8 A With Liptz & Associates.

9 Q And what is Liptz & Associates?

10 A It's a CPA firm.

11 Q And by CPA, you mean certified public
12 accountant?

13 A Correct.

14 Q Where is Liptz & Associates located?

15 A Newport Beach, California.

16 Q And are you the Mr. -- are you the Liptz in
17 the name Liptz & Associates?

18 A Yes, I am.

19 Q And how long have you worked at Liptz &
20 Associates?

21 A I formed my company in, I believe, 2000,
22 the year 2000.

23 Q And so where did you work prior to working
24 at Liptz & Associates?

25 A I worked in a variety of car dealerships as

1 a controller.

2 Q Were those accounting-related jobs?

3 A Yes.

4 Q And so you formed Liptz & Associates in
5 2000?

6 A As best I can recall, yes.

7 Q Okay. And from 2000 forward, where have
8 you worked? At Liptz & Associates?

9 A From -- during that time, I was working for
10 a variety of different companies and earning fees on
11 a per diem basis. On January 1, 2013, I merged my
12 practice with another local firm in southern
13 California called HKG, LLP, so I was a partner at
14 that firm until February 28 of 2017, when I decided
15 to leave that firm and start up as a sole
16 practitioner essentially with Liptz & Associates
17 again.

18 Q And so have you practiced with other
19 accounting firms in your career as an accountant?

20 A Yes.

21 Q And could you tell me what firms those
22 would be.

23 A HKG, LLP; Melton Colwell & Company; a firm
24 called Prime Associates.

25 Q And when did you become a CPA?

1 A 1989, I believe.

2 Q And after you became a CPA, what did you do
3 immediately after you became a CPA?

4 A I worked at Prime Associates, which then
5 turned into Melton Colwell & Company.

6 Q And what was your job at Prime Associates?

7 A Staff accountant.

8 Q Did you go to college?

9 A Yes.

10 Q Where did you go to college?

11 A California State University at Fullerton.

12 Q And did you graduate?

13 A Yes.

14 Q When did you graduate?

15 A 1986.

16 Q And your degree was in --

17 A Bachelor of science with emphasis in
18 accounting.

19 Q Do you hold any particular designations?

20 A I hold a designation. It's called an ACI,
21 associates in captive insurance.

22 Q And what does that mean?

23 A It's a course sponsored by an organization
24 called ICCIE and the University of Vermont, some
25 courses specifically addressing captive insurance,

1 and it's just a designation, saying I completed their
2 courses.

3 Q In captive insurance, but is there any
4 focus on any particular aspect of captive insurance
5 in this designation?

6 A No. It's a general, broad course --
7 courses.

8 Q Is there any particular type of accounting
9 work that Liptz & Associates performs?

10 A We have a specialty in captive insurance.

11 Q And so what do you do -- what makes up your
12 work that the firm does?

13 A We are purely a compliance firm. We
14 prepare income tax returns, prepare financial audits
15 for companies. We will do -- respond to notices from
16 different government agencies. We'll represent
17 clients in front of different government agencies,
18 taxing authorities, insurance regulators.

19 Q Do you do any planning?

20 A No.

21 Q Do you do any captive management?

22 A No.

23 Q Are you familiar with Capstone Associated
24 Services, Limited?

25 A Yes.

1 Q Is it okay with you if I refer to Capstone
2 Associated Services, Limited, as Capstone? You'll
3 understand what I'm asking you about?

4 A Yes.

5 Q Okay. How is it that you're familiar with
6 Capstone?

7 A They have retained us to perform financial
8 audits of different captive insurance companies that
9 they manage.

10 Q And so how many of these captive insurance
11 companies are you auditing?

12 A I seem to recall that we did, I think, 59
13 companies this past -- or this season that we are in
14 right now.

15 Q And so when did you first begin doing
16 audits for captive insurance companies administered
17 by Capstone?

18 A I seem to recall it was about eight years
19 ago.

20 Q And are you familiar with the statutory
21 financial statements that were filed by the
22 Petitioner in this case?

23 A Yes.

24 Q And would you have prepared those statutory
25 financial statements for 2008, '9 and '10?

1 A Well, we -- yes, we did. The 2008
2 financials were combined with the 2009. They were
3 included with the 2009.

4 Q So did you begin working with Capstone in
5 performing captive insurance company audits for 2008,
6 at least as early as 2008?

7 A I seem to recall this. Yes.

8 Q Okay. So do you recall how many captive
9 insurance companies that were administered by
10 Capstone that you audited in the 2008, 2009, 2010
11 time frame?

12 A I do not remember the number. We just have
13 to imagine that it was maybe 20 -- like 15 to 20.

14 Q And so has your level of work with Capstone
15 increased over the years?

16 A Yes.

17 Q So if you had to estimate how many audits
18 you've performed concerning captive insurance
19 companies administered by Capstone, how many audits
20 would you have done, would you say, over the period
21 when you started through the current year?

22 A 3- to 400.

23 Q Do you know what percentage of your
24 business is from this work of auditing captive
25 insurance companies administered by Capstone?

1 A I'd have to estimate it would be less than
2 7-1/2 percent.

3 Q On a yearly basis?

4 A Correct.

5 Q And when you say, 7-1/2 percent, is that by
6 revenues or by number of clients?

7 A That's by revenues.

8 Q Do others at your firm work with you in
9 performing the audits that you do for Capstone-
10 administered captive insurance companies?

11 A Yes.

12 Q And do the other persons from your firm
13 work under your direction and control in performing
14 their audit work?

15 A Yes.

16 Q And has that been true for every year, 2008
17 through the present?

18 A Yes.

19 Q When you do an audit of Capstone-
20 administered captive insurance companies, do you
21 visit the offices of Capstone?

22 A Yes.

23 Q And where are the offices of Capstone?

24 A They're here in Houston.

25 Q When you do an audit of a Capstone-

1 administered captive insurance company, what are the
2 steps that you follow in performing the audit? Can
3 you tell me about that generally.

4 A Well, it's quite extensive, the amount of
5 procedures that we are required to follow. We follow
6 generally accepted accounting standards which -- and
7 statutory accounting principles, which closely follow
8 Generally Accepted Accounting Principles.

9 There are hundreds of procedures that we're
10 required to follow, established by the California
11 Board of Accountancy and the AICPA that range from,
12 you know, building our files of the working trial
13 balance, all the way through having planning
14 meetings. We go through pre-planning and planning
15 checklists, substantive-type checklists, compliance
16 procedure checklists, concluding type checklists.

17 We test individual balances of the
18 financial statements in the general ledger. We
19 document different accounting processes that are
20 entailed in this business. We document procedures of
21 how they perform their underwriting, document
22 procedures on how they perform their reserve
23 analysis. We would look at basic segregation of duty
24 type issues, internal controls.

25 Those are just general type procedures that

1 we are required to follow in auditing any type of a
2 company.

3 Q Okay. So if you were to -- so if you were
4 doing an audit in 2008, 2009, and 2010 -- and let's
5 just focus on the audit of the Petitioner, Reserve
6 Casualty Corporation, if we could. Sort of walk me
7 through when the audit starts and then time of the
8 year, what records are provided to you. Just take me
9 through -- describe the process that you go through.

10 A The process is --

11 Q For example, do you start with some records
12 that are provided to you?

13 A Of course.

14 Q And tell me what records would be provided
15 to you for starters.

16 A Well, the first records that we need would
17 be an engagement letter, to get us engaged in the
18 engagement. Then we would need a set of financial
19 statements, which is a balance sheet, profit and
20 loss, and a detailed general ledger.

21 Q And so you would -- they would send you --
22 Capstone would send you a general ledger?

23 A Yes. That's the process.

24 Q What else would they send -- is there
25 anything else that they would send you to start with?

1 A We have a standard package of documents
2 that we request, which would include bank statements,
3 bank reconciliations, statements of brokerage
4 accounts, maybe some different types of investments
5 that they may have. I don't recall other types of
6 basic documents that we would ask for and have them
7 email to us, so that we could start prior to coming
8 out here and doing our on-site field work.

9 Q And so when you came down to Houston to do
10 the on-site work, you would go to the Capstone
11 offices.

12 A Correct.

13 Q Okay. And who would you meet with at
14 Capstone?

15 A We would meet with normally Chuck Earles
16 and other members of their accounting staff, usually
17 Megan Brooks or John Boskat.

18 Q And so how long would you be at the
19 Capstone offices doing these audits on an annual
20 basis?

21 A It varied between three to five days.

22 Q Would anybody from your firm come with you
23 on these trips?

24 A Yes.

25 Q And who might that be?

1 A My audit director, Eric Webber, and then
2 other staff members that we decided should accompany
3 us to do some of the work.

4 MR. ALBRIGHT: Your Honor, may I have this
5 document marked for identification as Petitioner's
6 Exhibit next in order?

7 THE COURT: Yes.

8 MR. ALBRIGHT: And let the record reflect
9 I'm showing -- handing a copy to Respondent's
10 counsel. (Handing document.)
11 May I approach, Your Honor?

12 THE COURT: Yes.

13 MR. ALBRIGHT: (Handing document.)

14 THE CLERK: A document entitled, Working
15 trial balance, dated January 31, 2009, is marked for
16 identification as Exhibit 123-P.

17 (The document referred to was
18 marked for identification as
19 Petitioner's Exhibit 123-P.)

20 MR. ALBRIGHT: Your Honor, may I provide
21 Mr. Liptz with a copy of Exhibit 123-P?

22 THE COURT: Yes.

23 BY MR. ALBRIGHT:

24 Q (Handing document.) Mr. Liptz, do you have
25 a copy of Exhibit 123-P in front of you?

1 A Yes.

2 Q What is Exhibit 123-P?

3 A This is our working trial balance.

4 Q And when you say, our working trial
5 balance, who's our?

6 A Liptz & Associates.

7 Q Okay. And working trial balance for what
8 company?

9 A This is for Reserve, Reserve Casualty, for
10 the time period -- this one's going to be from
11 inception 2008 through 2009.

12 Q Through December 31, 2009?

13 A Let me correct. This is for the period
14 ending December 31, '09.

15 Q Okay. So -- now, there are some notes down
16 -- so this -- tell me about how this -- there's some
17 notes down here. Were these -- when was this
18 prepared? Let's start with that? When was this
19 document prepared?

20 A This actual document?

21 Q Yes.

22 A Without the notes, it was prepared during
23 our audit process in 2010.

24 Q And so when you say, without the notes,
25 what are you referring to?

1 A These handwritten notes that are on here
2 were written on there during my process of responding
3 to my expert testimony.

4 Q So the original document didn't have notes
5 -- the notes 4 on here, the two notes at the bottom
6 of the page. Is that right?

7 A Correct.

8 Q Okay. And then I see a number 4 up here in
9 the middle of the sheet. But for those entries,
10 those markings, this would have been prepared during
11 the audit. Is that correct?

12 A Yes. For some reason, the name and the
13 date didn't print when I printed this out, so just
14 for identification, I wrote, Reserve, and 12/31/09,
15 you know, a few weeks ago or a few months ago, when I
16 looked at this.

17 Q So can you walk me through how this
18 document would have been prepared in the audit. How
19 did that occur?

20 A So standard procedure for us, we would take
21 the client's provided financial statements, unaudited
22 financial statements, and enter them into our
23 computer program. They would then appear in that
24 first column that says, Unadjusted balance, name,
25 question mark. So those are the balances that were

1 on the client's unaudited financial statements.

2 Q And would you --

3 A That's where we start.

4 Q And would you have had a copy of the
5 general ledger at this point in time?

6 A Yes.

7 Q And so what -- there's another column there
8 that says, Net AJEs. What is that?

9 A So that stands for adjusting --

10 MR. SCHEID: Objection, Your Honor. He is
11 now asking questions specifically relating to this
12 document. The document's not in evidence at this
13 point.

14 MR. ALBRIGHT: I --

15 THE COURT: Mr. Albright?

16 MR. ALBRIGHT: Your Honor, maybe I need to
17 ask a few more questions.

18 THE COURT: I'm going to allow him to ask
19 questions, because I think he was getting ready to
20 offer the document. Am I correct?

21 MR. ALBRIGHT: Yes, Your Honor.

22 THE COURT: Yes.

23 BY MR. ALBRIGHT:

24 Q And so who would make the entries under,
25 Net AJEs?

1 A Liptz & Associates.

2 Q And then the next column, who would make
3 those entries?

4 A That's just a computerization, mathematical
5 -- just adding the first two columns together.

6 Q And so is everything from the first column
7 to the right, is that -- that's what your firm did?

8 A Say that again.

9 Q Well, I thought I understood you to say
10 that the first column over here, this unadjusted
11 balance, these numbers, were provided to you by
12 Capstone.

13 A Correct.

14 Q Okay. And then everything to the right of
15 that column is work that you did in connection with
16 your audit.

17 A Correct.

18 Q Okay.

19 MR. ALBRIGHT: Your Honor, I want to offer
20 Exhibit 123-P into evidence.

21 MR. SCHEID: No objection, Your Honor.

22 THE COURT: 123-P is admitted.

23 (The document referred to, having been
24 previously marked for identification as
25 Petitioner's Exhibit 123-P, was received

1 in evidence.)

2 BY MR. ALBRIGHT:

3 Q So, Mr. Liptz, looking at Exhibit 123-P, I
4 see in the top there it says, "D.A. Davidson cash."
5 Do you see that?

6 A Yes.

7 Q Do you know what that represents?

8 A That should be a bank account with the bank
9 D.A. Davidson.

10 Q And do you see a number out there to the
11 right of that?

12 A Yes.

13 Q What would that represent, the 169,157?

14 A That should represent the balance in the
15 account as of 12/31/2009.

16 Q So what did you -- did you do anything to
17 verify the 169,157 in performing your audit?

18 A Yes.

19 Q Could you explain what you did.

20 A Standard procedure in my firm in auditing a
21 cash balance is to obtain the bank statement for the
22 time period 12/31/09, review and examine a bank
23 reconciliation, review any reconciling items that may
24 be on that bank statement, and then send out a
25 independently prepared bank confirmation to the bank

1 or brokerage house of this account, and ask them to
2 independently verify the balance that they have on
3 December 31, 2009.

4 Then we would receive that back. We would
5 mail that actually to the bank, after we got the
6 authorized signers to approve for D.A. Davidson to
7 release the information to us as an independent third
8 party. The banks won't do that unless they get
9 authorization.

10 We would have -- my office would have
11 internally prepared the document, the bank
12 confirmation, sent it to Capstone for them to mail to
13 the client to be signed. We then instructed the
14 clients to send -- when I say, the clients, that
15 would have been the authorized signers on that bank
16 account, to then send it back to my office, where we
17 would then, either through the postal -- you know,
18 U.S.P.O. or email, email it to D.A. Davidson and tell
19 them to respond to us directly.

20 And once we get it back, we would compare
21 it to the general ledger, the bank statement, and
22 bank reconciliation, and note any differences or
23 discrepancies.

24 Q Now, from looking at this work paper, can
25 you tell whether you made any adjustment relating to

1 that item for 2009?

2 A From this work paper, it doesn't look like
3 we made any adjustments.

4 Q And I see over here a column that -- so
5 what is, Net AJE? What does that stand for?

6 A AJE stands for adjusting journal entries.

7 Q What is an adjusting journal entry?

8 A That would be an adjustment as required to
9 be made to the unadjusted or the client-provided
10 amounts or balances, because they were incorrect. An
11 adjustment had to be made to make them correct.

12 Q Okay. And then there's also a column
13 headed -- so it looks like you made an adjustment
14 here to an item in this working trial balance. Do
15 you see down there where it says, MS common stocks,
16 Morningstar, 2903?

17 A Yes.

18 Q And then there's also an MS common stocks,
19 unrealized loss at 2903 negative.

20 A Correct.

21 Q Do you know what that would represent?

22 A Yes.

23 Q What does that represent?

24 A That represents to take the unaudited
25 financial statements and get -- and adjust them to a

1 statutory basis of financials to report the cost of
2 those assets sitting in the Morningstar account and
3 individually identifying how much unrealized, in this
4 case, losses there are, that they've incurred in
5 those assets.

6 Q And so with respect to assets, I don't see
7 any net RJE's. What's an RJE?

8 A That stands for reclassification journal
9 entry. That is to reclassify the adjusted balances
10 into -- for statutory or GAAP financial statement
11 purposes.

12 Q And so with respect to the asset portion of
13 this, I see a WP reference. What is that?

14 A That stands for work paper references.
15 Those are the work papers or the work paper number in
16 my file of where to find the support and the audit
17 procedures and work that we performed on these
18 individual balances.

19 Q Why is that important to you as a CPA?

20 A Well, it establishes our audit trail so we
21 can easily find the support is documented in our
22 files.

23 Q And so are you subject to peer review?

24 A Yes.

25 Q And what is a peer review?

1 A Peer review is a requirement of the
2 California State Board of Accountancy that all CPAs
3 that perform financial audits are reviewed every
4 three years by approved CPAs that have industry
5 knowledge of the industry that they are reviewing.

6 Q Okay. So if we could, would you look down
7 at accounts -- let's see. So the numbers in the left
8 column were provided to you by Capstone, if I
9 understood correctly.

10 A Yes.

11 Q And then the numbers in the middle column,
12 those are your numbers after making any adjustments.

13 A The one that says, adjusted balance?

14 Q Yes.

15 A Yes.

16 Q So I see down here a line item, Insurance
17 premium income, affiliated DW premiums. Would you
18 have looked at that line item?

19 A Yes.

20 Q And what would you do in looking at that
21 line item?

22 A We would have -- well, we would have --
23 first we would have established what the process,
24 their underwriting process, was for developing their
25 premiums and insurance contracts. Then we would have

1 selected a sample of the variety of different
2 directly written premiums issued by Capstone
3 Insurance for the variety of captive insurance
4 companies that we performed audits on.

5 And then we would review that sample of
6 those direct written policies, noting policy period,
7 the premiums, other terms of the contracts. We would
8 obtain a schedule from Capstone that would list all
9 the policies that were written, that are encompassed
10 in the \$365,224, and make sure that agrees with the
11 general ledger. And through our sampling testing, we
12 would determine if our testing was adequate in the
13 sample that we selected to give us comfort that the
14 numbers are presented -- or materially reasonable,
15 and no adjustment would have been necessary.

16 Q And so there's another line item there,
17 40133 REINS PREM income. Do you know what that would
18 be?

19 A That stands for reinsurance premium income.

20 Q Okay. And you had procedures to verify
21 that that number was correct. Is that right?

22 A Yes.

23 Q And then there's another line item there
24 that says, 40233. What would that item be?

25 A That is the reinsurance premium income for

1 the quota share pool reinsurance that they assumed.

2 Q And you would have followed procedures to
3 verify that number?

4 A Yes.

5 MR. ALBRIGHT: Your Honor, may I have this
6 document marked for identification as Petitioner's
7 Exhibit next in order?

8 THE COURT: Yes.

9 MR. ALBRIGHT: And please let the record
10 reflect that I'm handing a copy to Respondent's
11 counsel. (Handing document.)

12 May I approach, Your Honor?

13 THE COURT: Yes.

14 MR. ALBRIGHT: (Handing document.)

15 THE CLERK: Document entitled, Working
16 trial balance, dated December 31, 2010, is marked for
17 identification as Exhibit 124-P.

18 (The document referred to was
19 marked for identification as
20 Petitioner's Exhibit 124-P.)

21 MR. ALBRIGHT: Your Honor, may I provide a
22 copy of 124-P to Mr. Liptz?

23 THE COURT: Yes.

24 BY MR. ALBRIGHT:

25 Q (Handing document.) Mr. Liptz, do you have

1 a copy of Exhibit 124-P in front of you?

2 A Yes.

3 Q And could you tell me what Exhibit 124-P
4 is.

5 A This is the working trial balance that
6 Liptz & Associates prepared for the audit of Reserve
7 for December 31 -- for the year ending December 31,
8 2010.

9 Q And there are some notes on this document.
10 Were those notes put on here by you in preparation
11 for your testimony?

12 A Yes.

13 Q And was Exhibit 124-P prepared in a similar
14 manner to what Exhibit 123-P was prepared?

15 A Yes.

16 MR. ALBRIGHT: Your Honor, I'd offer 124-P
17 into evidence.

18 MR. SCHEID: No objection, Your Honor.

19 THE COURT: 124-P is admitted.

20 (The document referred to, having been
21 previously marked for identification as
22 Petitioner's Exhibit 124-P, was received
23 in evidence.)

24 BY MR. ALBRIGHT:

25 Q Now, Mr. Liptz, in looking at Exhibit 124-

1 P, did you make any -- in your audit for 2010, did
2 you make any net -- or did you make any adjusting
3 journal entries for that year?

4 A No.

5 Q Did you make any net reclassification -- or
6 any reclassification journal entries?

7 A No.

8 MR. ALBRIGHT: Your Honor, may I have this
9 document marked for identification as Petitioner's
10 Exhibit next in order?

11 THE COURT: Yes.

12 MR. ALBRIGHT: Please let the record
13 reflect that I'm handing Respondent's counsel a copy.
14 (Handing document.)

15 MR. SCHEID: Your Honor, I'm not clear as to
16 when this document was exchanged with Respondent's
17 counsel.

18 THE COURT: I'm going to first have the
19 trial clerk mark it for identification.

20 THE CLERK: Document titled, Audited
21 financial statements and notes of Reserve Casualty
22 Corp. is marked for identification as Exhibit 125-P.

23 (The document referred to was
24 marked for identification as
25 Petitioner's Exhibit 125-P.)

1 THE COURT: Mr. Albright, was this document
2 given to Respondent's counsel prior?

3 MR. ALBRIGHT: It was provided to
4 Respondent's counsel consistent with the 14-day
5 document exchange.

6 MR. SCHEID: Your Honor, may I have a moment
7 just to confirm that?

8 THE COURT: Yes, you may have a moment.

9 (Pause.)

10 MR. SCHEID: Your Honor, based upon locating
11 the previous document that was exchanged, it appears
12 these documents are different. There's different
13 dates on the independent auditor's reports, and
14 further, the first page of each of the documents is
15 different.

16 MR. ALBRIGHT: Your Honor, I could address
17 that.

18 THE COURT: Yes.

19 MR. ALBRIGHT: Your Honor, in the document
20 exchange, we sent Respondent's counsel a letter on
21 April 10, 2017, and we identified the documents that
22 Petitioner intended to utilize at trial.

23 And in there, there's a paragraph,
24 paragraph 5, that says that, "On March 27, 2017,
25 Petitioner submitted copies of expert reports to the

1 Court and also served Respondent with copies of these
2 reports." This Exhibit 125-P, this document, was
3 attached to Mr. Liptz's report. And so I believe we
4 identified this document as a document that we could
5 use at trial.

6 THE COURT: Mr. Albright, if you wouldn't
7 mind just taking a look at the document Respondent's
8 counsel is referring to, with the different dates,
9 and tell the Court what that document is from.

10 MR. ALBRIGHT: (Perusing document.) Well,
11 Your Honor, yes, I can.

12 THE COURT: Okay.

13 MR. ALBRIGHT: Should we have a sidebar, or
14 should I --

15 THE COURT: You can just --

16 MR. ALBRIGHT: -- address it?

17 THE COURT: You can just address it.

18 MR. ALBRIGHT: Okay. Your Honor,
19 Respondent's counsel is referring to the audited
20 financial statements and notes, statutory basis, for
21 -- it's Exhibit 27-J that's in the record. But it's
22 for the period December 31, 2010, and the period from
23 inception to December 31, 2009.

24 This 125-P is a similar document, but it's
25 from inception to December 31, 2009. It doesn't

1 include 2010.

2 THE COURT: So just to be clear, the one
3 that was in the stipulated exhibit included all
4 years.

5 MR. ALBRIGHT: Yes, Your Honor.

6 THE COURT: And this is just a partial that
7 was in the materials attached to the expert --
8 exchanged as part of the materials attached to the
9 expert report.

10 MR. ALBRIGHT: Yes, Your Honor.

11 MR. SCHEID: If I may have a moment, Your
12 Honor, to confirm that it was exchanged with respect
13 to the expert report --

14 THE COURT: You may have a moment.

15 MR. SCHEID: Thank you, Your Honor.

16 THE COURT: And it's attached to the expert
17 report the Court received.

18 MR. SCHEID: It is, Your Honor? Then, Your
19 Honor, we would withdraw the objection.

20 THE COURT: Thank you.

21 MR. ALBRIGHT: Your Honor, may I provide
22 Mr. Liptz with a copy of Exhibit 125-P?

23 THE COURT: Yes, you may.

24 BY MR. ALBRIGHT:

25 Q (Handing document.) Mr. Liptz, do you have

1 a copy of Exhibit 125-P in front of you?

2 A Yes.

3 Q Do you know what Exhibit 125-P is?

4 A Yes.

5 Q What is Exhibit 125-P?

6 A This looks like the audit report that Liptz
7 & Associates issued to Reserve Casualty Corp. for the
8 period from inception of the company through December
9 31, 2009.

10 MR. ALBRIGHT: Your Honor, I'd move 125-P
11 into evidence.

12 MR. SCHEID: If I may have just a moment,
13 Your Honor, just to look through the document
14 quickly.

15 (Pause.)

16 MR. SCHEID: Your Honor, it appears that
17 this exhibit, Exhibit 125-P, which has been marked
18 for identification, is duplicative of the document
19 that has been stipulated to by the parties that
20 Petitioner's counsel referred to previously, which I
21 believe is Exhibit 27-J.

22 THE COURT: The letter in 27-J has a May --
23 I'm looking at Bates number 525. That has May 20,
24 2011, and I think that Mr. Albright said before that
25 27-J was more inclusive than what was -- and the

1 letter and the exhibit we're discussing has May 3,
2 2010.

3 MR. SCHEID: Your Honor, with the exception
4 of the date of the auditor's report, it appears the
5 remainder of the document, Exhibit 27-J is inclusive
6 of all of this information, I guess, with the
7 exception of a solvency calculation at note 4 to the
8 notes to the financial statements.

9 MR. ALBRIGHT: Your Honor, I believe I
10 could clear this up with the witness.

11 THE COURT: I'm going to allow the exhibit
12 in, because it's -- it was attached to the expert
13 report, and it's just separating the columns, so I'm
14 going to admit 125-P.

15 (The document referred to, having been
16 previously marked for identification as
17 Petitioner's Exhibit 125-P, was received
18 in evidence.)

19 MR. ALBRIGHT: Your Honor, if I may, may I
20 have this document marked for identification as
21 Petitioner's Exhibit next in order?

22 THE COURT: Yes.

23 MR. ALBRIGHT: Please let the record
24 reflect I'm handing Respondent's counsel a copy of
25 the document. (Handing document.)

1 THE CLERK: A document entitled, General
2 ledger from January 1, 2009, to December 31, 2009,
3 for Reserve Casualty Corp., is marked for
4 identification as Exhibit 126-P.

5 (The document referred to was marked for
6 identification as Petitioner's Exhibit
7 126-P.)

8 MR. ALBRIGHT: Your Honor, may I provide
9 Mr. Liptz with a copy --

10 THE COURT: Yes.

11 MR. ALBRIGHT: -- of Exhibit 126-P?

12 BY MR. ALBRIGHT:

13 Q (Handing document.) Mr. Liptz, do you have
14 a copy of Exhibit 126-P in front of you?

15 A Yes.

16 Q What is Exhibit 126-P?

17 A It's the general ledger for Reserve
18 Casualty Corp., for the period from January 1, 2009,
19 to December 31, 2009.

20 Q And can you tell when Exhibit 126-P was
21 printed from looking at it?

22 A It appears it was printed on February 23,
23 2010, at 1413:45.40 hours.

24 Q And so how did you receive a copy of
25 Exhibit 126-P?

1 A This was provided to us from Capstone.

2 MR. ALBRIGHT: Your Honor, I'd offer
3 Exhibit 126-P into evidence.

4 MR. SCHEID: Objection, Your Honor. There's
5 been no testimony, no foundation laid as to who
6 prepared this, how it was prepared. All we've heard
7 from the witness is that he was provided a copy of
8 this from Capstone.

9 And furthermore, Your Honor, this is a
10 different copy, but essentially the same information
11 as contained in Exhibit 29-P, which is still the
12 subject of an authenticity objection by Respondent's
13 counsel.

14 MR. ALBRIGHT: Well, Your Honor, this is a
15 document that Mr. Liptz received from Capstone in
16 connection with performing his audit, and it should
17 be admitted for -- at least for that purpose, in
18 explaining what Mr. Liptz did.

19 THE COURT: Mr. Albright, how does this
20 differ from 29-P?

21 MR. ALBRIGHT: Your Honor, it should be the
22 same, with the exception of the transaction
23 description looks like it's truncated to get it on --
24 to get it printed on this page, on Exhibit 126-P.
25 And it looks like there's a handwritten note on here

1 on the first page. But otherwise it should be the
2 same document, Your Honor.

3 THE COURT: Could you just ask a couple
4 more questions about the -- to lay the foundation
5 more on this document.

6 BY MR. ALBRIGHT:

7 Q So, Mr. Liptz, Exhibit 126-P, this -- you
8 said that -- you testified that this came from where?

9 A We would have gotten this from Capstone.

10 Q Okay. And would you have utilized Exhibit
11 126-P in your audit of Reserve Casualty Corporation's
12 financial records for the year 2009 or in the audit
13 for the periods that you performed audits?

14 A We would have used this as part of our
15 supporting documents during our audit process for
16 2009.

17 Q And, Mr. Liptz, if you would go back to
18 Exhibit 123-P, please, would you have utilized
19 Exhibit 126-P in preparing Exhibit 123-P?

20 A We would have used actually the financial
21 statements, the unaudited balance sheet and profit
22 and loss, to prepare this 123-P document.

23 Q Would you have reviewed the general ledger
24 in connection with your audit of this period for
25 Reserve Casualty Corporation?

1 A Yes.

2 Q Do you know how the accounting system at
3 Capstone was maintained? Was it maintained on a
4 computer system? I mean, how was it -- do you know
5 how it was maintained?

6 A It was on a computer system.

7 Q And what is your understanding of what
8 Exhibit 126-P represents?

9 A This represents the individual -- well, the
10 transactions that Reserve Casualty Corp. transacted
11 during 2009.

12 MR. ALBRIGHT: Your Honor, I'd offer
13 Exhibit 126-P into evidence.

14 MR. SCHEID: Objection again, Your Honor,
15 for the same basis as before for Exhibit 29-P.
16 There's been no foundation laid, and Respondent
17 objects, based upon authenticity. Again, as stated
18 before, we don't know who prepared this, how it was
19 prepared. Though he reviewed it in the context of
20 his audit, beyond that, the authenticity objection's
21 still the same.

22 THE COURT: 126-P is admitted as -- and
23 it's admitted as the document that Liptz Accounting
24 received from Capstone.

25 (The document referred to, having been

1 previously marked for identification as
2 Petitioner's Exhibit 126-P, was received
3 in evidence.)

4 MR. ALBRIGHT: Your Honor, may I have this
5 document marked for identification as Petitioner's
6 Exhibit next in order?

7 THE COURT: Yes.

8 MR. ALBRIGHT: And please let the record
9 reflect that I am handing a copy to Respondent's
10 counsel. (Handing document.)

11 May I approach, Your Honor?

12 THE COURT: Yes.

13 MR. ALBRIGHT: (Handing document.)

14 THE CLERK: The document entitled, General
15 ledger for Reserve Casualty Corp., for the periods
16 from January 1, 2010, to December 31, 2010, is marked
17 for identification as Exhibit 127-P.

18 (The document referred to was marked for
19 identification as Petitioner's Exhibit
20 127-P.)

21 MR. ALBRIGHT: Your Honor, may I provide
22 Mr. Liptz with a copy of Exhibit 127-P?

23 THE COURT: Yes.

24 BY MR. ALBRIGHT:

25 Q (Handing document.) Mr. Liptz, do you have

1 a copy of Exhibit 127-P in front of you there?

2 A Yes.

3 Q And can you tell me what Exhibit 127-P is?

4 A It says that this is the general ledger for
5 Reserve Casualty Corporation for the period from
6 January 1, 2010, to December 31, 2010.

7 Q And do you -- how did you -- did you
8 receive a copy of Exhibit 127-P at some point?

9 A Yes.

10 Q And can you tell me the circumstances under
11 which you received Exhibit 127-P.

12 A We are engaged to perform the audit for
13 Reserve Casualty Corp. for the year ending 2010.
14 This would have been one of the basic documents we
15 would have requested from Capstone to begin our
16 audit.

17 MR. ALBRIGHT: Your Honor, I'd move Exhibit
18 127-P into evidence.

19 MR. SCHEID: Your Honor, before I respond, I
20 have a -- just a question. Is Exhibit 127-P marked
21 for identification a copy of Exhibit 30-P in all
22 respects Is there any differences between those two
23 documents, Your Honor?

24 MR. ALBRIGHT: Your Honor, it's the same.
25 The exhibit that Respondent's counsel is referring to

1 is printed in landscape. This is printed portrait on
2 paper, and it has the -- the transaction description
3 is truncated to get it on the paper.

4 THE COURT: There's also -- as in the
5 previous one, there's also the date of when it was
6 printed in the upper left-hand corner --

7 MR. ALBRIGHT: Yes, Your Honor.

8 THE COURT: -- is also different.

9 MR. SCHEID: Your Honor, Respondent objects
10 to the admissibility of Exhibit 127-P for
11 identification on the basis of authenticity for the
12 reasons previously stated.

13 THE COURT: And 127-P is admitted, subject
14 to, as the previous one, as the document that was
15 given by Capstone to Liptz Accounting.

16 MR. SCHEID: Thank you, Your Honor.

17 (The document referred to, having been
18 previously marked for identification as
19 Petitioner's Exhibit 127-P, was received
20 in evidence.)

21 MR. ALBRIGHT: Your Honor, if I could,
22 could I have this document marked for identification
23 as Petitioner's Exhibit next in order?

24 THE COURT: Yes.

25 MR. ALBRIGHT: And please let the record

1 reflect that I'm handing Respondent's counsel a copy.
2 (Handing document.)

3 Your Honor, may I approach?

4 THE COURT: Yes.

5 MR. ALBRIGHT: (Handing document.)

6 THE CLERK: The document entitled, Notice
7 of Claim from Reserve Casualty Corp. is marked for
8 identification as Exhibit 128-P.

9 (The document referred to was marked for
10 identification as Petitioner's Exhibit
11 128-P.)

12 MR. ALBRIGHT: Your Honor, may I provide
13 Mr. Liptz with a copy of Exhibit 128-P?

14 THE COURT: Yes.

15 BY MR. ALBRIGHT:

16 Q (Handing document.) Mr. Liptz, do you have
17 a copy of Exhibit 128-P in front of you?

18 A Yes.

19 Q Do you know what Exhibit 128-P is?

20 A This is a notice of claim from Reserve
21 Casualty Corporation.

22 Q And did you receive a copy of this document
23 in connection with your audits of Reserve Casualty
24 Corp.?

25 A Yes.

1 Q And who provided this document to you?

2 A Capstone.

3 Q And why would you ask for Exhibit 128-P
4 from Capstone?

5 A Based upon our -- during our planning
6 stages of the audit, we would have -- it would have
7 been indicated that claims expense was an area of
8 higher risk in our audit which required us to do
9 testing on this area of an audit, of the audit and
10 accompanying it.

11 Q And so you asked for this document?

12 A We asked for documents that supported the
13 general ledger balance. I don't remember what the
14 balance was, but that supported the balance, and this
15 is at least one of the documents that they gave us.
16 I don't remember if there's more than one document.

17 Q And if you would look at page 2 of Exhibit
18 128-P, there's a -- it looks like a note there in a
19 box.

20 A Yes.

21 Q Who would have put that on the document?

22 A Liptz & Associates put that on the
23 document.

24 MR. ALBRIGHT: Your Honor, I'd offer
25 Exhibit 128-P into evidence.

1 MR. SCHEID: Your Honor, Respondent again
2 objects to the admission of 128-P marked for
3 identification into evidence on the grounds of
4 authenticity, for the same reasons we previously
5 stated. With respect to the actual notice of claim
6 itself, we have no information as to who actually
7 prepared, how it was prepared, and why it was
8 prepared.

9 THE COURT: Do you want to respond, Mr.
10 Albright?

11 MR. ALBRIGHT: Well, Your Honor, this is a
12 document that was provided to Mr. -- Liptz &
13 Associates in connection with the audit that was
14 performed, and to the extent that Mr. Liptz used this
15 document in performing his audit, we're offering it
16 for that purpose.

17 THE COURT: And, again, it's admitted as a
18 document that was given by Capstone in preparation
19 for the audit. 128-P is admitted.

20 (The document referred to, having been
21 previously marked for identification as
22 Petitioner's Exhibit 128-P, was received
23 in evidence.)

24 MR. ALBRIGHT: Your Honor, may I have this
25 document marked for identification as Petitioner's

1 Exhibit next in order?

2 THE COURT: Yes.

3 MR. ALBRIGHT: And please let the record
4 reflect that I'm handing a copy to Respondent's
5 counsel. (Handing document.)

6 And this time, I will provide it to the clerk, if I
7 may.

8 THE COURT: Yes.

9 MR. ALBRIGHT: (Handing document.)

10 THE CLERK: The document entitled Insurance
11 Loss Report is marked for identification as Exhibit
12 129-P.

13 (The document referred to was marked for
14 identification as Petitioner's Exhibit
15 129-P.)

16 MR. ALBRIGHT: Your Honor, may I provide a
17 copy of Exhibit 129-P --

18 THE COURT: Yes.

19 MR. ALBRIGHT: -- to Mr. Liptz?

20 BY MR. ALBRIGHT:

21 Q (Handing document.) Mr. Liptz, do you have
22 a copy of Exhibit 129-P in front of you?

23 A Yes.

24 Q And can you tell me what Exhibit 129-P is.

25 A The first two pages are the summary of the

1 Capstone -- of how reserves are calculated by
2 Capstone-managed clients. And then -- I'm sorry.
3 The following pages are applicable directly to
4 Reserve Casualty Corporation for the period ending
5 December 31, 2009, that we used as audit support, to
6 support the general ledger balances for that time
7 period.

8 Q What time period was that?

9 A This is for the calendar year January 1,
10 2009, through December 31, 2009.

11 Q Okay. And so how is that you -- where did
12 this document come from?

13 A It came from Capstone.

14 Q And that's Exhibit 129-P?

15 A Correct.

16 Q And if you'd look at -- go about the third
17 page back, there's some handwriting.

18 A Yes.

19 Q Do you know whose handwriting that is?

20 A It's one of my staff.

21 Q And what's the point of the handwriting?

22 MR. SCHEID: Objection, Your Honor.

23 Foundation. He didn't write it.

24 THE COURT: I think -- it is his staff. I
25 think we can ask some clarifying questions.

1 BY MR. ALBRIGHT:

2 Q Okay. So do you know why these notes would
3 be made on this Exhibit 129-P? Can you identify the
4 handwriting?

5 A Yes.

6 Q Whose handwriting is it?

7 A At this time, I can see his initials down
8 in the lower right. It says, MDH, stand for Max
9 Henrick.

10 Q And who is Matt Hendrick?

11 A Max Henrick is -- he was a staff accountant
12 at the time for me.

13 Q Was he working for you?

14 A Yes.

15 Q And was he doing this, reviewing this
16 document at your request?

17 A Yes.

18 Q And so what is Matt doing here?

19 A His name is Max, M-A-X.

20 Q I'm sorry.

21 MR. SCHEID: Objection, Your Honor. It
22 calls for hearsay, I think.

23 THE COURT: Objection sustained.

24 BY MR. ALBRIGHT:

25 Q So why would Liptz & Associates be looking

1 at this report?

2 A This was the support that was provided to
3 us when we asked for supporting documents to support
4 the general ledger of the liabilities for incurred
5 but not reported reserves and any other types of
6 reserves. In this case, it looks like case reserves
7 and claims paid. We asked for support for those
8 balances. This is the document that we were
9 provided.

10 Q So, Mr. Liptz, do you still have Exhibit
11 123-P there in front of you?

12 A Yes.

13 Q And so there -- I see some numbers here on
14 Exhibit 129-P. Do you see the 495,789?

15 A Yes.

16 MR. SCHEID: Objection, Your Honor. Move to
17 strike the question. The document is not in evidence
18 at this point.

19 MR. ALBRIGHT: Your Honor, I'd like to just
20 ask this question for -- just to show that this is an
21 authentic document and why that -- how that ties to
22 this other document over here in connection with the
23 audit.

24 THE COURT: I want to hear the end of the
25 question. Thank you. You may proceed.

1 MR. ALBRIGHT: Yes.

2 BY MR. ALBRIGHT:

3 Q If you look at Exhibit 123-P, please --

4 A Okay.

5 Q -- and if you look at line item for 52803,
6 do you see that?

7 A Yes.

8 Q And what is that line item?

9 A it says, "Increase in insurance reserves -
10 reinsurance."

11 Q And what was the increase that's reflected
12 there?

13 A \$495,789.

14 Q Okay. And so if you go back to Exhibit
15 129-P on page 3, there's a number there, 495,789.

16 A Yes.

17 Q Does that have any relation to the number,
18 the similar number in Exhibit 123-P?

19 A Yes. The handwriting to the right says, TB
20 at 132. That indicates that that number agrees to
21 the trial balance, and we referenced this working
22 trial balance, 123-P, at work paper 132. That's what
23 that means.

24 MR. ALBRIGHT: Your Honor, I'd offer
25 Exhibit 129-P into evidence.

1 MR. SCHEID: Objection, Your Honor. on
2 hearsay grounds.

3 THE COURT: Do you want to respond to the
4 hearsay objection, Mr. Albright?

5 MR. ALBRIGHT: Yes, Your Honor. it's a
6 document that Liptz & Associates was provided by
7 Capstone in connection with performing the audit that
8 they were performing, and this is a document that
9 shows how a number in the working trial balance was
10 derived.

11 MR. SCHEID: Your Honor, that's exactly the
12 basis for my hearsay objection. This is a document,
13 an our-of-court statement, theoretically of Capstone,
14 and there's been no foundation laid as to any
15 exception to hearsay, for instance, business record.
16 It's not a business record of Mr. Liptz.

17 MR. ALBRIGHT: Your Honor, I believe it is
18 a business record of Mr. Liptz.

19 THE COURT: 129-P is admitted.

20 (The document referred to, having been
21 previously marked for identification as
22 Petitioner's Exhibit 129-P, was received
23 in evidence.)

24 MR. SCHEID: Your Honor, just for point of
25 clarification, is this admitted as a document that

1 Liptz & Associates received, or is it admitted for
2 all purposes?

3 THE COURT: It's admitted as a document
4 Liptz & Associates received from Capstone.

5 MR. SCHEID: Thank you, Your Honor.

6 BY MR. ALBRIGHT:

7 Q Mr. Liptz, do you know who files statutory
8 financials on behalf of Reserve Casualty Corporation
9 in 2008, 2009, and 2010, who did that?

10 A What do you mean, files? Can you explain
11 that?

12 Q Well, once you prepare -- and maybe if we
13 could go back to Exhibit -- do you have 125-P in
14 front of you there?

15 A Yes.

16 Q What do you do with Exhibit 125-P? What
17 did you do with it after you prepared it?

18 A We then send it to Capstone, along with a
19 management representation letter, a couple of other
20 type of required documents that then are reviewed by
21 Capstone, and then forwarded on to the owners of
22 Reserve Casualty Corporation for them to approve the
23 financials. And their approval is indicated by their
24 signature on a management representation letter, and
25 approving any --

1 If there were any adjusting journal
2 entries, they would approve those entries. Once we
3 received that back, we would finalize the draft of
4 this financial statement, and then get it ready to
5 file, and then we would file that with the
6 regulators, which in this case is Anguilla.

7 Q So would Liptz & Associates actually send
8 this to the regulators?

9 A Yes.

10 MR. ALBRIGHT: Your Honor, could I have one
11 moment, please?

12 THE COURT: Yes.

13 (Pause.)

14 MR. ALBRIGHT: Your Honor, may I provide
15 Mr. Liptz with a copy of Exhibit 27-J? It's actually
16 in the binder over the window.

17 THE COURT: Yes.

18 MR. ALBRIGHT: May I assist him?

19 THE COURT: Yes.

20 (Pause.)

21 BY MR. ALBRIGHT:

22 Q Mr. Liptz, do you have a copy of Exhibit
23 27-J in front of you there?

24 A Yes.

25 Q Would the procedure that you've just

1 described with respect to Exhibit 125-P, would that
2 have occurred with respect to Exhibit 27-J?

3 A Yes.

4 Q So would you explain how that process with
5 respect to 27-J, please, just for the record, to be
6 clear.

7 A Sure. So, again, when the -- when we feel
8 we are completed with the audit process, we then
9 prepare what we call a draft of the financial
10 statements. We send the draft of the financial
11 statements, along with a management representation
12 letter, a couple other required documents that we
13 need shareholders to sign off on, any adjusting
14 journal entries that may be proposed by us for the
15 officers, directors or shareholders to approve.

16 We send that to Capstone, who coordinated
17 the issuance of those documents to the shareholders
18 for their review and sign-off, and then we would get
19 those back from the clients. Once we got those back
20 from the clients, then we would finalize the audit
21 for issuance to Anguilla, and then we would send a
22 package of audits to Anguilla before the due date.

23 Q The due date? So would Exhibit 125-P have
24 been sent to Anguilla in a timely fashion?

25 A Yes.

1 Q Would Exhibit 27-J have been sent to
2 Anguilla in a timely fashion?

3 A Yes.

4 Q And when you say, timely fashion, in
5 compliance with what?

6 A The Anguilla insurance regulations that
7 require audits to be -- the original filing date is
8 June 30 of the year following the year end, and if
9 there's reasons that it cannot -- the audit cannot be
10 completed by that date, then an extension request is
11 submitted normally by the insurance manager, in this
12 case, Capstone, to ask for some additional time,
13 because we cannot complete the audit by June 30.

14 Q And so have you ever in your experience
15 filed a financial statement with Anguilla that was
16 late?

17 A No.

18 MR. ALBRIGHT: Your Honor, if I can have a
19 second, I believe I'm completed with the factual --

20 THE COURT: Yes. You may have a second.

21 MR. ALBRIGHT: -- part of his testimony,
22 but I'd like to have a second just to make sure.

23 THE COURT: Yes.

24 (Pause.)

25 MR. ALBRIGHT: I have just a few more

1 questions, Your Honor.

2 THE COURT: Okay.

3 BY MR. ALBRIGHT:

4 Q So when you did your audit of the -- of
5 Reserve Casualty Corporation's financial matters
6 during 2008, 2009, and 2010, did Capstone have
7 procedures in place as to how the accounting records
8 were kept?

9 A Yes.

10 Q Did you review those procedures?

11 A Yes.

12 Q Did you find those procedures to be
13 deficient in any way?

14 MR. SCHEID: Objection, Your Honor. This is
15 all very leading.

16 THE COURT: I'm going to allow the
17 question.

18 THE WITNESS: Can you repeat the question,
19 please.

20 BY MR. ALBRIGHT:

21 Q Did you find those procedures to be
22 deficient in any way?

23 A I do not recall -- I do not believe that
24 they were deficient in any material way.

25 Q And would Capstone seek your advice

1 concerning how their records were maintained?

2 A Yes.

3 Q And what exactly did they ask you? Or who
4 at Capstone talked to you about that?

5 MR. SCHEID: Objection, Your Honor.
6 Hearsay.

7 MR. ALBRIGHT: Your Honor, it's just part
8 of his audit procedures.

9 THE COURT: I'm going to allow the question
10 at this point.

11 THE WITNESS: Well, pretty much everybody
12 associated with Capstone was interested in if we had
13 comments about any type of procedure that could be
14 improved, ranging from the bookkeepers to, you know,
15 Megan Brooks, Chuck Earles, and Mr. Feldman. They
16 were interested in how they could -- if there was
17 anything that they could improve upon, tighten up
18 internal controls. So they all inquired at different
19 stages of our field work.

20 MR. ALBRIGHT: Your Honor, if I could just
21 verify that -- I kind of lost where I was. Exhibit
22 124-P has it been received in evidence?

23 THE COURT: Yes.

24 BY MR. ALBRIGHT:

25 Q And one final question. Mr. Liptz, are you

1 approved or licensed by the Anguilla insurance
2 regulators to provide audited financial statements to
3 Anguilla?

4 A They've approved my firm to submit audits
5 to the Anguilla insurance department.

6 Q And was that true in 2008, 2009, and 2010?

7 A Yes.

8 MR. ALBRIGHT: Pass the witness, Your
9 Honor.

10 THE COURT: Why don't -- the Court's going
11 to take a -- we'll take a recess till five after
12 11:00.

13 THE CLERK: All rise.

14 (Whereupon, a short recess was taken.)

15 THE CLERK: All rise.

16 Please be seated.

17 MR. SCHEID: May I proceed, Your Honor

18 THE COURT: Yes.

19 MR. SCHEID: Good morning again, Your Honor.
20 Justin Scheid for Respondent.

21 CROSS-EXAMINATION

22 BY MR. SCHEID:

23 Q Good morning, Mr. Liptz.

24 A Good morning.

25 Q I want to focus first on Exhibit 128-P.

1 This is the notice of claim. Now, you reviewed this
2 in connection with your audit of Reserve. Is that
3 correct?

4 A Correct.

5 Q What is Stillwater Mining Company? Are you
6 aware of that entity?

7 A I believe that is an entity that is insured
8 by Reserve Casualty Corporation.

9 Q Okay. Did you do any confirmation whether
10 Stillwater Mining represented 35 percent of Peak's
11 sales?

12 A No.

13 Q Did you ever speak with the contact on this
14 claim, Jill Howard?

15 A I do not believe so.

16 Q Now, you performed the audit for Capstone
17 in Houston, Texas. Is that correct?

18 A No.

19 Q Where was the audit for Capstone performed?

20 A I don't perform audits for Capstone.

21 Q You performed an independent audit -- my
22 apologies. You performed an independent audit with
23 respect to Reserve. Correct?

24 A Reserve Casualty Corporation, yes.

25 Q And that was performed in Houston, Texas?

1 A We performed some field work in Houston,
2 Texas, and started the audit and finished the audit
3 in my office.

4 Q In California.

5 A Correct.

6 Q And Reserve is an Anguilla-domiciled
7 captive. Right?

8 A Correct.

9 Q And Reserve's insurance manager is
10 Capstone. Is that right?

11 A That's my understanding. Yes.

12 Q And so Reserve has an Anguilla-domiciled
13 captive manager. Right?

14 A Yes.

15 Q But Reserve's books are kept in Houston.
16 Is that right?

17 A That's my understanding.

18 Q And those are kept at Capstone's offices?

19 A That's my understanding.

20 Q And all the documents that you needed to
21 perform your audit were requested from Capstone in
22 Houston. Right?

23 A Correct.

24 Q Are you aware of any documents maintained
25 by Reserve in Anguilla?

1 A I'm not aware of any documents.

2 Q As part of your independent audit of
3 Reserve, did you consider documents in Anguilla?

4 A The documents that we needed to conduct our
5 audit were provided to us by the staff here in
6 Houston.

7 Q You indicated that in the past year, you've
8 conducted approximately 59 audits of Capstone
9 captives. Is that right?

10 A That's what we're currently doing now.
11 Yes.

12 Q Did you conduct the same audit procedures
13 for each one of those 59 audits?

14 A Yes.

15 Q And would that be the same as of 2008,
16 2009, and 2010?

17 A We are always evolving to improve our
18 processes, so they are not going to -- there's some
19 things that we did in 2008 that we may not feel
20 necessary to do now. There may be things that we're
21 doing now that we maybe should have done a little bit
22 better in 2008. And we're always learning.

23 Q For the audits of the Capstone captives
24 that you conducted in 2008, did you employ the same
25 audit procedures for all those captives?

1 A Yes.

2 Q And that would be the same as well in 2009?

3 A Yes.

4 Q And as well in 2010?

5 A Yes.

6 Q For all of the Capstone captives that
7 you've audited from -- when did you start initially
8 auditing Capstone captives?

9 A I believe eight years ago.

10 Q About eight years ago.

11 A Yes.

12 Q So for the past eight years, you've been
13 auditing Capstone captives pretty continuously?

14 A Yes.

15 Q Are the premiums in all of those Capstone
16 captives always under \$600,000?

17 A No.

18 Q Which Capstone captives have you audit had
19 premiums beyond 600,000?

20 A I do not recall the names of those.

21 Q Now, in connection with your independent
22 audit, you request records from Capstone Anguilla.

23 A I don't understand your question.

24 Q The captive manager of Reserve was Capstone
25 in Anguilla. Is that correct?

1 A I believe so.

2 Q Did you request documents in connection
3 with your independent audit from that entity?

4 A No.

5 Q Are you aware of that entity having any
6 documents?

7 A I'm not aware of --

8 Q Are you familiar with PoolRe Insurance
9 Corp.?

10 A Yes.

11 Q How are you familiar with PoolRe Insurance
12 Corp.?

13 A During our audit process, we reviewed
14 records that were provided to us regarding the PoolRe
15 reinsurance transactions.

16 Q Who provided those records to you?

17 A Capstone.

18 Q What records specifically did you review in
19 connection with your audit?

20 A We reviewed the reinsurance agreements and
21 other documents supporting the payments of the
22 premiums and possibly, you know, claim activity.

23 Q What claim activity did you review with
24 respect to PoolRe in the context of your Reserve
25 audit?

1 A We reviewed the Reserve calculation sheets
2 and tested those for reasonableness.

3 Q Are those the incurred but not recognized
4 calculations that we looked at previously during your
5 direct?

6 A Those are -- yes.

7 Q Did you review in connection with your
8 independent audit of Reserve any actual claims
9 activity with respect to PoolRe?

10 A I don't recall.

11 Q Did you have an engagement letter with
12 Reserve?

13 A Yes.

14 Q And who executed that engagement letter on
15 behalf of Reserve?

16 A The shareholders of Reserve.

17 Q Did you have an engagement letter with
18 Capstone as well?

19 A Yes.

20 Q And did that relate to your audit in
21 Reserve?

22 A Yes.

23 Q And who executed your engagement letter
24 with Capstone relative to your audit of Reserve?

25 A I believe it was Stewart Feldman. I'm

1 sorry. Could you repeat that question.

2 Q I can't.

3 A Okay.

4 Q Now, have you performed any audit work for
5 Reserve Casualty for 2011 through 2016?

6 A I do not remember what year or if we're
7 continuing to audit Reserve. I know we did an audit
8 in 2011 and, I believe, 2012, maybe 2013. I don't
9 remember if there's any years after that.

10 Q Have you performed any audit or accounting
11 work for Peak Mechanical & Components, Inc.?

12 A No.

13 Q Do you perform any audit or accounting work
14 for PoolRe Insurance Corp.?

15 A No.

16 MR. SCHEID: May I have just a moment, Your
17 Honor

18 THE COURT: Yes.

19 (Pause.)

20 BY MR. SCHEID:

21 Q Do you perform any audit work for ZW
22 Enterprises?

23 A No.

24 Q Or RocQuest, LLC? Have you performed any
25 audit work for RocQuest, LLC?

1 A No.

2 Q If you turn back to Exhibit 128-P, now this
3 reflects a claim paid in the amount of \$339,820. Is
4 that right?

5 A Yes.

6 Q Was all of that claim paid during the
7 calendar year 2009?

8 A I'd have to go back and look.

9 Q I want to turn to Exhibit 126-P. This is
10 the general ledger for 2009, and specifically if you
11 could look at the loss expense. It's account number
12 50100.

13 A (Complying.)

14 Q Are you there, Mr. Liptz?

15 A Yes.

16 Q So this is the loss expense account for
17 Reserve Casualty Corporation for 2009. Is that
18 right?

19 A Yes.

20 Q Now, there's what appear to be quarterly
21 entries for Record Reinsurance. You see the first on
22 3/31/09. If you flip the page to page 7 of Exhibit
23 126-P, we see, Record Reinsurance on 6/30/2009 and on
24 9/30/09 and 12/31/09. Do you see each of those
25 entries?

1 A Yes.

2 Q Have you seen any support for any of those
3 four entries I've just referenced?

4 A I'd have to go back and look at my
5 accounting -- my support.

6 Q Do you have that with you?

7 A I do not believe so.

8 Q And would that be the same as well for 2010
9 with respect to loss expenses in account 50100?

10 A I would believe so.

11 MR. SCHEID: Your Honor, if I may approach
12 the witness to hand him a copy of a stipulated
13 exhibit, it's Exhibit 59-J. This is the 2009
14 insurance binder.

15 THE COURT: Yes, you may.

16 (Pause.)

17 BY MR. SCHEID:

18 Q Mr. Liptz, I'm showing you what's been
19 marked and stipulated by the parties as Exhibit 59-J.
20 This is the 2009 insurance binder. Now, if we turn
21 to the third page in of Exhibit 59-J, which is RSV-
22 0005988 -- I guess, before I get there, did you
23 review this insurance binder in connection with your
24 independent audit of Reserve?

25 A I do not recall if we looked at this

1 specific document.

2 Q Let's just go through it and see how we do.

3 So if we look at the page number I just referenced,

4 5988, do you see direct written premiums to Reserve

5 Casualty Corp., \$365,223.52?

6 A Yes.

7 Q Do you see that? Now, if I could trouble

8 you to turn back to Exhibit 126-P, if I may have just

9 a moment to find the correct account here, it's

10 account 40000, I believe. It's entitled, Affiliated

11 DW premium. Does that stand for affiliated direct

12 written premium?

13 A Yes.

14 Q And we see the same number, the 365,223.52.

15 Is that correct?

16 A Yes.

17 Q Now, again, turning back to 59-J, if we'd

18 flip the page to page number RSV-0005989, these are

19 the premiums that were paid by the named insured,

20 Peak Mechanical, to PoolRe Insurance Corp. Is that

21 your understanding?

22 A Which number are you referring to?

23 Q This is the 89 -- or \$82,903.51 on page

24 5989.

25 A (Perusing document.) Based on the

1 schedule, that's what I would assume it is.

2 Q Okay. So then if we turn back to Exhibit
3 126-P, if we flip the page from where we were, so
4 we're on page 4, at the bottom we see account number
5 40100, entitled, QS PoolRe Insurance assumed, I
6 guess. It's cut off. The next page, on page 5, we
7 see the \$82,903.49. Is that right?

8 A Correct.

9 Q So these -- and do you know what the QS
10 stands for? Does the QS stand for quota share?

11 A I believe so.

12 Q So Reserve is reporting as income the quota
13 share pool reinsurance premium. Is that correct?

14 A Yes.

15 Q But in the insurance binder at 59-J, it's
16 clear that Peak is paying that premium to PoolRe
17 Insurance Corp. Correct?

18 A Can you repeat your question, please.

19 Q Sure. At Exhibit 59-J, if you look back,
20 we see that the premium of \$82,903.49 is paid by Peak
21 to PoolRe Insurance Corp. Correct?

22 A That's what I would -- that's what this
23 document appears would be -- indicate.

24 Q So why is Reserve reporting those premiums
25 as income in account number 40100?

1 A Because they are assuming reinsurance from
2 PoolRe for the same amount.

3 Q But those direct premiums were actually
4 paid to PoolRe. Correct?

5 A Yes.

6 MR. SCHEID: May I have just a moment, Your
7 Honor?

8 THE COURT: Yes.

9 (Pause.)

10 MR. SCHEID: Your Honor, I have just one
11 more question very briefly. If I may approach to
12 hand the witness a copy of stipulated Exhibit 3-J,
13 Your Honor --

14 THE COURT: Yes.

15 BY MR. SCHEID:

16 Q (Handing document.) Mr. Liptz, I've handed
17 you what's been stipulated as Exhibit 3-J. Do you
18 see that in front of you?

19 A Yes.

20 Q And this is a copy of the 2009 Form 990 for
21 Reserve Casualty Corp. Is that correct?

22 A Yes.

23 Q Did you review this document or tax return
24 information in connection with your independent
25 audit?

1 A I do not recall.

2 Q If we turn to page RSV=0000644 --

3 A (Complying.)

4 Q Are you there?

5 A Yes.

6 Q And this is part A, statement of revenue,
7 and we see in 2B, on page 644, that Reserve reported
8 that same 82,903 as revenue on its return. Is that
9 correct?

10 A Yes.

11 MR. SCHEID: No further questions, Your
12 Honor.

13 REDIRECT EXAMINATION

14 BY MR. ALBRIGHT:

15 Q Mr. Liptz, do you still have a copy of
16 Exhibit 128-P there with you?

17 A Yes.

18 Q Would you take a minute and look at Exhibit
19 128-P, please. Right in the middle there, it says,
20 Description of claim. Would you take a look at that.

21 A Yes.

22 Q So I believe Mr. Scheid, Respondent's
23 counsel, asked you a question, and I wanted to be
24 clear. Stillwater Mining Company -- was the
25 Stillwater Mining Company an insured under this

1 particular claim?

2 A In reading the description, it indicates
3 they're describing Stillwater Mining Company as a
4 customer of the insured, Peak Mechanical or RocQuest
5 or ZW Enterprises.

6 Q So look at Exhibit 128-P and tell me if you
7 can tell who the insured entity is.

8 A (Perusing document.) It's -- on the notice
9 of claim, it says that the named insured of Peak
10 Mechanical & Components, Incorporated, RocQuest, LLC
11 and ZW Enterprises, LLC.

12 Q So just to be clear, I thought I heard you
13 say that Stillwater Mining Company was the insured.

14 A I may have said that, but looking at this
15 document and reading the document, that was -- I just
16 read Stillwater Mining Company, the customer of the
17 insureds.

18 Q Now, you testified -- you've been asked a
19 lot of questions about these audit reports that you
20 did for -- that your firm did for Reserve Casualty
21 Corp. Did you issue an unqualified opinion for
22 Reserve Casualty Corp. for the periods that you
23 audited those entities, from inception to 2009, end
24 of 2009, and from inception to 2010?

25 A Yes.

1 Q Mr. Liptz, do you still have a copy of 27-J
2 there in front of you?

3 A Yes.

4 Q And I believe Mr. Scheid asked you some
5 questions about paid losses. Do you know whether --
6 just turning to Exhibit 27-J, would paid losses be
7 addressed anywhere in this document?

8 A No.

9 Q Well, if I could direct your attention to
10 the page that's got 5533 on the bottom of it -- do
11 you see that there?

12 A Yes, I do.

13 Q Would that -- in looking at that, would
14 that change your answer?

15 A Yes, it would.

16 Q Okay. So what does this reflect?

17 A This reflects the amount of losses and loss
18 adjustment expenses that were paid during 2010 and
19 2009.

20 Q And the amount that's reflected for 2009,
21 would that include from inception to 12/31/2009?

22 A Yes.

23 Q Now, when you did your audit and you
24 prepared this financial statement, this Exhibit 27-J
25 --

1 A Okay.

2 Q -- would you have reviewed documentation to
3 support that Reserve Casualty Corp. actually paid
4 these claims?

5 A We would have performed audit procedures
6 that gave us comfort that the balances are materially
7 and reasonably stated.

8 Q Do you recall with whom you executed the
9 engagement letter with Capstone that Mr. Scheid asked
10 you about, about the audit? Do you recall?

11 A Yes.

12 Q And do you recall who that was?

13 A Yes.

14 Q Who was it?

15 A This with Capstone?

16 Q Yes.

17 A Stewart Feldman.

18 Q Okay. Earlier Mr. Scheid asked you a
19 question and you asked if you could clarify, and I
20 don't recall what the question was. But is there
21 something you would like to clarify about your
22 answer?

23 MR. SCHEID: Objection, Your Honor. That's
24 a very vague question, and I think it actually
25 mischaracterizes his prior statement.

1 THE COURT: I think the witness has, in the
2 questions offered by Petitioner's counsel, has
3 clarified that one question in particular. Did you
4 want to rephrase the question or --

5 MR. ALBRIGHT: No, Your Honor.

6 THE COURT: Okay.

7 MR. ALBRIGHT: I believe, unless Mr. Scheid
8 has some questions --

9 MR. SCHEID: Well, no recross with respect
10 to this witness as a fact witness. I don't know
11 where we're going from here.

12 THE COURT: Okay.

13 MR. ALBRIGHT: And, Your Honor, at this
14 point, I'd like to proceed with the expert portion of
15 his testimony.

16 THE COURT: Yes.

17 MR. ALBRIGHT: Your Honor, I would offer
18 Mr. Liptz as an expert in accounting matters. I
19 believe he's already been qualified by the testimony
20 that he's given.

21 MR. SCHEID: Your Honor, may I -- this was a
22 subject of a motion in limine. May I briefly voir
23 dire the witness with respect to some areas of his
24 qualification?

25 THE COURT: You may.

1 VOIR DIRECT

2 BY MR. SCHEID:

3 Q Mr. Liptz, what's the process to become
4 registered with the Anguilla Financial Services
5 Commission? I understand -- let me step back for --
6 I understand you're registered with the Anguilla
7 Financial Services Commission from your direct
8 testimony earlier. Is that correct?

9 A Correct.

10 Q What is the process that you went through
11 to become registered?

12 A We submit -- I do not recall if Anguilla
13 has an actual application or we submit a letter,
14 requesting approval from the Anguilla Financial
15 Services Department to perform captive insurance
16 audits.

17 Q So beyond submitting a letter requesting
18 approval, are there documentation that you need to
19 provide? Is there information regarding your
20 experience or prior audits that you've done? Is
21 there anything else that you need to do, other than
22 submit a letter to be registered with the Commission?

23 A In the letter, they do require us to
24 describe prior experience.

25 Q And what was the prior experience that you

1 described when you were registered with the
2 Commission?

3 A I do not remember the exact letter that we
4 had written, but it would have described our prior
5 experience in auditing captive insurance companies.

6 Q Now, is there a difference between being
7 registered with the Commission and approved by the
8 Commission?

9 A I don't understand the difference.

10 Q Okay. Now, how many years have you been
11 performing independent audits for Anguilla-licensed
12 insurance companies?

13 A It may -- I do not recall. It's been eight
14 to ten years.

15 Q Now, how many of those Anguilla-licensed
16 insurance companies were also captive insurance
17 companies?

18 A 100 percent.

19 Q So you never performed an independent audit
20 for a non-captive Anguilla-licensed insurance
21 company. Is that correct?

22 A Can you rephrase your -- restate your
23 question, please.

24 Q You've never performed an independent audit
25 for a non-captive Anguilla-licensed insurance

1 company. Is that a correct statement?

2 A Yes. Correct.

3 Q Now, how many of the Anguilla-licensed
4 captive insurance companies that you've audited
5 involved a reinsurance arrangement?

6 A I believe 100 percent.

7 Q How many of those Anguilla-licensed captive
8 insurance companies involved a reinsurance
9 arrangement with PoolRe Insurance Corporation?

10 A I don't remember the number or percentage.

11 Q More than 50 percent?

12 A I would say so. Yes.

13 Q More than 75 percent?

14 A I again don't know -- remember the amount
15 of other clients that we may audit that are not
16 involved with the PoolRe structure.

17 Q How many other clients do you audit that
18 aren't involved with the PoolRe structure?

19 A Hundreds.

20 Q Now, how many times have you analyzed
21 whether insurance risk has transferred from an
22 insured to an insurer?

23 A It's part of our standard audit process.

24 Q And how does that come into play in your
25 audit process?

1 A It's one of the underlying factors that we
2 are looking at. It pretty much -- it crosses over in
3 a variety of different areas that we are auditing.
4 We will address it during the documentation of our
5 processes, their underwriting processes, reserve
6 processes, testing of the actual premiums paid,
7 claims, so it goes through our entire process.

8 Q Now, during your independent audit, how do
9 you determine whether insurance risk has transferred?

10 A It's a process. There's no steps per se.
11 It's a process of analyzing the entire company as a
12 whole, whether or not -- to determine that.

13 Q But what is the process? Specifically,
14 what steps do you take to determine whether insurance
15 risk has transferred from an insured to an insurer in
16 the context of your independent audit?

17 A We are looking at the insurance contract,
18 make sure that the terms of the contract have been
19 fulfilled, and that the amounts of risk and possibly
20 in claim payments are -- seem -- are not
21 insignificant. They're not remote.

22 Q Okay. So you look at the insurance
23 contract?

24 A Yes.

25 Q And then what else do you look at, other

1 than the insurance contract?

2 A We would look at the claim activity. We
3 would look at the -- how the reserves are calculated.
4 We would document, again, the processes that the
5 company or manager goes through to perform these
6 tasks.

7 Q Anything else?

8 A I cannot specifically remember right now.
9 I'd have to look at more files to give you further
10 details.

11 Q Okay. Now, how many times have you
12 analyzed whether an entity would be considered an
13 insurance company for accounting purposes?

14 A Each time that we perform an audit, we
15 would be answering that question.

16 Q And how do you answer that question in the
17 context of your independent audit?

18 A Again, we would then go through our audit
19 process, look at the documented processes that the
20 captive manager or the client goes through to
21 determine how they calculate their premiums, develop
22 their underwriting processes, their reserve
23 processes.

24 We would look at the insurance contracts,
25 analyze and read the contracts, the terms regarding

1 whether the terms of the contract are executed. We
2 would review the claim activity, the reserve
3 calculation activity.

4 Q Anything else?

5 A Again, I'd have to look at my files to
6 determine if there were other procedures that we may
7 have performed.

8 (Page 597 and subsequent pages enclosed
9 under separate cover.)

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1 CERTIFICATE OF TRANSCRIBER AND PROOFREADER

2 CASE NAME: Reserve Mechanical Corp, f.k.a. as

3 Reserve Casualty Corp. v. Commissioner

4 DOCKET NO.: 14545-16

5 We, the undersigned, do hereby certify that the
6 foregoing pages, numbers 502 through 596, inclusive,
7 are the true, accurate and complete transcript
8 prepared from the recording made by electronic
9 recording by Leslie Berridge, on May 1, 2017, before
10 the United States Tax Court at its session in
11 Houston, Texas, in accordance with the applicable
12 provisions of the current verbatim reporting contract
13 of the Court, and have verified the accuracy of the
14 transcript by comparing the typewritten transcript
15 against the verbal recording.

16

17 _____

18 Anita Tyler 05/24/2017

19 (Transcriber) (Date)

20

21 _____

22 Laurel H. Stoddard 05/25/2017

23 (Proofreader) (Date)

24

25

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IN THE UNITED STATES TAX COURT

In the Matter of:)
)
RESERVE MECHANICAL CORP., f.k.a.)
RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
v.)
)
COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

Volume: 8
Pages: 597 through 692
Place: Houston, Texas
Date: May 1, 2017

1 IN THE UNITED STATES TAX COURT

2

In the Matter of: _____)

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RESERVE MECHANICAL CORP., f.k.a.)

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RESERVE CASUALTY CORP.,)

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Petitioner,) Docket No. 14545-16

6

v.)

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COMMISSIONER OF INTERNAL REVENUE,)

8

Respondent.)

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Room 7006
Casey U.S. Courthouse
515 Rusk Avenue
Houston, Texas

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May 1, 2017

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The above-entitled matter resumed for
trial, pursuant to recess, at 9:13 a.m.

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15

BEFORE: HONORABLE KATHLEEN KERRIGAN
Judge

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APPEARANCES:

17

For the Petitioner:

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1 APPEARANCES: (continued)

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C O N T E N T S

WITNESSES:	DIRECT	CROSS	REDIRECT	RECROSS	VOIR DIRE
For Petitioner:					
David Liptz	602	603	608		
Stewart Feldman	613				
For Respondent					
None					

1		E X H I B I T S	
2	EXHIBITS:	IDENTIFIED	RECEIVED
3	130-P	601	602
4	131-P	608	609
5	132-P	672	677

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1 P R O C E E D I N G S

2 MR. SCHEID: Your Honor, Respondent has no
3 objection to the witness's qualifications.

4 THE COURT: Okay. Mr. Liptz is accepted as
5 a qualified expert.

6 MR. ALBRIGHT: Your Honor, may I have this
7 document marked for identification as Petitioner's
8 Exhibit --

9 THE COURT: Yes.

10 MR. ALBRIGHT: -- next in order? And
11 please let the record reflect that I've handed Mr.
12 Scheid a copy of the proposed exhibit. (Handing
13 document.)

14 May I approach?

15 THE COURT: Yes.

16 MR. ALBRIGHT: (Handing document.)

17 THE CLERK: The expert report of David B.
18 Liptz is marked for identification as Exhibit 130-P.

19 (The document referred to was
20 marked for identification as
21 Petitioner's Exhibit 130-P.)

22 MR. ALBRIGHT: Your Honor, may I provide
23 Mr. Liptz with a copy of Exhibit 130-P?

24 THE COURT: Yes.

25 MR. ALBRIGHT: (Handing document.) Your

1 Honor, may I remove this book? He --

2 THE COURT: Yes.

3 MR. ALBRIGHT: -- doesn't have much room
4 here.

5 THE COURT: Yes.

6 (Pause.)

7 DIRECT EXAMINATION

8 BY MR. ALBRIGHT:

9 Q Mr. Liptz, do you have a copy of Exhibit
10 130-P in front of you?

11 A Yes.

12 Q And can you tell me what Exhibit 130-P is.

13 A This is my expert report regarding this
14 case.

15 MR. ALBRIGHT: Your Honor, I would move
16 Exhibit 130-P into evidence.

17 MR. SCHEID: No objection, Your Honor.

18 THE COURT: 130-P's admitted.

19 (The document referred to, having been
20 previously marked for identification as
21 Petitioner's Exhibit 130-P, was received
22 in evidence.)

23 BY MR. ALBRIGHT:

24 Q Mr. Liptz, have you had an opportunity to
25 look through Exhibit 130-P since you prepared it?

1 A Yes.

2 Q Is there anything in this report that you
3 would like to change or is in error in any way?

4 A No.

5 MR. ALBRIGHT: Pass the witness, Your
6 Honor.

7 THE COURT: Okay.

8 CROSS-EXAMINATION

9 BY MR. SCHEID:

10 Q So I want to look first at your opinion in
11 your report that the transfer of insurance risk from
12 insured's reserve was accomplished by execution of a
13 contract and collection of the stated premium by
14 Reserve. That's one of your opinions. Correct?

15 A Yes.

16 Q And that opinion's based upon the language
17 of the insurance contract.

18 A Yes.

19 MR. SCHEID: May I approach, Your Honor, to
20 hand the witness a copy of stipulated Exhibit 36-J?

21 THE COURT: Yes.

22 BY MR. SCHEID:

23 Q (Handing document.) Mr. Liptz, I've handed
24 you what's been stipulated by the parties as Exhibit
25 36-J. Do you see that in front of you?

1 A Yes.

2 Q And this is the excess directors and
3 officers liability insurance policy. Right?

4 A And this is for, if we flip the page and we
5 look at page RSV-0005876 of Exhibit 36-J, we see in
6 the middle of the page the policy period. Do you see
7 that?

8 A Yes.

9 Q And it's for the period December 4, 2008,
10 to January 1, 2009. That's correct. Right?

11 A Yes.

12 Q So if we flip a few more pages to 5879,
13 this is the insuring agreement. Correct?

14 A Yes.

15 Q And did you review this in connection with
16 the preparation of your report?

17 A I believe so.

18 Q Now, in insuring agreement number 1, it's
19 entitled, Executive liability coverage. Correct?

20 A Yes.

21 Q What is the executive liability coverage
22 provided under insuring agreement number 1?

23 A They will indemnify each of the insured
24 persons for all damages which the insured person is
25 not indemnified by the insured organization, and

1 which the insured person becomes legally obligated to
2 pay and defense expense as a result of any claim
3 first made against the insured person individually or
4 otherwise during the policy period and reported in
5 writing to the insured during the policy period for a
6 wrongful act first committed, attempted, or allegedly
7 committed or attempted --

8 THE COURT: The document speaks for itself.
9 The witness doesn't need to read it.

10 MR. SCHEID: Okay.

11 BY MR. SCHEID:

12 Q But it focuses on the indemnification with
13 respect to each of the insured persons. Correct?

14 A Yes.

15 Q And if we look at the second insuring
16 agreement, it's insuring the organization for all
17 damages with respect to, again, an insured person.
18 Right? Is that your understanding of insuring
19 agreement number 2?

20 A Yes.

21 Q Now, insured person is also defined in this
22 contract. If we flip to page 5882 --

23 A (Complying.)

24 Q And it's defined as a person designated as
25 such in the declarations. Is that correct? Do you

1 see that language?

2 A (Perusing document.) Yes.

3 Q And so if we read on, it also says,
4 "Coverage will not extend to any person not specified
5 by name in Schedule 1-A." Do you see that language
6 as well on page 5882?

7 A Yes.

8 Q Now, if we turn to Schedule 1-A, which is
9 on page 5885, there are no names of insured persons.
10 Correct?

11 A Correct.

12 MR. SCHEID: No further questions, Your
13 Honor.

14 MR. ALBRIGHT: Could I just have a moment,
15 Your Honor?

16 THE COURT: Yes.

17 (Pause.)

18 MR. ALBRIGHT: Your Honor, I have no
19 redirect for Mr. Liptz. Now, Mr. Liptz also prepared
20 a rebuttal report, and we would like to follow the
21 procedure that we did with one of the prior
22 witnesses, so that Mr. Liptz can put his -- so we can
23 put his rebuttal --

24 THE COURT: Yes.

25 MR. ALBRIGHT: -- report in, and he can

1 leave.

2 THE COURT: Yes. We can do -- Respondent's
3 counsel, you're still in agreement, as we discussed
4 the other day?

5 MR. SCHEID: Yes. We have no objection to
6 that process.

7 MR. ALBRIGHT: Your Honor, may I --

8 THE WITNESS: Can I just ask --

9 THE COURT: I'm sorry?

10 THE WITNESS: I just want to have a
11 bathroom break or just let me take a couple minutes
12 and -- can we do that?

13 THE COURT: We can take a five-minute
14 break.

15 THE WITNESS: Thank you.

16 THE COURT: The Court's in recess.

17 THE CLERK: All rise.

18 (Whereupon, a short recess was taken.)

19 THE CLERK: All rise.

20 Please be seated.

21 MR. ALBRIGHT: Your Honor, may I have this
22 document marked --

23 THE COURT: Yes.

24 MR. ALBRIGHT: -- Petitioner's Exhibit next
25 in order for identification? And please let the

1 record reflect that I'm handing Mr. Scheid a copy.

2 (Handing document.)

3 May I approach?

4 THE COURT: Yes.

5 MR. ALBRIGHT: (Handing document.)

6 THE CLERK: Document entitled, David Liptz

7 Rebuttal to Expert Report of Mr. Donald J. Riggin is

8 marked for identification as Exhibit 131-P.

9 (The document referred to was marked for

10 identification as Petitioner's Exhibit

11 131-P.)

12 MR. ALBRIGHT: Your Honor, may I hand Mr.

13 Liptz a copy of --

14 THE COURT: Yes.

15 MR. ALBRIGHT: -- 131-P?

16 REDIRECT EXAMINATION

17 BY MR. ALBRIGHT:

18 Q (Handing document.) Mr. Liptz, do you have

19 a copy of 131-P in front of you there?

20 A Yes.

21 Q Can you tell me what Exhibit 131-P is.

22 A David Liptz's rebuttal of the expert report

23 of Mr. Donald J. Riggin.

24 Q And is this a report that you prepared?

25 A Yes.

1 MR. ALBRIGHT: Your Honor, I'd offer
2 Exhibit 131-P into evidence.

3 MR. SCHEID: No objection, Your Honor.

4 THE COURT: 131-P is admitted.

5 (The document referred to, having been
6 previously marked for identification as
7 Petitioner's Exhibit 131-P, was received
8 in evidence.)

9 MR. ALBRIGHT: Pass the witness, Your
10 Honor.

11 MR. SCHEID: Respondent has no cross-
12 examination with respect to Mr. Liptz' rebuttal
13 report.

14 THE COURT: Okay. You may step down.
15 Thank you.

16 (Whereupon, the witness was excused.)

17 MR. ALBRIGHT: And, Your Honor, we're going
18 to have Mr. Liptz leave Houston, so -- just to be
19 clear.

20 THE COURT: Okay. Respondent?

21 MR. SCHEID: Your Honor, we have no cross.

22 MR. ALBRIGHT: Okay. Your Honor, the next
23 witness is going to take quite some time, and we had
24 discussed -- Respondent's counsel and myself had
25 discussed what an appropriate lunch break would be,

1 subject to the Court's approval. But we were
2 suggesting now would be a good time.

3 THE COURT: So from my understanding from
4 Friday, the next witness would be Mr. Feldman. Is
5 that correct?

6 MR. ALBRIGHT: That's correct, Your Honor.

7 THE COURT: And, Mr. Albright, do you have
8 additional witnesses you are planning on doing today
9 after Mr. Feldman?

10 MR. ALBRIGHT: I don't believe we do, Your
11 Honor. We have rebuttal witnesses.

12 THE COURT: Approximately what length were
13 you -- and I'm expecting this to be approximate --
14 the length of entirety of Mr. Feldman, including the
15 cross be?

16 MR. ALBRIGHT: I can't really speak to the
17 cross-examination.

18 THE COURT: No. But Mr. Markley's
19 standing.

20 MR. MARKLEY: Yes, I know. I'm here. We
21 had a little conversation before, and what do you
22 want to suggest for your direct, and I can -- I don't
23 know. I think the rest of the day. It depends on
24 what the rest of the day is, because if the rest of
25 the day would be five or six o'clock, that would be

1 the rest of the day. If you want to go longer, I
2 don't know anybody's opinion on that. I'd like to be
3 out of here in a couple more days, and we said four
4 days all together.

5 THE COURT: So, Mr. Albright, after this
6 witness, except for rebuttals, would Petitioner rest?

7 MR. ALBRIGHT: I -- if you won't lock my
8 feet in concrete, I'll say most likely.

9 THE COURT: Okay.

10 MR. MARKLEY: And let's assume for the sake
11 of argument we finish Mr. Feldman today or close to
12 it, I hope, at most we have two, one of which would
13 be an expert, and the other one would be Agent
14 Batory, assuming he still testifies and so forth. He
15 wouldn't be that terribly long. It's hard to say
16 with an expert. I would guess since he's our main
17 expert, there'll be some significant cross-
18 examination, so I would think that would probably be
19 most of tomorrow, and maybe we'd be done. I don't
20 know.

21 THE COURT: Okay.

22 MR. ALBRIGHT: It's hard to say how long
23 cross-examination --

24 THE COURT: I'm not holding you to --

25 MR. ALBRIGHT: it could be give minutes, or

1 it could be several hours.

2 THE COURT: I'm not holding you to --

3 MR. MARKLEY: No. And actually, quite
4 honestly, if it's all day tomorrow, that's fine, and
5 I guess at some point in time by the end of the day,
6 because we're all, you know, traveling from Chicago
7 down -- actually including Agent Batory, we have to
8 tell the hotel like, I think --

9 THE COURT: We'll go off the record for a
10 minute.

11 (Discussion held off the record.)

12 THE COURT: Okay. The Court is in recess.

13 THE CLERK: All rise.

14 (Whereupon, at 12:07 p.m., the trial in
15 the above-entitled matter was recessed, to
16 reconvene at 1:00 p.m., this same day,
17 Monday, May 1, 2017.)

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1 A F T E R N O O N S E S S I O N

2 THE CLERK: All rise.

3 Please be seated.

4 THE COURT: You may proceed.

5 MR. ALBRIGHT: Your Honor, Petitioner calls
6 Stewart Feldman.

7 THE CLERK: Please raise your right hand.

8 Whereupon,

9 STEWART A. FELDMAN having been first duly
10 sworn, was called as a witness herein, and was
11 examined and testified as follows:

12 THE CLERK: Would you please state your
13 name and address for the record.

14 THE WITNESS: Stewart A. Feldman. My
15 office address is 1900 Post Oak Boulevard, Houston,
16 Texas 77056, 19th Floor.

17 THE CLERK: Thank you. You may be seated.

18 THE WITNESS: Good morning -- or good
19 afternoon.

20 DIRECT EXAMINATION

21 BY MR. ALBRIGHT:

22 Q Good afternoon, Mr. Feldman. Mr. Feldman,
23 are you employed?

24 A I am.

25 Q And where are you employed?

1 A Feldman Law Firm, LLP, Houston.

2 Q And are you -- do you work with other
3 entities?

4 A Yes. Several other businesses.

5 Q Do you have a role with a company called
6 Capstone?

7 A I do.

8 Q And what's the name -- what's the full name
9 of Capstone?

10 A Capstone Associated Services, Limited, A
11 Texas Limited Partnership.

12 Q And do you have a title at Capstone
13 Associated Services, Limited?

14 A I do.

15 Q And what is your title?

16 A I'm chief executive officer of the
17 corporate general partner, which is, I believe,
18 Capstone Holding Corp. or Holdings Corp. It's a
19 corporate general partner of Capstone Associated
20 Services, Limited. It may be Capstone Management. I
21 don't recall the exact name.

22 Q Okay. So is it okay with you, Mr. Feldman,
23 if I refer to Capstone Associated Services, Limited,
24 as Capstone?

25 A Sure.

1 Q Are you familiar with the business of
2 Capstone?

3 A I am.

4 Q And can you please describe the business of
5 Capstone.

6 A Well, primarily Capstone is involved in two
7 lines of business. The first briefly is designing,
8 implementing and managing, administering interest
9 charged domestic international sales corporations for
10 exporters of goods and certain services.

11 And the second, I guess you'd call it, line
12 of business is administering alternative risk funding
13 programs or alternative risk transfer programs or you
14 could alternatively describe it as administering
15 captive insurance arrangements.

16 Q So what are your duties as the chief
17 executive officer of Capstone?

18 A I can tell you what I do there.

19 Q Okay.

20 A Actively involved in personnel development,
21 making sure the various positions are filled and with
22 qualified people, evaluating the personnel, quality
23 control, reviewing documentation, making sure the
24 systems are in place to properly administer various
25 work of Capstone, reviewing government filings or

1 drafts of filings, making sure that we have
2 compliance, making sure there's a proper interface
3 between Capstone and the various other professionals
4 that service it, such as The Feldman Law Firm, the
5 actuaries, the accountants, the government regulators
6 from Delaware and Anguilla knew our work and
7 basically audit Capstone itself, and I work on
8 onboarding new clients to ensure that they understand
9 the plan, at that point wearing both hats of
10 Capstone and the law firm, making sure everyone
11 understands what we're doing.

12 Q Do you serve as general counsel of
13 Capstone?

14 A Yes.

15 Q And are your duties with respect to that
16 any different than what you've described?

17 A No. It's subsumed within the discussion,
18 the description I just gave you.

19 Q Do you know who owns Capstone?

20 A Of course.

21 Q And who is that?

22 A Myself and my family.

23 Q Do you know when Capstone was formed?

24 A 1998.

25 Q And where does Capstone have offices?

1 A They're on the same floor as The Feldman
2 Law Firm. It's Suite 1950, 1980 Post Oak Boulevard.
3 Capstone also has an office in Bloomington, Delaware;
4 The Valley in Anguilla; Portland, Oregon; and just
5 outside of Minneapolis, Minnesota.

6 Q Okay. And do you have any insurance
7 professionals in Minneapolis?

8 A Yes.

9 Q And who would that be?

10 A Steve Lonergan, who spent like 20 years at
11 Aon, or a long time at Aon, and ran the General
12 Motors captive insurance company in Bermuda for about
13 four or five years. He's there.

14 Q Okay. And do you have any people in
15 Portland, Oregon, that have any insurance-related
16 experience?

17 A Bob Howell spent like 23 years at Marsh
18 doing transportation risk mitigation for truckers,
19 trucking companies.

20 Q Now, you've mentioned The Feldman Law Firm.
21 What is your relationship to The Feldman Law Firm?

22 A Your meaning mine?

23 Q What is your -- yes, your, Stewart
24 Feldman's relationship?

25 A I'm managing partner of the firm.

1 Q And are there other lawyers that work at
2 The Feldman Law Firm?

3 A About a dozen.

4 Q And can you tell me a little bit about
5 generally what The Feldman Law Firm does, just other
6 than practicing law. What kind of law?

7 A Corporate, corporate financing, bank loans,
8 estate planning, at one point in time, estate tax,
9 not so much anymore, federal income tax, some
10 business litigation, a lot of arbitration, employment
11 agreements.

12 Q So are you familiar with RSL Funding?

13 A Yes.

14 Q What is RSL Funding?

15 A It's a company that I own with my family.

16 Q And what does it do?

17 A It markets to persons who are selling long-
18 term financial instruments back to buy insurance
19 companies.

20 Q When you say, long-term financial
21 instruments, what do you mean?

22 A Basically annuities, lotteries, Texas
23 lottery or a Colorado lottery, Massachusetts
24 lotteries, that people buy and then sell off in part.
25 So if someone buys a lottery, wins it -- maybe they

1 won 20 years of financial payments, and they want to
2 sell of years five through seven or five through ten.
3 So it markets to those people and arranges the
4 purchase of those instruments. They're actually
5 acquired by other entities.

6 Q So if you took Capstone, RSL Funding, and
7 The Feldman Law Firm, how many people collectively do
8 those entities employ?

9 A About 70 people.

10 Q Are there any insurance-related tasks that
11 Capstone and The Feldman Law Firm have recently
12 undertaken?

13 A Well, I mean, every day we're working on --
14 I can tell you the last week.

15 Q Give me a recent project.

16 A I've been retained a labor union with about
17 30,000 members, which provides benefits to the
18 workers. They're agricultural workers. Right now,
19 their extended workers' compensation program -- it's
20 a worker compensation look-alike program -- is a
21 self-funded program by the union, and they're
22 uncomfortable with that.

23 They want to have a reinsurance
24 arrangement, so they're retaining us to design a
25 captive that would interface with a reinsurer and

1 reintroduce them to reinsurers of workers' comp for -
2 - in the agricultural industry. That's one.

3 Yesterday for an hour, I spent on the phone
4 on Sunday with a short-line railroad in Mississippi.
5 They provide -- it's a railroad. It has cars and
6 locomotives and that, between other rail systems, and
7 then they have sidings, so they support about -- a
8 large part of their business is supporting a large
9 utility in that area, in the generation of electrical
10 power. That was yesterday.

11 This morning, I worked on an alternative
12 risk-planning mechanism for a company that has 157
13 play parks around the United States, trampoline
14 parks, through their franchisees, so they have kids
15 jumping around on trampolines in the dark or with red
16 lights and laser lights and all that.

17 So they have some serious problems, because
18 kids jump up and fall down and hurt themselves and
19 break their back and all that kind of stuff on the
20 trampolines. So they have a -- we're working with
21 them on an alternative risk plan structure. They
22 spend about \$13 million a year on liability
23 insurance, and they're trying to find a better way to
24 do it. I mean, that's the last four days.

25 Q So can you tell me about your college

1 education.

2 A I have an undergraduate degree, bachelor of
3 science in economics, from University of
4 Pennsylvania, Wharton; master's of science with a
5 specialization in accounting, also from Wharton. I
6 attended the London School of Economics and Political
7 Science as a General Course student, and attended the
8 University of Michigan Law School, where I graduated.

9 Q And when did you -- you graduated from
10 Wharton?

11 A Yes.

12 Q And when was that, undergrad?

13 A Undergrad and grad were concurrent in 1975.

14 Q And did you receive a degree from the
15 London School of Economics?

16 A I was part of a General Course program,
17 which is a well-known and well-recognized program.
18 It's called capital G, General, capital C, Course
19 program, where they invite, in those years, about 60
20 people from around the world to use their facilities
21 for up to two years, to do research or to do specific
22 projects.

23 Q And so you were --

24 A I was on leave from Penn.

25 Q Oh, I see.

1 A I was on leave from Penn at that time.

2 Q Were you ever a CPA?

3 A Yes. I practiced as a CPA from '75 --
4 well, full-time from '75 through, I'd say, '77 in
5 Cleveland, Ohio, with the national office staff for
6 Ernst & Ernst.

7 Q And by CPA, I mean certified public
8 accountant.

9 A Yes. Passed the exam in '75, 1975.

10 Q Are you still a CPA?

11 A No. In the late '80s, AICPA changed the
12 continuing education requirements from about -- they
13 raised it to about 40 hours a year, and it was not --
14 it was for accounting programs, so there was some
15 overlap with legal, but not necessarily a lot, and
16 for a lawyer who wasn't practicing as a CPA -- I
17 hadn't practiced as a CPA for ten years at that point
18 -- to continue to spend 40 hours a year was a bit
19 much.

20 Q And you graduated from the University of
21 Michigan Law School?

22 A Yes.

23 Q And what year was that?

24 A 1980.

25 Q Do you have any continuing involvement with

1 the University of Michigan?

2 A I do.

3 Q And what is that?

4 A I'm on their national fund-raising
5 committee. We're just finishing a national campaign
6 for a billion-dollar raise that's been successful,
7 the largest raise by a -- largest campaign by a
8 public institution in the United States.

9 Q Do you have any continuing involvement with
10 the London School of Economics?

11 A I do. I'm on their North American advisory
12 committee where the North -- I should have called it
13 the North American Advisory Board. We provide
14 guidance to the school on issues that would affect
15 students coming from North America and North American
16 issues.

17 Q And who are some of the other members of
18 that board?

19 A Some pretty senior people. Vice chairman
20 of Morgan Stanley; the vice chairman of Citi Corp.;
21 former managing partner worldwide of Shearman &
22 Sterling; Robert Rubin, former secretary of Treasury;
23 Paul Volcker. Some pretty senior people who were
24 graduates of the school. Actually they're graduates
25 of the General Course program.

1 Q Have you ever been a teacher?

2 A Yes.

3 Q And would you describe what you did?

4 A I taught at the University of Michigan
5 Business School, accounting graduate -- accounting
6 majors in accounting theory and consolidations,
7 second semester and intermediate, while I was in law
8 school to help pay my way through. And then I taught
9 CPAs who were studying for the exam for about a year
10 with one of the national review courses that's now
11 owned, I think, by Washington Post or Kaplan
12 University. It's called the Becker CPA Review
13 Course.

14 Q Have you ever done any writing, published
15 writings?

16 A Quite a bit.

17 Q Could you just briefly summarize what that
18 is about.

19 A Well, in the '70s when I was on the
20 national office staff of Ernst & Ernst, my specialty
21 was international accounting standards. I did that
22 when I was at the London School of Economics, so I
23 was trying to rationalize accounting standards
24 between Europe, which was about 20 years behind the
25 United States, and the United States.

1 So I wrote in that -- in that area, I wrote
2 an article for -- published in 1975, January '75, in
3 the Institute of Chartered Accountants in England and
4 Wales on prior period adjustments and extraordinary
5 items, which was actually a very interesting topic,
6 even though it doesn't sound it; then published an
7 article on the cover story of the New York State
8 Society magazine, called the CPA Journal on
9 international accounting standards; published an
10 article in Management Accounting, which was the
11 magazine of the National Association of Accountants.
12 Several other publications, that was in the '70s.

13 Over the last decade, I've been publishing
14 articles in the captive publications on technical
15 issues involved in alternative risk planning and
16 captive insurance companies. And hopefully this
17 summer, we're coming up with a book or treatise on
18 captives. We're at about page 150 or 160, in the
19 area.

20 Q Now, after you graduated from law school,
21 where did you work immediately after law school?

22 A I joined the law firm of Vinson & Elkins in
23 Houston.

24 Q And what is Vinson & Elkins?

25 A It's an international law firm. It was

1 Governor Connelly's law firm. Governor Connelly was
2 a partner. Very well-known, top-rate firm, hundred
3 years old as of last week.

4 Q And what did you do at Vinson & Elkins?

5 A I was a corporate lawyer, corporate and
6 corporate securities lawyer, happened to do a lot of
7 work in the insurance industry.

8 Q Are you licensed to practice law?

9 A Yes.

10 Q And in what jurisdictions are you admitted
11 to practice law?

12 A From a state point, Texas, Tax Court,
13 Southern District of Texas. I have argued a case in
14 the Second Circuit, so I was either -- either I was
15 admitted or pro hac vice; Fifth Circuit, I believe
16 I'm licensed there; maybe licensed in the Third
17 Circuit, but I haven't argued anything in the Third
18 or the Fifth Circuit that I recall.

19 Q And when did you receive your law license
20 from Texas?

21 A 1980.

22 Q Now, you mentioned you had some exposure to
23 insurance-related issues at Vinson & Elkins. Would
24 you describe that.

25 A Yes. It was pretty interesting. I was

1 doing work with American General, which was at that
2 point, probably the third largest, maybe the fourth,
3 but the third largest life insurance company in the
4 United States. They were looking to diversify out of
5 the pure life business, which they had historically
6 been in. Actually American General was in some ways
7 founded by Vinson & Elkins in the 1920s and 1930s.

8 And I worked on two large acquisitions.
9 One was the acquisition of Credit Thrift, which was a
10 near stock exchange, consumer finance company, like
11 Household Finance or Beneficial or Associates. It
12 was a consumer finance operation, based in
13 Evansville, Indiana, with maybe 5- or 600 or a
14 thousand offices around the United States. It was
15 pretty large.

16 And then I worked on the hostile takeover
17 for National Life of Tennessee, which was the first
18 Pac-Man defense in the United States, where we were
19 eating that company and they were eating us at the
20 same time. It was the first one. It was with Marty
21 Lipton from Wachtell, Lipton, and we ate them before
22 they ate us.

23 It was a pretty interesting project. And
24 that was because the desire was that American General
25 wanted to begin to diversify. NLT owned the Grand

1 Ole Opry and station WSM and Opryland, along with
2 National Life of Tennessee. and they were very big
3 in debit policies, which, as you know, it's like a
4 life product or a credit life product.

5 So I had that exposure from that. It was a
6 very large project.

7 Q So you ultimately left Vinson & Elkins.
8 Right?

9 A Yes.

10 Q And when was that?

11 A Late '82.

12 Q Okay. And what did you do after you left
13 Vinson & Elkins?

14 A I became vice president of finance of a
15 merchant bank in Houston.

16 Q And did your job at the bank have any
17 insurance-related aspects?

18 A Yes. I call it a merchant bank, which --
19 just so it's clear, we bought things and operated
20 them. It wasn't a bank from the standpoint of
21 receiving deposits. It was a bank from the
22 standpoint of we had sources of capital, and we
23 deployed them in companies that we owned.

24 And, yes. We had significant exposure to
25 the credit life, credit disability, and extended

1 warranty, which is contractual liability insurance,
2 during that period of time.

3 Q Okay. And so how long were you involved at
4 the bank?

5 A In various capacities and various entities,
6 for about ten years.

7 Q Okay. And when did you leave the bank?

8 A 1991, 1992.

9 Q Now, Mr. Feldman, directing your attention
10 to Capstone, why did you cause Capstone to be formed?

11 A Well, I was practicing law for about six
12 years, and there was a recurring problem that I saw
13 with my clients. They would have commercial
14 coverages, but when a loss occurred, the insurance
15 company would not step up to the table and pay it,
16 and the client would be in two lawsuits, one from the
17 underlying issue, fire, business interrupt, a lawsuit
18 against them, whatever the underlying issue was, and
19 then they'd have a dec action from the insurance
20 company against them where they'd have two fights
21 going on at one time.

22 So -- commercial companies are infamous for
23 -- and I've written some articles on this -- are
24 infamous for not responding when demand for coverage
25 is made. So I saw that happen time and time again,

1 including personal situations where the insurance
2 company just wouldn't respond.

3 So I continue to read on it. I read a lot,
4 and I saw a thread which I traced into the Internal
5 Revenue Code where the -- dating back for a hundred
6 years, the Internal Revenue Code had provisions which
7 facilitated and encouraged the formation of small
8 insurance companies to provide businesses -- to
9 provide insurance for their affiliates. It's a
10 longstanding congressional mandate going back now
11 over a hundred years.

12 Q Can you describe your experience with
13 captive insurance companies. Well, first of all,
14 back up. What is a captive insurance company?

15 A Well, there's really no technical
16 definition of that. It's -- as it's used, it's just
17 a relationship between the insureds and the insurer.
18 usually there's some relationship between the two as
19 opposed to, for instance, me buying insurance from
20 GEICO, where I have no relationship. So usually in
21 the captive context, there's some kind of
22 relationship between the insured and the insurer,
23 usually through a parent or an affiliate or common
24 shareholder.

25 Q Can you describe your experience with

1 captive insurance companies.

2 A Over the last 20 years?

3 Q Yes.

4 A Well, I've designed -- I've probably led
5 200 projects over that period of time. Been involved
6 in a lot more, but 200 projects through fruition.
7 Been on -- I don't know -- 150 site visits perhaps.
8 I'm approximating that. Maybe it's 125; maybe it's
9 175, but a lot.

10 Q Site visits to do what?

11 A When you're doing a captive, you -- the
12 idea of a captive is you're tailoring coverages
13 directly to the needs of the business. You're
14 getting coverage -- you're buying coverages or
15 designing coverages not with a blunt instrument but
16 with a scalpel. So you want to see what the risks
17 are on the business on the ground. You want to walk
18 the facilities. You want to talk to the people.

19 You want to obviously review the insurance
20 policies and the corporate structure and the vendor
21 information and the customer information, the loss
22 history, and the litigation. You want to review all
23 that, but you want to walk the facilities and see
24 where the risks are.

25 Maybe because of my CPA background and

1 because of my corporate law background and my
2 business background at the merchant bank, maybe I
3 have more of that than other people. I don't know,
4 but you certainly want to do that. Insurance people
5 want to do that, and we want to -- it would be
6 typical in the insurance industry to do a site visit,
7 but it's doubly more so when you're doing a captive.
8 You don't want to hear someone's third-party summary
9 of what the business is and the risks. You want to
10 look at it on the ground.

11 So I've done, as I said, approximately 150
12 site visits. I've been licensed as a captive manager
13 in Utah, Arizona, Tennessee, Delaware, BVI, Anguilla;
14 met with regulators on dozens of occasions and
15 multiple jurisdictions.

16 I've reviewed and approved probably a
17 thousand independent audits, probably a thousand
18 year-end filings with insurance commissions; been
19 involved in designing coverages, been involved in
20 lost of coverage litigation over the years, major
21 coverage litigation with national companies. That's
22 the type of stuff that I'm involved with towards my
23 experience with captives.

24 Q So -- now, RSL Funding is on the life and
25 annuity business side. What is the business of

1 Capstone?

2 A Capstone is all property and casualty, so
3 between the two, we've got the world covered. There
4 are areas where there's a gray area between life and
5 annuity and property and casualty, so there's some
6 areas there where there's overlap. Like credit life
7 or credit disability is an overlap area.

8 Q Okay.

9 A Often that's viewed as a property/casualty
10 coverage, but, yes. We've been involved in the
11 acquisition of 1,500 separate annuity contracts or
12 lottery contracts. Tremendous experience.

13 Q So directing your attention to 2008, 2009,
14 and 2010, how many employees did Capstone have in
15 that time period?

16 A Capstone on its own? Probably about 18,
17 15, 20, something in that area, of full-time people.

18 Q And can you briefly describe the functions
19 --

20 A More -- let me say, more now. More now,
21 but you're looking at 2008 through 2010.

22 Q Correct.

23 A Yes.

24 Q Can you briefly explain the functions that
25 these Capstone employees performed in 2008, 2009, and

1 2010.

2 A Well, there's an insurance department, so
3 we have people involved in the insurance area, who
4 review the coverages, analyze the coverages, handle
5 claims, settlements of claims, manuscripting of
6 policies, working with the law firm, designing
7 coverages, feasibility studies, and coordinating with
8 outside CPCUs, actuaries, and underwriters.

9 Q So --

10 A That's --

11 Q Go ahead. Sorry.

12 A That's one department. There's four people
13 in that department now, I believe. Maybe there were
14 two or three earlier on. It's always headed up by --
15 basically -- well, I mean, there may be an exception
16 where someone was finishing up a part of their exam,
17 but generally it's always headed up by a CPCU, a
18 chartered property and casualty underwriter, who's
19 someone that has a lot of experience in property and
20 casualty underwriting.

21 Then there's a department which is
22 accounting that handles the -- what I'd call the
23 books and records and accounting and the filings for
24 Reserve and other captive insurance arrangements,
25 also for the IC discs, but most of it, probably 90

1 percent of their effort or 95 percent of their effort
2 is on the captive side. They're responsible for
3 coordinating the fillings.

4 then there's another department that deals
5 with relationships with the domiciles, scheduling
6 reviews of the domiciles of the captives or of the --
7 or of our operations.

8 Another department works as the -- what I
9 would call the corporate secretary, keeping minutes,
10 documentation in place for the pool, pooling
11 arrangements, and other type of corporate-type
12 documents, formations.

13 And then there's another department that
14 works on business developments. And then there's a
15 team that manages the business, Chuck Earles and
16 Megan Brooks. In 2008 through 2010, it was more
17 Chuck Earles who's president.

18 Q And does Capstone have policies and
19 procedures as to how its personnel should conduct
20 themselves in connection with Capstone's operations?

21 A Yes. Yes, we have lots of policy manuals
22 and step-by-step courses of action in different
23 areas.

24 Q And who's responsible for seeing to it that
25 those policies and procedures are implemented and

1 followed?

2 A I guess ultimately it's me, but from an
3 operational standpoint, Chuck Earles and Megan Brooks
4 tend to be now more of that. Chuck Earles did more
5 of it back than 2008 through 2010.

6 Q Would you have had any involvement in --

7 A Sure. I mean, ultimately it's with me, and
8 I meet with the Capstone, if not, you know, once a
9 week or sometimes every day on outstanding issues.

10 Q Are you familiar with Lance McNeel?

11 A Yes.

12 Q And what was his role at Capstone during
13 2008, 2009 and 2010?

14 A Lance was head of the insurance department.
15 He's a CPCU.

16 Q And what were --

17 A I think he was an ARM in those years, which
18 is an associate of risk management. It's another
19 professional designation.

20 Q And what were Mr. McNeel's responsibilities
21 as the head of the insurance department?

22 A Well, as I described it, I mean, the
23 insurance department then and now handles the binding
24 of policies, the preparation of the dec page, the
25 declaration pages in the policies, on-site

1 feasibility studies from the insurance side. The law
2 firm also joins in on that, coordinating with the
3 outside actuaries, underwriters, consultants, risk
4 managers.

5 If I didn't say it, claims payment, claims
6 handling, claims adjusting, designing coverages with
7 the lawyers, and providing input, of course, to the
8 accounting department on reserves that need to be
9 booked for the captive.

10 Q And who is responsible for pricing of the
11 work that Capstone did with regard to premium
12 pricing?

13 A You mean, in general or for Reserve?

14 A Well, in 2008, 2009, and 2010 in general.

15 A Mr. McNeel is handling it, but again, he
16 had a team of people. He had a team of actuaries and
17 underwriters and lots of people providing input to
18 him. But ultimately it's the client's decision.
19 We're not -- it's not our company. We're the
20 advisors.

21 Q Okay.

22 A They make the decisions, the ultimate
23 decisions in all aspects of the planning.

24 Q Now, why was Mr. McNeel placed in the role
25 of being in charge of the insurance department at

1 Capstone during 2008, 2009, and 2010?

2 A Because he was good. He's knowledgeable
3 and good and capable, and Lance has been with us for,
4 I think, over ten years. He's got tremendous
5 experience in the insurance industry, mostly on the
6 P&C side as a broker at Marsh McLennan, before that
7 Johnson & Higgins. University of Texas grad, worked
8 for -- oversaw a large book of business, I believe on
9 the life side, for Swiss Re, and then on behalf of
10 Computer Science Corporation. He just has a lot of
11 experience in the insurance industry.

12 Q Okay.

13 A Specifically property and casualty.

14 Q Now, you said that -- I believe you said
15 that Capstone utilized outside consultants to conduct
16 its business in 2008, '9, and '10.

17 A Right. There's a lot that we do, but like
18 any organization, we're not everything to every man,
19 so we need to seek the input from outside folks.

20 Q Okay.

21 A And assistants.

22 Q Can you describe for me who some of those
23 consultants may have been or were in 2008, '9 and
24 '10.

25 A One was an actuary, Gary Fagg. He's out of

1 Dallas. He's probably the nation's leading authority
2 in the credit life, credit disability, contractual
3 liability area, very well-known and well-respected
4 actuary who's now semi-retired. He's had some health
5 issues.

6 We worked with an actuary in Florida who
7 used to be part of Aon, which is one of the
8 international brokerage firms. His name is Steven
9 Glicksman.

10 We worked with Myron Steves, which is a 2-
11 or 300-person regional MGA, managing general agent,
12 that holds the pen, meaning they can bind Lloyd's
13 syndicates in different areas.

14 We worked with a company that they owned at
15 that time, Mid-Continent, which was an underwriter of
16 certain home health care programs. And then we
17 worked with -- continued to work with Mid-Continent
18 when it was bought by Proassurance, which is a
19 publicly held company out of, I believe it is,
20 Birmingham. It may be Atlanta, publicly held
21 insurance company.

22 Around that time we worked with ARM. I
23 don't remember the exact year, but around that same
24 time period, which was an actuarial firm out of
25 Dallas. The actuary was from -- well, ARM was the

1 actuary.

2 We worked with -- prior to that, we had
3 worked with a CPCU, Stephen Steinberg, who passed
4 away. And we consulted with, in the early part --
5 days of Capstone with Peter Steffens, who was a
6 former London reinsurance broker who ran the captive
7 arrangement that was our risk arrangement for Harris
8 Gambling Casino Company and with Cemix, which is
9 either the largest or the second largest concrete
10 company in the world, cement company. Sorry.
11 Cement, not concrete.

12 Q What about Willis?

13 A We worked with Willis from -- we worked
14 with Myron Steves, and we also worked with HRH, which
15 is Hilb Rogal &, I believe it is, Hilbert. It's
16 called HRH, which is a international background firm
17 that merged into Willis, and we continue to work with
18 them today. It's been about ten years. Willis is
19 the second largest insurance or risk management firm
20 in the world, 40,000 employees. We work with Bob
21 Snyder there.

22 Q Do you have any role with the financial
23 records that are maintained by Capstone?

24 A Of course.

25 Q Can you tell me what your role is with

1 regard to the financial records.

2 A You're talking about the financial records
3 not of Capstone but of the captives.

4 Q Of the captives.

5 A Right. Well, sure. We're constantly
6 reviewing draft financials, general ledgers, trial
7 balances, draft audit reports, proposed final audit
8 reports, financial filings with the regulators. It's
9 a numbers business. It's a finance business, so I
10 have a bit of a background in that. I review that on
11 an ongoing basis.

12 Q Okay. Do you know how those records are
13 maintained?

14 A Of course. Yes.

15 Q Can you explain how the records are
16 maintained.

17 A Again, these are records of the captives.

18 Q Yes.

19 A Of Reserve, in particular?

20 Q Reserve, in particular.

21 A Capstone receives directly from the
22 financial institutions original copies of the bank
23 brokerage or financial transaction statements, so in
24 this case, it's from -- I believe it's American Bank
25 that became Banner Bank, and then the securities were

1 held at DAE or D.A. Davidson, I believe. There may
2 have been another bank involved as well.

3 So we receive statements directly from
4 those financial institutions. Maybe Capstone
5 receives a thousand statements a month, I mean, just
6 very large number from various -- lots of people, and
7 the information then is put into the accounting
8 packages that we use, generally Sage 50 or Peachtree.

9 Journal entries are made. Monthly or
10 quarterly adjustments are done to amortization and
11 for -- both the amortization of any organizational
12 costs, but also amortization of the prepaid premium
13 and amortization of the loss reserve.

14 Claims would be booked. Claims that were
15 paid would be reflected, and the trial balances
16 prepared. Then a -- well, of course, a general
17 ledger is prepared. Trial balance is prepared. Then
18 interim financial -- draft statements are prepared,
19 and interim statements are prepared, and finally an
20 independent audit is prepared.

21 Q Do you ever participate in the conduct of a
22 feasibility study?

23 A As I mentioned, probably 150 times on site,
24 probably 200 times in total.

25 Q And the -- in 2008, 2009, and 2010, I

1 believe you said, Chuck Earles was the president.

2 A Yes. He still is.

3 Q Okay. And did you have an executive vice
4 president in 2008, '9 and '10?

5 A No. But we had a vice president in charge
6 of insurance operations which was Lance McNeel.

7 Q Okay. Does Capstone utilize the services
8 of The Feldman Law Firm?

9 A Yes. And other lawyers.

10 Q And how do the lawyers at The Feldman Law
11 Firm assist Capstone in connection with the captive
12 insurance activities of Capstone or captive
13 insurance-related activities of Capstone?

14 A Can I give you a couple of examples?

15 Q Sure.

16 A So what I mentioned today in my earlier
17 testimony, we're designing an enhanced workers'
18 compensation look-alike policy for the union. It's a
19 new project that's come in the door. That would
20 involve lawyers in our firm to draft a policy based
21 upon input from the insurance department.

22 Because it's an ERISA program, we would
23 also interface with outside counsel that we would
24 retain or the union would retain to ensure that it's
25 ERISA-compliant and it's part of the ERISA preemption

1 of state law.

2 So it's a project where you're going to
3 have two or three law firms, insurance people inside,
4 insurance people outside involved, so The Feldman Law
5 Firm would be part of the team, arranging that
6 particular financial document, designing that
7 program.

8 The Feldman Law Firm would interface with
9 Capstone on any new or unique coverage that's being
10 designed for which there needs to be a policy
11 written. So the insurance people may come up with a
12 policy summary of a risk that they need covered or
13 program that they need covered, and the law firm
14 would draft policy, review the policy, edit the
15 policy.

16 The law firm would also deal with -- assist
17 Capstone -- Capstone's not a CPA firm, and Capstone
18 is not a law firm, so Capstone itself doesn't do any
19 tax work. Or they don't give any tax advice. Maybe
20 that's the better way to do it -- to say it. So they
21 would look to the law firm to advise the clients on
22 tax issues and also to advise Capstone on tax issues.

23 Q Can you tell me about the source of
24 Capstone's clients. Where do they come from?

25 A Well, I've been in Houston, Texas, for 37

1 years. Even then I was in Texas for 27 years, so I
2 know a lot of people who own businesses. Generally
3 speaking, Capstone's clients are the same as the
4 clients of the law firm. They're owners of closely
5 held businesses, successful business people, so they
6 tend to refer them to us, their clients to us.

7 This morning, you know -- actually
8 yesterday I got a call from someone who's on the
9 board of a company. He's on -- this fellow's on the
10 board of a railroad. He's on the board of directors.
11 he referred the railroad to us. I know him because
12 he -- I've assisted him over the last 20 years here
13 and there on business issues, business and legal
14 issues.

15 CPA firms throughout the country call us
16 up, because we're noted as being the go-to shop in
17 the United States. I think we're the most
18 sophisticated, the most careful in the area. I think
19 we're well recognized as that. So people call us up.

20 I had a project that Chase Bank referred to
21 us. The fellow was a partner at Baker Botts. He
22 went to Goldman Sachs, and I believe he's now at
23 Chase Bank. And it's a large client out of
24 Louisiana.

25 They have 25,000 self-storage units

1 throughout the Southeast, and they were unhappy with
2 the quality of the services that they were getting
3 from people that they were working with because they
4 were clerical in nature, and they didn't have the
5 technical answers to the questions that the client
6 raised.

7 The client was a sophisticated client. The
8 owner of the business was a 40-year lawyer, graduate
9 of the University of Texas law school. His CFO was a
10 partner in a regional accounting firm, former partner
11 in a regional accounting firm, so they were a
12 sophisticated company, and they were asking
13 sophisticated questions of their advisors, and they
14 were getting less than satisfying answers.

15 So they happened to be meeting with their
16 bank, Chase, and they said, Well, if you've got
17 problems in the captive area, you come to Capstone.
18 They're -- or The Feldman Law Firm. They're the go-
19 to guys.

20 We get referrals from Frost Bank, Iberia
21 Bank, a \$30 billion bank based in New Orleans. Frost
22 Bank's based in Texas. NFP has sent us business over
23 the years. Wells Fargo. You know, we're known as
24 being the careful guys and sophisticated buys in the
25 area where we do it right.

1 Q Now, directing your attention to --

2 A And CPA -- a lot of CPA firms.

3 Q Directing your attention to Peak Mechanical

4 -- remember the Peak Mechanical?

5 A Yes, yes.

6 Q From Idaho.

7 A Osburn.

8 Q Yes.

9 A Osburn, Idaho.

10 Q Do you know how they became a client of

11 Capstone?

12 A Yes.

13 Q And how was that?

14 A One of the instances I mentioned, we had a

15 longstanding relationship with a client out of

16 southwestern Colorado, the Four Corners area of New

17 Mexico. They're in the mining business. They

18 provide track, narrow gauge track for underground

19 mining activities, mine hoists, you know, a million-

20 dollar mine hoist that'll drop people and equipment

21 down two miles.

22 So we did a large variety of work for them,

23 a wide variety of work, both domestic and

24 international over the years, captive and non-

25 captive-related, and they had a relationship with

1 Peak Mechanical principals. So apparently there was
2 some discussion between the two of them, leading to a
3 referral from mining -- the company in Colorado,
4 Mining Equipment, to us.

5 Q And who was the name of the person there at
6 Mining Equipment?

7 A Robert E. Pope.

8 Q Who?

9 A Robert E. Pope.

10 Q Did you ever tell a prospective client that
11 a captive insurance company does not make sense for
12 the prospective client?

13 A Probably 80 percent of the time.

14 Q And --

15 A About 80 percent of the calls we get, maybe
16 more, it just doesn't make any sense.

17 Q Can you tell me -- give me an example of a
18 situation that might not make sense.

19 A Person is a -- runs a team or a laboratory,
20 but he's a W-2 employee. Like, for instance in
21 Houston, someone may run a medical department at the
22 University of Texas Health Science Center or Memorial
23 Hermann or Methodist, so they may control a whole
24 book of business, but they're W-2 employees at the
25 end of the day. A captive doesn't have any

1 relationship there, because a captive is not going to
2 insure Methodist Hospital or the University of Texas
3 or M.D. Anderson. That's one series.

4 Another series is the company is too small,
5 or it's too large. So if it's a publicly held
6 company, we typically are not involved. We would
7 refer that out to someone like Willis. We tend to
8 work in the privately held areas.

9 Another would be -- if it's a -- sometimes
10 if it's a not-for-profit hospital -- you know, there
11 are thousands of captives in the captive area
12 involving hospitals. Usually those captives are
13 disregarded captives, because they're part of the
14 tax-exempt function of the parent company, and
15 they're looking for liability insurance on the London
16 markets or the Cayman Island markets. We typically
17 wouldn't do that, so we refer that out.

18 There are calls we get that are just
19 inappropriate that we've declined to get involved. I
20 can think of a couple of those projects over the
21 years, one of which was on the front page of the Wall
22 Street Journal that we just declined to get involved
23 in.

24 Q What was that?

25 A It was a person from China who was

1 cornering the market in aluminum ingots -- you may
2 have been reading it -- with a Dallas law firm. And
3 we did a planning memo on that and declined to get
4 involved.

5 So there are a wide variety of situations,
6 but again, as I say, probably eight out of ten isn't
7 -- doesn't get very far, because it just doesn't make
8 sense. You need a substantial, closely held business
9 that has bona fide risks.

10 Q Okay. Do government regulators review your
11 -- Capstone's work?

12 A Nonstop. Nonstop. We're reviewed by --
13 work is reviewed by every domicile where we are, so
14 it's extensively reviewed by Delaware, Anguilla,
15 before that BVI, now Tennessee, Utah.

16 In fact, we just had last summer an on-site
17 audit by the Financial Services Commission of
18 Anguilla at our offices for a week, and that was not
19 the first time they were there for a week. They were
20 sincere. They came to Houston in July and August.

21 We also have -- Delaware has throughout the
22 country what I would call examiners, insurance
23 examiners, and they come to our office and look at
24 our facilities, and look at our processes, as well as
25 the actual books and records of the individual

1 captives, but they're also interested in just looking
2 at our processes.

3 Q Have captive insurance companies
4 administered by Capstone been examined by the
5 Internal Revenue Service?

6 A Oh, yes. Almost 5,000 times, I'd say.
7 Yes. A lot.

8 Q And are you familiar with the fact that the
9 Petitioner in this case filed Forms 990 or 990-EZ for
10 2008, 2009, and 2010?

11 A Yes.

12 Q And do you recall when the 2010 return for
13 Petitioner was filed?

14 A Oh, sometime in '11, sometime in 2011.

15 Q Sometime in 2011?

16 A Yes. If you show me the document, I could
17 tell you, but I don't --

18 MR. ALBRIGHT: Your Honor, may I provide
19 Mr. Feldman with a copy of Exhibit 4-J?

20 THE COURT: Yes, you may.

21 (Pause.)

22 THE WITNESS: Your Honor, may I just
23 stretch -- I just had knee surgery.

24 THE COURT: Yes.

25 THE WITNESS: Can I just --

1 THE COURT: Yes.

2 THE WITNESS: It still hurts.

3 (Pause.)

4 THE WITNESS: What exhibit?

5 BY MR. ALBRIGHT:

6 Q Do you have a copy of Exhibit 4-J in front
7 of you?

8 A Yes.

9 Q And can you tell from looking at Exhibit 4-
10 J when the 2010 return for Petitioner was filed?

11 A It's dated August 2011.

12 Q Now, as of August 2011, do you know how
13 many of the captive insurance companies that were
14 administered by Capstone had been examined by the
15 Internal Revenue Service?

16 MR. MARKLEY: Excuse me, Your Honor. I
17 have to object as to the relevance of that question.
18 That's part of what we had been talking about prior
19 to the case and regarding the motion in limine
20 regarding the relevance of that type of activity.
21 And even though this witness may know the answer to
22 that, I don't think that's relevant to the
23 determination of the tax liability of this taxpayer.

24 MR. ALBRIGHT: Your Honor, this is just
25 background. These are background facts to give the

1 factual context in which the facts in this case
2 occur.

3 THE COURT: I think you can reword your
4 question.

5 MR. ALBRIGHT: Okay.

6 BY MR. ALBRIGHT:

7 Q As of August 2011, do you know how many of
8 the captive insurance companies that were
9 administered by Capstone had gone through an Internal
10 Revenue Service audit?

11 A As of August 2011, seven had gone through
12 and completed audits with no changes.

13 MR. MARKLEY: I'm -- I'm sorry. I
14 apologize. He answered a little bit more than he was
15 asked as to whether or not there were audits, so I
16 would move to strike the "no changes," because that's
17 the whole point. I know what counsel's trying to do,
18 and I don't blame him for trying to do that. But
19 he's trying to get around my objection to get to the
20 point of what happened in other cases.

21 THE COURT: I didn't sustain your
22 objection, though. I asked him to rephrase the
23 question.

24 MR. MARKLEY: I know, and -- yes. And I'm
25 objecting to this question, too. I'm sorry.

1 THE COURT: Okay.

2 MR. MARKLEY: I'm objecting to the new
3 question, because he's -- actually I'm objecting to
4 the answer, moving to strike the answer, as to the
5 result of the audit, not the fact that there was an
6 audit, so that's what I'm actually doing.

7 MR. ALBRIGHT: Your Honor, these were not
8 audits of the Petitioner. We're not going behind the
9 notice, so to speak, with regard to Petitioner.
10 We're just explaining what --

11 THE COURT: I'm going to overrule the
12 objection.

13 MR. ALBRIGHT: Okay.

14 BY MR. ALBRIGHT:

15 Q Mr. Feldman, do you know whether the
16 Internal Revenue Service had a rulings program in
17 2011 for captive insurance companies seeking to
18 obtain a ruling that such companies qualified for
19 exempt status under Section 501(c)(15)?

20 A In 2011?

21 Q Yes.

22 A Yes, I do know whether they had it or not.

23 Q And did they have a -- did the Internal
24 Revenue Service have a ruling program for 501(c)(15)?

25 A I don't think I can answer that with a yes

1 or no.

2 Q Okay. Could you explain.

3 MR. MARKLEY: Well, if he answers it with a
4 yes or no, I wouldn't object. If he explains and the
5 explanation results in the fact of what happened as a
6 result of those rulings, then I would object, and not
7 because it's going behind the notice, just because
8 it's not relevant to this case.

9 THE COURT: I don't think you can object to
10 an answer until you've heard the answer, and --
11 because the answer might have some hearsay, but until
12 I hear the answer, I won't know that, so I'm going to
13 allow the question and the answer.

14 THE WITNESS: Can I answer? So in 2011,
15 which was really the same as 2008 and earlier years,
16 the Service had a program by which a taxpayer would
17 file a Form 1024, which the filing's about the size
18 of this, probably more than this, where it provides
19 all kinds of information on the insureds, on the
20 insurer, the program, the insurance program, the
21 copies of the policies, pricing methodology, pro
22 formas, pro forma financial information, historical
23 financial information, corporate papers on the
24 captive insurance company, ownership of the various
25 entities that are the insureds, and submitted it to

1 the Service.

2 That was still in existence in 2011.

3 However, the Service had shut it down and was
4 refusing to rule in 2011, and we were told that by
5 the Service. We were told that by its attorneys in
6 2011. So we had experience dating back to 1999 of
7 this program that had been in existence for decades
8 where the Service issued hundreds, if not thousands
9 of tax-exempt determination letters or denied them --

10 MR. MARKLEY: I hate to interrupt the
11 witness, because I don't like to do that, but now I
12 think we're going beyond the actual question that was
13 asked. We're getting into now, I think, where my
14 objection would be ripe as to Mr. Feldman going into
15 an area that gets into the question of whether
16 there's been some degree of equal treatment.

17 What the background is -- I understand what
18 the background is, and he could answer the question
19 about that. But I think he's going beyond that.

20 THE COURT: The last sentence of his
21 answer, I'm going to strike that. And we'll go to
22 the next question.

23 BY MR. ALBRIGHT:

24 Q Mr. Feldman, did you apply for any rulings
25 for captive insurance companies seeking to obtain a

1 ruling of determination that such companies qualified
2 for tax-exempt status under Section 501(c)(15) as of
3 that time of this document?

4 A As of 1998 or --

5 Q As of 2011, how many ruling requests had
6 you filed?

7 A I have to break it down. We had filed and
8 received determinations, favorable determinations, on
9 39, so we were 39 and 0, and then we filed 12 -- let
10 me just back up --

11 MR. MARKLEY: Well, while he's backing up,
12 I'll object and move to strike not to whether or not
13 he requested them, but what the results are. We keep
14 going back into the same kind of question of going
15 beyond -- the same kind of issue of going beyond the
16 question to put something in evidence that's not part
17 of this case as to this taxpayer. It might be
18 background for Mr. Feldman, certainly is for Mr.
19 Feldman, but it's not background for this taxpayer.

20 THE COURT: Well, the Court was allowing a
21 little bit of questioning on this, because the Court
22 disagrees with Respondent on part of this and thinks
23 it is relevant.

24 MR. MARKLEY: Okay. Well, then I won't
25 waste any more time on that, because I think you

1 understand my point. Thank you. I will not go any
2 further into that kind of objection, because I think
3 I see where it's going. Okay. Thank you.

4 BY MR. ALBRIGHT:

5 Q So how many rulings had you applied for as
6 of August 2011?

7 A That's what -- I'm breaking it down into
8 two groups.

9 Q Okay.

10 A Rulings we applied for and were completed,
11 rulings we applied for and weren't completed. So as
12 of 2011, in the history of our operation, we applied
13 for 39 which we saw through to completion and
14 ultimately received tax-exempt determination letters.

15 Following the same methodology for the same
16 kind of program for the same -- basically the same
17 facts, we applied for 12 rulings, which under the
18 exact same facts, four were denied, eight were
19 withdrawn, because the Service told us, We're not
20 issuing any more favorable rulings; it doesn't matter
21 what -- it doesn't matter what you say; we're not
22 issuing any rulings.

23 MR. MARKLEY: We know have to object on
24 hearsay. I --

25 THE COURT: And I'm going to sustain the

1 objection. So the answer would be -- I need some
2 time here to think -- the answer where it said about
3 the four and the 12 -- I think I got it backward --
4 four and then how many you said withdrawing?

5 THE WITNESS: Of the 12 --

6 THE COURT: Yes.

7 THE WITNESS: -- four were applied for --

8 THE COURT: And the rest withdrew, and so
9 the remaining part of the answer after how many
10 withdrew is struck.

11 THE WITNESS: Sorry.

12 BY MR. ALBRIGHT:

13 Q With respect to the 39 favorable rulings
14 that you had received --

15 A Yes.

16 Q -- were the captive insurance companies
17 that were the subject of these requests for
18 determination similar to the Petitioner in this case?

19 A Yes. Basically exactly the same.

20 MR. ALBRIGHT: Your Honor, may I please
21 provide a copy of Exhibit 19-J to Mr. Feldman?

22 THE COURT: Yes.

23 MR. ALBRIGHT: May I assist?

24 THE COURT: Yes.

25 (Pause.)

1 BY MR. ALBRIGHT:

2 Q Mr. Feldman, do you have a copy of 19-J in
3 front of you?

4 A I do.

5 Q Are you familiar with Exhibit 19-J?

6 A Yes.

7 Q What is Exhibit 19-J?

8 A It's a Form 1024 application to the
9 Internal Revenue Service for recognition of a company
10 under 501(a), in this case 501(c)(15).

11 Q And do you know what company is the subject
12 of this application?

13 A Reserve Casualty Corp.

14 Q Were you involved in the preparation of
15 this application?

16 A Yes.

17 Q And is this application consistent with the
18 applications that you testified about where you
19 received a favorable ruling?

20 A Yes --

21 MR. MARKLEY: I have to -- excuse me.

22 THE WITNESS: I'm sorry.

23 MR. MARKLEY: I have to object on
24 foundation, Your Honor. We don't really have any
25 evidence in the record to indicate what really was in

1 those other -- I think it was, 39 other situations or
2 whatever the number of other situations were. So he
3 may personally know that from his own personal
4 knowledge, but the record doesn't know that.

5 THE COURT: You can rephrase your question.

6 BY MR. ALBRIGHT:

7 Q Was the information contained in this
8 Exhibit 19-J -- is this -- well, let's back up. Were
9 you involved in preparing the applications for the
10 rulings where you got the 39 favorable rulings? Were
11 you involved in the preparation of those?

12 A Every one, including this one, so I would
13 have been involved in helping to draft it, review it,
14 edit it, page by page.

15 Q Were you -- so you're familiar with what
16 was included in those applications that gave the 39
17 favorable rulings?

18 A Every one of them, including this one,
19 intimately.

20 MR. ALBRIGHT: Your Honor, I believe that
21 that's a foundation that would permit -- he's
22 demonstrated that he knows, and he can testify to
23 that.

24 MR. MARKLEY: As Judge Couvillion used to
25 say years ago, it's like one of those things, If the

1 witness knows, he can answer. And that's really not
2 the way it works. I think if the witness has a
3 foundation for knowing what those are would be proven
4 what would be in the record, and I don't know under
5 Rule 1006, assuming that that's a lot of paperwork --
6 if it's anything like this, probably would be a lot -
7 - that under 1006, we don't have the underlying
8 documents to make a determination.

9 He may well know, but it's not in the
10 record, and I don't think there's a foundation for
11 that. This is -- he's already given his answers.
12 This is a stipulated document. It's already in.
13 Whether there was 39 other like this -- I think if
14 there were 39 other like this, then those other 39
15 should be here.

16 MR. ALBRIGHT: Your Honor, Mr. Feldman was
17 involved in the preparation of those other rulings
18 applications, and he has a basis for knowledge.

19 THE COURT: And I'm going to allow the --
20 and I believe the answer was similar.

21 MR. ALBRIGHT: Yes.

22 THE COURT: And I'm going to allow that,
23 and we can move on to the next question.

24 BY MR. ALBRIGHT:

25 Q Now, Mr. Feldman, if you would turn to 5716

1 in Exhibit 19-J --

2 A Yes, sir.

3 Q What is -- what starts here at page 5716?

4 A This is the totality of the application to
5 the government body for the formation of the
6 insurance company, which subsumed within the 1024
7 application.

8 Q And if you would turn to page 5725 of
9 Exhibit 19-J --

10 A (Complying.)

11 Q Do you see that?

12 A Yes.

13 Q What is that part of the document?

14 A It's a confirmation to the regulators that
15 Capstone would be involved in providing the
16 comprehensive administrative services to Reserve as
17 it provides for other companies in the jurisdiction,
18 meaning in Anguilla, to provide the assurance to the
19 regulators that there's a professional team in place
20 to administer the insurance company, and it's not
21 being administered or run by -- on an ongoing basis
22 by people who were unfamiliar with insurance company
23 regulation.

24 Q And was it -- in the rulings that we're
25 talking about, would you provide this kind of

1 information in the application?

2 A Yes. This is subsumed within the
3 application, the 1024 application, and it's on
4 Capstone letterhead and addressed to the director of
5 the Financial Services Commission.

6 Q Whose signature is that on 5725?

7 A That's mine.

8 Q And if you would turn to page 5751 --

9 A Yes.

10 Q What is page 5751?

11 A It's the beginning of the business plan and
12 the financial pro formas for the insurance company,
13 which is part of the application to the regulator and
14 subsumed within the filing of the 1024 that's
15 required of all insurance companies in most -- let's
16 say, in every jurisdiction that I know, including
17 Anguilla, which describes the ownership of the
18 company, the insureds, the types of coverage that
19 would be written, the reserve methodology, the
20 financial pro formas, the ways in which the policies
21 would be obtained, the underwriting activity, claims
22 handling, the investment function, the assets of the
23 company.

24 Q Now, if you would, please, would you turn
25 to page 5753.

1 A Yes, sir.

2 Q And look at paragraph 124 there on page
3 5753. There's a discussion of 501(c)(15) and 831(b).
4 Do you see that?

5 A Yes.

6 Q Do you know what the difference is between
7 a 501(c)(15), a captive insurance company, or an
8 831(b) captive insurance company?

9 A Yes.

10 Q And directing your attention to this time
11 frame, what was the difference?

12 A 501(c)(15) is a statutory provision of the
13 Code. It traces back a hundred years in the Code.
14 That provides if you are a non-life company, in
15 effect, a property and casualty company, and the
16 total gross receipts as defined are less than
17 \$600,000, that the company by statute is tax-exempt.

18 831(b) is a election process which says
19 that if you are a non-life company and your gross --
20 I'm sorry -- your net written premiums are less than
21 \$1.2 million in that year, the underwriting profits
22 are tax-exempt and the investment income is taxed as
23 any other C corp.

24 So they're sister provisions. They don't
25 sit on top of one another, 831(b) surrounds

1 501(c)(15), but 501(c)(15) trumps, because it's a
2 statutory mandate, should its criteria be met.

3 MR. MARKLEY: Your Honor, I have to -- it's
4 a little bit late, but, I think -- and I appreciate
5 the abilities of Mr. Feldman to understand what he
6 may be talking about, but he really wasn't asked to
7 come in as an expert to explain tax law. I don't
8 think you explain tax law to a Tax Court Judge in Tax
9 Court, and that's not the purpose of his testimony.

10 If it's just to explain what's on that
11 page, that's fine, but now we're getting into
12 technical. I think we're taking it out of the
13 province of you, and he's not even being called as an
14 expert.

15 THE COURT: I'm sustaining the objection.

16 BY MR. ALBRIGHT:

17 Q Mr. Feldman, if you would turn to page
18 5755, and there's a Section 3.5 there.

19 A Yes, sir.

20 Q And can you tell me, what is the purpose of
21 Section 3.5?

22 A It deals with underwriting activities of
23 the company, describes those.

24 Q Okay. And does this describe what Capstone
25 was doing in 2008, 2009, 2010?

1 A Well, it describes what Reserve was doing
2 in 2008, 2009, 2010.

3 Q but in terms of the manner in which
4 Capstone assisted in determining premiums for the
5 policies that were written, does it describe the
6 methodologies that Capstone used to assist in
7 determining those premiums?

8 A Yes. Towards the bottom of that section.

9 Q And had the other -- the rulings that were
10 -- the applications for the rulings that resulted in
11 the 39 favorable determinations, did those rulings
12 contain similar descriptions of premium pricing
13 methodology?

14 A Yes.

15 MR. MARKLEY: I move to strike. I think
16 we're going far afield from what you had already --

17 THE COURT: And I'm going to sustain that
18 objection.

19 BY MR. ALBRIGHT:

20 Q Mr. Feldman, if you would turn to page 5782
21 of Exhibit 19-J --

22 A Yes.

23 Q What's contained in Exhibit 19-J at page
24 5782?

25 MR. MARKLEY: Your Honor, the record speaks

1 -- objection. The record speaks for itself, what's
2 contained. It's a stipulated exhibit. It's in the
3 stipulations. He doesn't need to tell us what's in
4 there. We already know.

5 MR. ALBRIGHT: Your Honor, it's a
6 foundation for asking a follow-up question.

7 THE COURT: I'm going to allow the question
8 to be answered.

9 THE WITNESS: I do know what it is. It's
10 the internal financial statements, the unaudited
11 financial statements of Reserve Casualty for the year
12 ended December 31, 2008.

13 BY MR. ALBRIGHT:

14 Q Okay. And do you know how this financial
15 statement would have been prepared?

16 A Yes.

17 Q How would it have been prepared?

18 A It would have been prepared by Capstone,
19 using the source documentation obtained directly from
20 the financial institutions -- that's plural,
21 financial institutions -- with input from the client,
22 Reserve Casualty or its officers and directors, and
23 with input from the insurance department at Capstone.
24 And it results in the issuance of this unaudited
25 financial statement which is then filed with the

1 regulators.

2 Q Mr. Feldman, if you would turn to 5795 of
3 Exhibit 19-J --

4 A Yes, sir.

5 Q Do you know who Linden Property Insurance
6 Company is?

7 A Yes.

8 Q Who is Linden Property Insurance Company?

9 A They're a New York Stock Exchange company
10 through their parent, publicly held, AM best-rated, I
11 think, AM best-rated 13. It's a highly rated
12 insurance company, which generated the original
13 policies that are the subject of this agreement, of
14 this retrocedent agreement.

15 Q And are these -- is some of the insurance
16 that was written by Linden Property Insurance Company
17 reinsured by Reserve Casualty Corporation?

18 A Correct. So it's clear, it went through
19 two or three intermediate layers levels. It started
20 with Linden and ended up at Reserve.

21 Q And if you would turn to page 5796, are you
22 familiar with that document?

23 A I am.

24 Q And what is that document?

25 A That's the last step of the ceding process

1 or retroceding process of the insurance coverages
2 from Linden to Reserve. So at the stage before it
3 came to Reserve Casualty Corporation, the coverages
4 with PoolRe who retroceded those coverages to
5 Reserve.

6 MR. ALBRIGHT: May I have just a moment,
7 Your Honor?

8 THE COURT: Yes.

9 (Pause.)

10 MR. ALBRIGHT: We're asking for a break, if
11 that's okay with Your Honor.

12 THE COURT: Okay.

13 MR. MARKLEY: Yes. We're both in agreement
14 on that. You may not be.

15 THE COURT: The Court will take a five-
16 minute recess.

17 THE CLERK: All rise.

18 (Whereupon, a short recess was taken.)

19 THE CLERK: All rise.

20 Please be seated.

21 THE COURT: You may proceed.

22 BY MR. ALBRIGHT:

23 Q Mr. Feldman --

24 A Yes, sir.

25 Q -- do you still have Exhibit 16-J in front

1 of you -- 19-J -- I'm sorry -- 19-J.

2 A I do.

3 Q Would you turn to the page that's numbered
4 5756 in the lower right-hand corner.

5 A Yes, sir.

6 Q And there's a Section 3.8 there.

7 A Yes.

8 Q Do you see a reference to 30 percent there?

9 A Yes.

10 Q Can you explain why that is in this
11 document.

12 A Well, the company was intending to have and
13 did have a 30 percent, what's called, unrelated
14 business, meaning premiums and risk not associated
15 with any insured related to, directly or indirectly,
16 Norman Zumbaum or Corey Weikel. And that's what that
17 30 percent is. It's composed of two different
18 components. It's a number that's -- I won't say, set
19 in stone, but it's well recognized in the insurance
20 industry as a key number.

21 Q And was a similar statement contained in
22 the ruling requests that led to the 39 favorable
23 rulings?

24 MR. MARKLEY: Same objection for the same -
25 - I'm sorry. Same objection for the same reason.

1 THE COURT: I'll allow the question to be
2 answered.

3 THE WITNESS: Yes. The same 30 percent,
4 the same discussion of the 30 percent, the same
5 structure.

6 THE COURT: Okay.

7 MR. ALBRIGHT: Your Honor, may I have this
8 document or this notebook marked for identification
9 as Petitioner's Exhibit next in order?

10 THE COURT: Yes.

11 MR. ALBRIGHT: And please let the record
12 reflect that I'm handing a copy to Mr. Markley.
13 (Handing document.)

14 THE COURT: Yes.

15 MR. ALBRIGHT: May I approach?

16 THE COURT: Yes.

17 MR. ALBRIGHT: (Handing document.)

18 THE CLERK: A binder of documents from the
19 Internal Revenue Service is marked for identification
20 as Exhibit 132-P.

21 (The document referred to was
22 marked for identification as
23 Petitioner's Exhibit 132-P.)

24 MR. ALBRIGHT: Your Honor, may I provide
25 Mr. Feldman with a copy --

1 THE COURT: Yes.

2 MR. ALBRIGHT: -- of Exhibit 132-P?

3 BY MR. ALBRIGHT:

4 Q (Handing document.) Do you have a copy of
5 Exhibit 132-P in front of you?

6 A Yes.

7 Q Would you take a minute and look through
8 it.

9 A (Perusing document.) Yes.

10 Q And do you know what Exhibit 132-P is?

11 A Yes.

12 Q What is it?

13 MR. MARKLEY: Your Honor, I was waiting for
14 a question to actually object to. I would object at
15 this point, because I do not believe that these
16 documents were provided by counsel within 14 days.
17 Now, if they can show me that they were, then that's
18 a different situation. Then I would just be
19 objecting on relevancy, but I've been advised that we
20 didn't get these. I've not seen these before.

21 THE COURT: Mr. Albright, if you could
22 answer that --

23 MR. ALBRIGHT: Your Honor, these documents
24 were provided to Respondent with my letter dated
25 April 10, 2017, and they were attached to one of the

1 expert reports that was submitted on that same --
2 March -- back in March.

3 And they're referenced in paragraph 5 of my
4 letter dated April 10, 2017, which states that on
5 March 27, 2017, Petitioner submitted copies of expert
6 reports to the Court and I also served Respondent
7 with copies of these reports.

8 And then we also sent on March 27, 2017,
9 two separate letters, enclosing CDs that contained
10 copies of materials that were considered by
11 Petitioner's experts in connection with expert
12 reports that were submitted to the Court and served
13 on Respondent on March 27, 2017.

14 So these documents were provided to
15 Respondent, and the letter dated April 10, 2017,
16 states that Petitioner planned to utilize these
17 documents at trial.

18 MR. MARKLEY: May I inquire what experts
19 they were -- their reports were attached to?

20 MR. ALBRIGHT: As I recall, Mr. Markley
21 asked a question of Mr. Snyder about a footnote in
22 his report that referred to the 39 rulings, and those
23 39 rulings were provided in the materials that Mr.
24 Snyder had considered in -- or had reviewed in
25 preparing his report.

1 MR. MARKLEY: May I have a moment?

2 THE COURT: You may have a moment.

3 (Pause.)

4 MR. MARKLEY: I'll withdraw my objection as
5 to whether they were provided or not. I would
6 maintain my objection as to the relevance of these
7 documents.

8 THE COURT: Mr. Albright, if you want to
9 respond briefly to the -- his relevance objection --

10 MR. ALBRIGHT: Well, Your Honor, I thought
11 the Court had decided the motion in limine, that
12 denied Respondent's motion in limine and concluded
13 that these documents were relevant, and so based on
14 that, I would offer Exhibit 132-P into evidence.

15 THE COURT: Well, I think the -- if the
16 Court could just have a little foundation, because
17 the objection -- if you could lay a little
18 foundation, because you asked the witness what they
19 were and --

20 MR. ALBRIGHT: Oh, sure.

21 THE COURT: And then I'll make my ruling.

22 MR. ALBRIGHT: Okay.

23 BY MR. ALBRIGHT:

24 Q Mr. Feldman, would you take a look at
25 Exhibit 132-P, please.

1 A Yes. I've looked through -- yes. I've
2 looked through it.

3 Q And what is contained in Exhibit 132-P?

4 A If I counted it right, there are 39 ruling
5 determinations, affirmative rulings from the Service,
6 or said another way, approvals from the Service on a
7 501(c)(15) determination, based on a Form 1024
8 application, which is the same as the application we
9 saw in one of the other exhibits a few minutes ago.
10 Was it 19-J, I believe? 19-J. So these are the
11 rulings from the other 39 separate and distinct
12 captives, where I reviewed and in large part, wrote
13 or edited the ruling requests.

14 Q And are these the 39 rulings that you
15 testified about previously?

16 A Yes. These are the -- so it's clear, these
17 are the affirmative rulings, the approved rulings,
18 where a favorable determination was made by the
19 Service.

20 MR. ALBRIGHT: Your Honor, I'd offer
21 Exhibit 132-P into evidence.

22 MR. MARKLEY: Your Honor, I still -- my
23 objection also goes to there is no way to determine
24 in this exhibit -- in the exhibit or the letters
25 within it as to what companies were at issue. And I

1 understand why it doesn't say in there as to what
2 companies are at issue, because I would imagine
3 Petitioner and Mr. Feldman don't want to get into a
4 question about 6103 disclosure. I understand that,
5 that problem.

6 But there is no way of really determining
7 what companies we're talking about. There's -- it
8 seems like this is a potential waste of time for the
9 Court to have to go through. I mean, I suppose I
10 could cross-examine Mr. Feldman on each one of these
11 and ask him which companies they related to, assuming
12 that would even be relevant to do, and I don't really
13 know if he'd be able to answer that question or
14 whether he would feel that he's permitted to answer
15 the question as to who the taxpayers are.

16 THE COURT: The Court is going to admit
17 these documents, and knowing that they do not have
18 the taxpayer, but that these are the 39 that Mr.
19 Feldman was referring to.

20 MR. MARKLEY: Okay.

21 THE COURT: So 132-P is admitted.

22 (The document referred to, having been
23 previously marked for identification as
24 Petitioner's Exhibit 132-P, was received
25 in evidence.)

1 BY MR. ALBRIGHT:

2 Q So, Mr. Feldman, how many different people
3 at the IRS National Office did you work with in
4 obtaining the 39 rulings?

5 A Seven different issuing specialists, and
6 four or five managers.

7 Q Do you recall their names?

8 A Yes.

9 Q Who were they?

10 MR. MARKLEY: I object to the relevance of
11 that. I don't think there's any dispute at this
12 point that the letters are in, and Mr. Feldman knows
13 what they said or what they caused to take effect.
14 I'm not sure that it's that terribly relevant about
15 who they are. I have no idea. I'll just say that.

16 MR. ALBRIGHT: Well, Your Honor, if the 39
17 rulings are relevant, which they are, then some of
18 the details concerning those rulings are also
19 relevant.

20 THE COURT: I think that these 39 are
21 relevant to some point, but I don't think who -- I
22 don't think the names of the IRS are necessary, so
23 I'm sustaining the objection.

24 MR. ALBRIGHT: Okay.

25 BY MR. ALBRIGHT:

1 Q Mr. Feldman, did the IRS issue a favorable
2 determination regarding Petitioner's tax status?

3 A No.

4 Q Do you know whether Petitioner's request
5 for determination was withdrawn?

6 A It was withdrawn.

7 Q And why was Petitioner's application for
8 tax-exempt status withdrawn?

9 MR. MARKLEY: I have to object on
10 foundation, Your Honor.

11 THE COURT: I think you can ask one more
12 question on this, one more background question.
13 Rephrase your question.

14 MR. ALBRIGHT: Okay.

15 BY MR. ALBRIGHT:

16 Q Mr. Feldman, do you personally know why
17 Petitioner's application for tax-exempt status was
18 withdrawn?

19 MR. MARKLEY: Your Honor, I think it's
20 hearsay, potentially could be hearsay.

21 THE COURT: We don't -- I can't tell
22 hearsay until I hear the answer.

23 MR. MARKLEY: Thank you.

24 THE WITNESS: Yes.

25 BY MR. ALBRIGHT:

1 Q And how do you know -- what do you -- why
2 was the application withdrawn?

3 A I had a series of conversations with
4 attorneys from the National Office staff --

5 MR. MARKLEY: Objection. Hearsay. Now we
6 know what might be hearsay, not because -- we
7 actually have an answer to the question, that he
8 talked to somebody. It was a conversation outside of
9 court.

10 MR. ALBRIGHT: Your Honor, it's not offered
11 for the truth or the falsity of the matters asserted.
12 It's just explaining how he -- why he acted on this
13 the way that he did.

14 MR. MARKLEY: I'm not sure why Mr. Feldman
15 -- Mr. Feldman's not on trial here. The Petitioner
16 is on trial, so I'm not sure why it matters what Mr.
17 Feldman did and acted in regard to what it is that he
18 didn't act about. I don't know what he supposedly
19 didn't act about, so I object on relevance as well as
20 hearsay.

21 THE COURT: He can answer the question
22 without telling what someone else -- without hearsay,
23 telling what someone said to him.

24 THE WITNESS: I discussed actively, in an
25 interactive conversation, with a group of people --

1 and I can identify who those were -- on February 14,
2 2011. On the phone call was Cheryl Flomm [phonetic]
3 from the IRS's National Office. I believe it was
4 Matt Parish [phonetic], but it was someone whose name
5 was Parish.

6 MR. MARKLEY: Okay. I was going to move to
7 strike, because he's already been -- now he's
8 answering the question that you already ruled upon
9 that he shouldn't answer.

10 THE COURT: I move to strike that last
11 sentence. If you could just move on to the next
12 question --

13 BY MR. ALBRIGHT:

14 Q Were you involved in the decision to
15 withdraw the ruling request?

16 A Yes.

17 Q And why did you withdraw the ruling
18 request?

19 A Because I concluded that the Service will
20 never issue a tax-exempt determination letter and
21 then shut down their program. No matter what we said
22 in the application, it would be denied.

23 Q And was your conclusion based on
24 conversations that you had with the IRS National
25 Office?

1 MR. MARKLEY: Back-door hearsay, Your
2 Honor. Well, actually it's yes or no. I guess it's
3 not. It's a premature objection.

4 THE COURT: You can answer the question.

5 THE WITNESS: Yes. Yes, it was based on my
6 conversations with the IRS's National Office,
7 extended conversations with them.

8 BY MR. ALBRIGHT:

9 Q And did anybody ever tell you why there
10 wouldn't be any favorable rulings issued?

11 A Yes.

12 Q Do you recall what you were told?

13 MR. MARKLEY: Objection. Hearsay.

14 THE COURT: I'll sustain.

15 MR. ALBRIGHT: Your Honor, may I make an
16 offer of proof?

17 THE COURT: Yes.

18 MR. ALBRIGHT: By asking Mr. Feldman
19 questions?

20 MR. MARKLEY: Well, it's your decision. As
21 I understand offer of proof, it just comes in, and
22 we'll find out whether the Court can rule one way or
23 the other, as opposed to the admissibility of what it
24 is that this witness would actually testify about.
25 Is that -- am I correct about that?

1 THE COURT: So I'm not sure what --

2 MR. ALBRIGHT: Your Honor, I understand --

3 I don't profess to be an expert in offers of proof,
4 but I understand that it is one way, putting
5 information into the record that reflects further
6 information about the evidence that was being
7 submitted, so that if the case were to go on appeal
8 or considered by someone else, that the appellate
9 judges would have that information available to them.

10 MR. MARKLEY: I think that's pretty close
11 to what I think, too. I think an offer of proof is
12 that you ask this witness a question. You've already
13 ruled on -- you've already ruled, so Mr. Albright's
14 going to ask him a question that wouldn't come in for
15 this trial determination purposes, but he's
16 preserving the record for appeal. So I think that's
17 right.

18 THE COURT: Yes.

19 MR. ALBRIGHT: So is it okay to ask him a
20 question?

21 THE COURT: Yes.

22 OFFER OF PROOF ON BEHALF OF PETITIONER

23 BY MR. ALBRIGHT:

24 Q What exactly were you told that led you to
25 believe that you would no longer be able to get any

1 501(c) (15) favorable determination letters?

2 A In my conversation with -- well, what I was
3 told on Valentine's Day, February 2011, February 14,
4 was that the Service would not rule affirmatively on
5 any rulings, no matter what was put into it, put in
6 the application, no matter what was reflected. And
7 in the interactive discussion as to why, we were
8 told, quote, There's a new sheriff in town, unquote.

9 Q And did anyone give you any other reason as
10 to why the Service changed directions?

11 A Quite the contrary. They dodged any
12 technical issue. They just said, New sheriff in
13 town; we're not going to issue any more rulings.
14 We've made that decision at the National Office.
15 Absolutely you can do whatever you want; they're
16 going to be denied.

17 (Whereupon, the offer of proof was
18 concluded.)

19 BY MR. ALBRIGHT:

20 Q Now, Mr. Feldman, did you -- you're aware
21 that Capstone prepared a feasibility study for
22 Reserve Casualty Corporation or for -- not for
23 Reserve Casualty Corporation but for --

24 A Peak Mechanical.

25 Q -- Peak Mechanical.

1 A Capstone produced it jointly with Willis,
2 and with input from The Feldman Law Firm. It was a
3 joint effort.

4 Q And were you involved in the feasibility
5 study?

6 A Yes. I traveled to Osburn, Idaho, a long
7 way.

8 Q And who went with you?

9 A Mr. McNeel.

10 Q Do you recall when you went on Capstone's
11 feasibility study trip?

12 A August 2008. Flew into Spokane and drove
13 two hours plus to Osburn.

14 Q And what did you do on this trip?

15 A We discussed the documents that they had
16 given us up to that point in time, and I don't recall
17 which they gave us in advance and which they gave us
18 afterwards. We discussed their products, their
19 remanufacturing and their manufacturing operation,
20 and they actually manufacture -- actually build
21 trucks from the ground up. They build trucks.

22 We discussed and saw their ventilation
23 fans, which they manufacture or rehabilitate and sell
24 and install; saw their pump operation. There were, I
25 think, three different locations, maybe four

1 different locations we saw, including the truck
2 manufacturing operation, and we saw the -- and
3 discussed the Superfund issues.

4 Several of the sites of the company are
5 located on Superfund sites where you can't put a
6 shovel in the ground without permission. It's a
7 toxic area. I'm not sure I would want to office
8 there, but they were officing there. Actually not
9 only officing there, but all their facilities were on
10 Superfund sites.

11 And we evaluated the business and the risks
12 against their conventional policies. So on the one
13 hand, you look at the range of policies that the
14 company has from the conventional markets, and then
15 you look at the actual risks of the business, and you
16 see whether they match or don't match, and you see
17 where the holes are, the gaps in coverages, and try
18 to plug those holes through an alternative risk type
19 of procedure.

20 MR. ALBRIGHT: Now, Your Honor, may I
21 provide Mr. Feldman with a copy of Exhibit 16-J?

22 THE COURT: Yes.

23 MR. ALBRIGHT: And may I assist him in
24 finding it?

25 THE COURT: Yes.

1 (Pause.)

2 BY MR. ALBRIGHT:

3 Q Mr. Feldman, would you turn -- well, first
4 of all, are you familiar with Exhibit 16-J?

5 A Yes.

6 Q And what is Exhibit 16-J?

7 A It's a copy of the final feasibility study
8 that was done for Peak Mechanical and their
9 affiliates back in 2008.

10 Q If you would turn to page 5998 --

11 A Yes, sir.

12 Q And there's a section in here where it
13 discusses 501(c)(15) and 831(b) captive insurance
14 companies.

15 A Yes.

16 Q Why would this be included in the
17 feasibility study?

18 A Well, I think there are a couple of
19 reasons. One is, you know, we're lawyers. We're
20 joining in the feasibility study. What we're paid to
21 do is advise the client on the consequences of a
22 transaction. The -- I don't think I've ever been
23 involved in a transaction where I didn't advise a
24 client or at least bring to the client's attention
25 tax consequences of the transaction.

1 Here an insurance company was being formed,
2 and we needed to advise the client as to the tax
3 consequences of doing it and the sections of the Code
4 under which it would operate or try to operate.

5 Insurance companies are, in many ways, controlled or
6 guided by the Internal Revenue Code, just because of
7 the nature of it being and having -- just the nature
8 of an insurance company, where they're taking in
9 premiums and establishing reserves against those
10 premiums.

11 So those sections of the Code are -- were a
12 small part of -- or a part of the overall discussion
13 with the client of the corporate tax financial
14 consequences of the transaction.

15 Q And so has Capstone ever been involved with
16 a captive insurance company that started out as a
17 501(c)(15) that later becomes an 831(b)?

18 A Many times. Sometimes they become 831(a)s.

19 Q So would you explain the progression, if
20 you would, please.

21 A Well, under the Internal Revenue Code, if
22 you meet the criteria for 501(c)(15), legislatively
23 you're mandated into that reporting. You can get a
24 tax-exempt determination letter. At least, you could
25 for a couple of decades, but if you fit within the

1 criteria of 501(c)(15), that's where you report.
2 831(b) is an election process, and 831(a) is another
3 statutory provision.

4 So a company could start off -- let's say,
5 if a company is growing and they're doing, as this
6 one did, \$10 million in revenue, they might have a
7 dozen policies that are appropriate that need
8 coverage, and if they grew from 9 or \$10 million to a
9 hundred million dollars, the company may have the
10 need for more coverage or coverages in other areas,
11 either larger policies or lower deductibles or more
12 coverage areas or just more limits.

13 The company then may be structured as an
14 831(b) transaction or an 831(a). 831(a) could be
15 anything from a company with -- at this point in
16 time, with \$1.2 million of premiums or more, right up
17 to several billion dollars of premiums. So 1.2
18 million to several billion, unlimited, would be an
19 831(a). 831(b) would be below 1.2 million, and that
20 would wrap around the 501(c)(15).

21 Q So if in the first year the captive
22 insurance company had receipts greater than \$600,000
23 -- let's say, it had \$650,000 -- what would happen?

24 A It could not, could not ever report as a
25 501(c)(15). It's impossible.

1 Q So how would it reporting those
2 circumstances?

3 A It may report as an 831(b) if it has -- if
4 it elects -- so elects, or it would report as an
5 831(a).

6 Q And so the difference between --

7 A So --

8 Q -- a 501(c)(15) and an 831(b) in terms of
9 taxation would be what?

10 A 501(c)(15) is tax-exempt on the
11 underwriting profits and on the investment income.
12 It's a little like a Roth IRA, so to speak. All the
13 activities of the company are tax-exempt, provided
14 you meet the stringent rules or the rules of
15 501(c)(15).

16 If you don't meet those, you may be an
17 831(b) or an 831(a). 831(b) is taxable on the
18 investment income, but the underwriting profits are
19 tax-exempt.

20 If I could just add one more thing, from --
21 all this is based on accounting rules. Insurance
22 companies are divided into two. All the revenue of
23 an insurance company is divided into two. It's
24 either underwriting activities or investment
25 activities, so the world is composed of just those

1 two.

2 Under 501(c)(15), both halves of that
3 circle are taxed the same at zero. When I say, zero,
4 the activities of the company. When the company is
5 liquidated, it's taxable. 831(b), the underwriting
6 activities are not taxed --

7 MR. MARKLEY: Your Honor, I --

8 THE WITNESS: The investment activities --

9 MR. MARKLEY: I'm sorry. I'm listening,
10 because I thought I understood that we were just
11 going to end at a certain point, but I think it's --
12 Mr. Feldman's testifying more as a tax expert now. I
13 object on going beyond the scope -- or not beyond the
14 scope -- going into your province.

15 THE COURT: I sustain the objection. So
16 we'll just -- the answer was going into more detail
17 than I was expecting. So the last sentence is
18 stricken.

19 (Page 693 and subsequent pages enclosed
20 under separate cover.)

21

22

23

24

25

1 CERTIFICATE OF TRANSCRIBER AND PROOFREADER

2 CASE NAME: Reserve Mechanical Corp, f.k.a. as

3 Reserve Casualty Corp. v. Commissioner

4 DOCKET NO.: 14545-16

5 We, the undersigned, do hereby certify that the
6 foregoing pages, numbers 597 through 692, inclusive,
7 are the true, accurate and complete transcript
8 prepared from the recording made by electronic
9 recording by Leslie Berridge, on May 1, 2017, before
10 the United States Tax Court at its session in
11 Houston, Texas, in accordance with the applicable
12 provisions of the current verbatim reporting contract
13 of the Court, and have verified the accuracy of the
14 transcript by comparing the typewritten transcript
15 against the verbal recording.

16

17 _____

18 Anita Tyler 05/24/2017

19 (Transcriber) (Date)

20

21 _____

22 Laurel H. Stoddard 05/25/2017

23 (Proofreader) (Date)

24

25

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IN THE UNITED STATES TAX COURT

In the Matter of:)
)
RESERVE MECHANICAL CORP., f.k.a.)
RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
v.)
)
COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

Volume: 9
Pages: 693 through 791
Place: Houston, Texas
Date: May 1, 2017

1 IN THE UNITED STATES TAX COURT

2

In the Matter of:)
)
 RESERVE MECHANICAL CORP., f.k.a.)
 4 RESERVE CASUALTY CORP.,)
)
 5 Petitioner,) Docket No. 14545-16
)
 6 v.)
)
 7 COMMISSIONER OF INTERNAL REVENUE,)
)
 8 Respondent.)

9 Room 7006
 Casey U.S. Courthouse
 10 515 Rusk Avenue
 Houston, Texas

11 May 1, 2017

12 The above-entitled matter resumed for
 13 trial, pursuant to recess, at 9:13 a.m.

14 BEFORE: HONORABLE KATHLEEN KERRIGAN
 15 Judge

16 APPEARANCES:

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C O N T E N T S

WITNESSES:	DIRECT	CROSS	REDIRECT	RECROSS	VOIR DIRE
For Petitioner:					
Stewart Feldman	697	755			
For Respondent					
None					

1	E X H I B I T S		
2	EXHIBITS:	IDENTIFIED	RECEIVED
3	28-P	(previously)	719
4	29-P	(previously)	720
5	30-P	(previously)	721
6	126-P & 127-P	(previously)	746
7	128-P	(previously)	744
8	129-P	(previously)	742
9	133-P	730	734
10	134-P	746	

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1 P R O C E E D I N G S

2 DIRECT EXAMINATION (CONTINUED)

3 BY MR. ALBRIGHT:

4 Q Mr. Feldman, why is it important for
5 someone like yourself to go out on a site visit?

6 A Well, I think it's definitely critical for
7 the people designing the company, designing the
8 alternative risk planning structure to go out. I
9 provide the background from having done 200
10 feasibility studies and appreciating the significant
11 difference between the liability of a distributor and
12 the liability of a manufacturer. I don't think most
13 insurance people understand that nuance.

14 So since this particular client was --
15 actually manufactured vehicles -- just didn't sell
16 vehicles; they actually manufacture trucks that went
17 7,000 feet underground in operating them -- I wanted
18 to see that operation, to see whether they crossed
19 the line from being a distributor to a manufacturer.
20 And that same issue runs to the pump business that
21 they had and the ventilation, basically life science
22 services, which they were providing for people that
23 are underground, a mile and a half underground. So I
24 wanted to understand that.

25 And I wanted to educate the clients, meet

1 them. If I was going to take on the representation
2 of a client, I wanted to meet them and eyeball them
3 face to face.

4 Q During 2008, 2009, and 2010, did Capstone
5 charge for captive feasibility studies?

6 A Of course.

7 Q Do you recall how much they would have
8 charged? Do you recall how much Capstone would have
9 charged?

10 A It would have been about \$15,000, including
11 travel for two people up and back to Idaho.

12 Q Is there a reason that you charge for
13 captive feasibility studies?

14 A Well, I mean, we're a for-profit business.
15 We're in the business of making a living. It's a
16 service between Capstone and the law firm. It's a
17 professional service, and the client has no
18 obligation to go beyond the feasibility study.
19 Sometimes they do; sometimes they don't. Sometimes
20 we conclude that it doesn't make any sense.

21 So we certainly don't want to -- with all
22 due respect to Osburn, Idaho, we don't want to be
23 traveling, taking two-and-a-half days out of our
24 lives, traveling up to Osburn, Idaho, and come back
25 and just say, Look, it doesn't make any sense to do,

1 because if we did that, our costs would have to be
2 distributed to someone else. So the idea is let
3 every ship sit on its own bottom, and we charge
4 people to do the feasibility study, and they're
5 welcome to go forward with the planning if it makes
6 sense after that or not. It's totally up to them.

7 Q So you're saying that they're not locked in
8 to doing a -- to creating a captive insurance company
9 at the time the feasibility study is done.

10 A Exactly. And that -- a lot of feasibility
11 studies don't continue on to a captive. Not only are
12 they not locked in; we're not locked in, because
13 we've got to be comfortable with it.

14 Q You have to be comfortable with what?

15 A That it makes sense.

16 Q Do you -- does Capstone undertake to form
17 captive insurance companies without insurance
18 professionals doing an on-site visit to the
19 facilities?

20 A It would be rare. It would be rare --

21 Q And --

22 A -- that that would happen.

23 Q -- why is that?

24 A Why is --

25 Q Why would you -- why do you have to have a

1 site visit to -- from Capstone's perspective, to move
2 forward with a captive insurance company?

3 A Well, Capstone is charged with the
4 responsibility of helping to design the coverages and
5 price the -- assist in pricing the coverages and
6 adjusting the losses, manuscripting the policies.

7 So just like a conventional insurance
8 company, a commercial insurance company, if it were
9 doing work for a significant client would send people
10 on premises to look at the premises, because you
11 learn a whole lot by looking at the premises --
12 sometimes you get there, and you say -- and they're a
13 mess, and you say, I don't want to do business with
14 this company.

15 So Capstone goes there, looks at the
16 premises, and then looks at the policies relative to
17 those, and asks a lot of questions of a lot of
18 different people. And, again, it mimics what's done
19 in the conventional markets.

20 MR. ALBRIGHT: Your Honor, may I provide a
21 copy of Exhibit 24 to Mr. Feldman?

22 THE COURT: Yes.

23 MR. ALBRIGHT: May I come up and assist?

24 MR. ALBRIGHT: Yes.

25 (Pause.)

1 BY MR. ALBRIGHT:

2 Q Do you have Exhibit 24 in front of you?

3 A I do.

4 Q And the parties have stipulated that this
5 is the unaudited financial statement for Reserve
6 Casualty Corporation for the quarter and year ending
7 December 31, 2008.

8 A Yes.

9 Q And I believe I asked you about this
10 particular document in connection with asking you
11 about the 1024 application.

12 A Correct.

13 Q But, again, just to be clear, do you know
14 how Exhibit 24-J was prepared?

15 A Yes.

16 Q And how was it prepared?

17 A It was prepared by Capstone as directed by
18 Reserve. Capstone provided administrative services,
19 bookkeeping services for -- accounting services, I
20 guess, for Reserve Casualty Corp. Capstone staff
21 received the source documents directly from the
22 financial institutions, American Bank, Banner Bank,
23 D.A. Davidson.

24 It composes just the information into the
25 computer system, the Sage 50 computer system, which

1 used to be called Peachtree Complete Accounting.

2 That's used to generate a trial balance and a general
3 ledger, unaudited financial statements, and
4 ultimately the audit for report, independent audit
5 report, and also filings to the Government.

6 Q Okay. If you would, turn to page 5785.

7 And this is in Exhibit 24-J.

8 A Yes, sir.

9 Q And if you look at the -- this looks like
10 an income statement.

11 A It is.

12 Q And it's for what period?

13 A 2008.

14 Q And can you tell -- what is that line item
15 there, Affiliated DW premiums?

16 A That's affiliated direct written premiums.
17 Those are premiums that the various insureds that are
18 controlled by Mr. Zumbaum and Mr. Weikel pay to the
19 captive.

20 Q Okay. And the captive being Reserve.

21 A Reserve, yes.

22 Q And the second line item there that says,
23 Other reinsurance assumed, do you see that?

24 A I do.

25 Q And what does that line item represent?

1 A That is retroceded insurance from Linden
2 Insurance through PoolRe and on to Reserve. It's the
3 CreditRE program or Credit Reassurance Corp. program.

4 Q And how much were the premiums from that?

5 A 69,500.

6 Q And then there's also a line item there,
7 PoolRe Insurance assumed. Do you see that?

8 A Yes, sir.

9 Q What is that?

10 A That is the premium from the quota share
11 program, wherein Reserve and the insureds participate
12 in a risk diversification program with, in that year,
13 maybe 55 other captives, about 50 captives, 500
14 different policies, 150 other insureds, unaffiliated
15 insureds.

16 Q And can you determine from -- it looks like
17 there's net written premiums, \$481,589.02.

18 A Yes, sir.

19 Q And what would that represent in terms of
20 the captive insurance company's revenues?

21 A That would be gross receipts.

22 Q Gross receipts.

23 A Right. 100 percent of the gross receipts.

24 Q And can you tell from looking at these
25 numbers? How would you calculate the percentage that

1 \$69,500 and \$76,236.47 represents of the total net
2 written premiums? Could you do that?

3 A Yes.

4 Q And how would you do it?

5 A I'd add 69,500 to 76,236.47, and divide
6 that result by 481,589.02.

7 Q And do you know approximately what that
8 number would be?

9 A Greater than 30 percent. If you want, I'll
10 calculate it. It's certainly greater than 30
11 percent.

12 Q Okay. Now, look at the line item down
13 there that says, Reinsurance commissions. Do you
14 know what that is?

15 A Yes.

16 Q And what is that?

17 A Those are commissions that Reserve paid to
18 third parties, unaffiliated with themselves,
19 unaffiliated with us, for the reinsurance that they
20 assumed.

21 Q And what is loss expenses? There's a
22 number there of 170,328.14. What is that made up of?

23 A It's made up of the -- I guess I would call
24 it, the -- those are the debits, the expenses,
25 associated with the case reserves and incurred but

1 not reported, and actually paid claims, so it would
2 all be lumped in there. That's what the expense
3 would be. It would be the provision for loan losses
4 -- for insurance losses.

5 Q Now, if you would, please, can you turn to
6 Exhibit 25-J.

7 A (Complying.)

8 Q Do you have that exhibit in front of you?

9 A I do.

10 Q And are you familiar with Exhibit 25-J?

11 A Yes, sir.

12 Q And what is Exhibit 25-J?

13 A It's the financial statements for the
14 quarter -- for the year ending December 31, 2009, for
15 Reserve Casualty Corp., along with a balance sheet as
16 of December 31, 2009.

17 Q And if you turn to --

18 A And footnotes.

19 Q I'm sorry.

20 A And the footnotes to the financials.

21 Q And if you turn to the page that's labeled
22 5510 in the lower right-hand corner --

23 A I'm there.

24 Q So in the revenue -- in the revenues,
25 there's a line item, Affiliated DW premiums. What is

1 that?

2 A The same as the -- the same as for the year
3 2008. It's the direct written premiums that were
4 written by the insureds, the companies that Norm and
5 Corey own over to the captive. And that was 365,000
6 and change.

7 Q Okay. And then the next item there, it
8 looks like QS PoolRe NS assumed. What is that?

9 A That's the quota share PoolRe Insurance
10 assumed. That's the retroceded portion of the
11 insurance that relates to the quota share, which is
12 the result of the stop-loss.

13 Q And then what about the other reinsurance
14 assumed?

15 A That's all CreditRE Insurance Corp.
16 business.

17 Q And just to be clear, what is that number?

18 A 76,500.

19 Q And quota share PoolRe insurance assumed
20 was how much?

21 A \$82,903.

22 Q And so if you were going to calculate what
23 the reinsurance income was, those last two line
24 items, of the total net written premiums, how would
25 you do that?

1 A You would take as the denominator
2 \$524,627.01, and as the numerator, the sum of 82,903
3 and 76,500.

4 Q Okay.

5 A That would --

6 Q And do you know what that percentage would
7 be?

8 A It's greater than 30 percent.

9 Q Is there a reason that's greater than 30
10 percent?

11 A Yes.

12 Q What is the reason?

13 A It's commonly accepted in the insurance
14 industry. It's commonly accepted by the Sixty
15 Circuit, revenue rulings --

16 MR. MARKLEY: I have to object what's
17 commonly accepted. Outside of the industry, that's
18 fine, but not the Sixth Circuit.

19 MR. ALBRIGHT: He's just explaining his
20 understanding of the -- of this, Your Honor. It's
21 not binding on anyone.

22 MR. MARKLEY: And that's exactly why he
23 shouldn't be testifying about it, because it's the
24 Court's decision with what's accepted by any other
25 circuit. It's not -- he's giving a legal opinion

1 about what the Sixth Circuit thinks, which has no
2 relevance for his testimony.

3 THE COURT: I'm going to sustain the
4 objection.

5 BY MR. ALBRIGHT:

6 Q Now, Mr. Feldman, if you would look on 5510
7 -- stay with me on 5510 for a second.

8 A I'm there.

9 Q Do you see the reinsurance commissions down
10 there?

11 A I do.

12 Q And what would that number represent?

13 A Reinsurance commissions related to the
14 retroceded CreditRE insurance portion.

15 Q And then I see loss expenses of
16 \$495,789.47.

17 A Yes.

18 Q Do you know -- that number -- is that
19 number high for that year?

20 A There was a large loss that year.

21 Q A large loss? Do you know what it was?

22 A It was a adjudicated loss under the loss of
23 B-to-B customer or loss of major customer policy that
24 existed for Reserve. It was about a \$325,000 paid
25 claim.

1 Q And do you know whether Reserve would have
2 been paying claims under the CreditRE reinsurance
3 arrangement?

4 A Yes.

5 Q And would it have paid claims in all three
6 years, 2008, 2009, and 2010?

7 A Yes.

8 Q And would that -- would those payments --
9 those claims paid, would they be included in that
10 \$495,789.47?

11 A Yes.

12 Q The portion that related to 2009 would be
13 in that number.

14 A Yes.

15 MR. ALBRIGHT: Your Honor, I'd like to
16 provide Mr. Feldman with a copy of Exhibit 26-J.

17 THE COURT: Okay.

18 (Pause.)

19 BY MR. ALBRIGHT:

20 Q Now, are you familiar with Exhibit 26-J?

21 A I am.

22 Q What is Exhibit 26-J?

23 A It's the unaudited financial statements of
24 Reserve Casualty Corp., the year ending December 31,
25 2010, and the balance sheet as of that date.

1 Q And if you would, please -- so are you
2 familiar with the way that this financial statement
3 was prepared?

4 A I am.

5 Q Okay. If you would turn to the page with
6 the 5518 in the lower right-hand corner --

7 A Yes, sir.

8 Q And do you see in the revenue column that
9 looks like, Affiliated DW premiums?

10 A Yes.

11 Q What is that?

12 A Same as it was for the other two years. It
13 was the direct written premiums from the companies
14 owned by Mr. Zumbaum and Weikel, payable directly --
15 paid directly to the captive.

16 Q And then the next line item is, QS pool.
17 What is that?

18 A It's the quota share PoolRe insurance
19 assumed. That's the quota share portion that's
20 assumed by Reserve Casualty Corp. and results from
21 the stop-loss policies that were paid to the pool, to
22 PoolRe Insurance Corp.

23 Q And can you tell what the premiums were for
24 that line item for that year from looking at this?

25 A Premiums that were -- premiums from whom to

1 whom?

2 Q For the quota share PoolRe Insurance
3 assumed.

4 A Yes.

5 Q And what --

6 A 88,617.

7 Q Okay. And then what is the line item,
8 Other reinsurance assumed?

9 A Same as for the other two years. It's the
10 Credit Reassurance Corp. retroceded insurance from
11 Linden.

12 Q Okay. And so the total net written
13 premiums for the year would be what?

14 A \$511,314.

15 Q Okay. And so if you were going to
16 determine the percentage of the quota share PoolRe
17 Insurance assumed and the other reinsurance assumed
18 premiums, to determine what those premiums
19 represented as a percentage of the total premiums,
20 how would you do that?

21 A I have as a denominator 511.314, and I
22 would divide it by the sum of 88,617 and \$66,000.

23 Q Mr. Feldman, if you would, please, would
24 you turn to Exhibit 27-J. Is that in that book?

25 A Yes.

1 Q Are you familiar with this document?

2 A I am.

3 Q And how is it that you're familiar with
4 this document?

5 A I reviewed it as it was being prepared, and
6 I approved the final version, and I had available to
7 me the detailed financial information that was
8 compiled and tied into and traced into the numbers in
9 this statement.

10 Q And if you would turn to page 5533 --

11 A Yes, sir.

12 Q Can you tell from looking at this what the
13 losses that were paid in 2010 were?

14 A Yes.

15 Q And how much were they?

16 A \$56,399.

17 Q And would that include any loss and loss
18 adjustment expense paid?

19 A I'm sorry. Once again?

20 Q Would it also include loss adjustment
21 expense paid?

22 A Yes.

23 Q And what about 2009?

24 A \$471,312.

25 Q Now, would that be the amount for 2009, or

1 would that be the amount from inception to December
2 31, 2009?

3 A These financial statements are from
4 inception. You would typically, in most
5 jurisdictions, not do an audit of -- for a couple of
6 months. So the tail of '8 and all of '9 was included
7 in one audit. And then '10 is a stand-alone year.
8 '11 is a stand-alone year. '12 is a stand-alone
9 year. But the first year here would include the stub
10 portion of the prior year.

11 Q And can you tell whether Reserve, from
12 looking at this Exhibit 27-J, can you tell whether
13 Reserve Casualty Corp. met the minimum margin of
14 solvency it was required to meet?

15 MR. MARKLEY: Well, I have to object, Your
16 Honor. I think he -- this may be a question getting
17 into potential expert-type testimony about what the
18 solvency that was required. I assume that's in
19 Anguilla, so I think we've had an expert witness on
20 that already, and I think this witness shouldn't be
21 allowed to testify about that and has not been
22 qualified to that position.

23

24 MR. ALBRIGHT: Well, Your Honor, Mr.
25 Feldman is chief executive officer of Capstone. he

1 is an accountant. He --

2 THE COURT: I'm going to overrule the
3 objection.

4 MR. ALBRIGHT: Okay.

5 BY MR. ALBRIGHT:

6 Q Can you tell from looking at this financial
7 statement whether Reserve Casualty Corp. met the
8 minimum margin of solvency in Anguilla for from
9 inception through December 31, 2010?

10 A I can.

11 Q You say you can or can't?

12 A I can.

13 Q Okay. And how do you determine that?

14 A The margin of solvency would be the -- in
15 Anguilla is the statutory minimum. This is the
16 minimum solvency margin. It would be the \$100,000
17 capital plus the approximately \$209,000 of
18 liabilities.

19 Q Is that 209,000 or is that 307-?

20 A Are we talking about '9 or '10?

21 Q Oh, I'm sorry. I believe we're talking
22 about -- if you turn to page 5534 --

23 A I was on 26.

24 Q Oh, I'm sorry.

25 MR. MARKLEY: That's where I was, too.

1 BY MR. ALBRIGHT:

2 Q 26? Well, let's go to 26.

3 A 5526 in Exhibit 27.

4 Q Okay. Go ahead.

5 A So just tell me which year you want.

6 Q Well, let's start with 2009.

7 A Okay. The minimum margin of solvency in
8 Anguilla would be the statutory minimum -- I'm sorry
9 -- the stated capital, which is \$100,000, which is
10 the minimum, plus the liabilities of the company,
11 209,753, and the admissible assets or the admitted
12 assets have to -- at least have to be greater than
13 that.

14 Q Okay. And can you tell whether they are
15 greater than that number in this financial statement?

16 A Yes. Just by eye-balling it, I can see
17 that, because we're dealing with quoted securities.
18 Those would be listed securities, marketable
19 securities, that are traded on recognized exchanges.

20 Q And what about for 2010?

21 A It's the same calculation. It's \$100,000
22 plus the 307,262. So it would be 407-. And 2010,
23 the quoted securities on their own were more than
24 that amount. So -- but again, that's the minimum
25 margin of solvency, the absolute minimum. You don't

1 go below that.

2 Could I request a break at this time?

3 THE COURT: Yes. We can take a break till
4 quarter of 4:00.

5 THE WITNESS: Thank you, Your Honor.

6 THE CLERK: All rise.

7 (Whereupon, a short recess was taken.)

8 THE CLERK: All rise.

9 Please be seated.

10 MR. ALBRIGHT: Your Honor, I have some
11 missing papers here. Just give me a second.

12 (Pause.)

13 MR. ALBRIGHT: Your Honor, I'm missing some
14 papers here. I apologize.

15 THE COURT: We'll go off the record for a
16 minute.

17 (Off the record.)

18 MR. ALBRIGHT: Your Honor, may I provide
19 Mr. Feldman with a copy of Exhibit 125-P?

20 THE COURT: Yes.

21 (Pause.)

22 THE WITNESS: Yes, sir.

23 BY MR. ALBRIGHT:

24 Q Do you have a copy of Exhibit 125-P in
25 front of you?

1 A I do.

2 Q And can you tell me what it is.

3 A It's the audited financial statement by the
4 independent CPAs, Liptz & Associates, of Reserve
5 Casualty Corporation, for the period of inception
6 through December 31, 2009, and the balance sheet as
7 of December 31, 2009.

8 Q And would you have reviewed this audited
9 financial statement prior to the time that it was
10 finalized?

11 A I would be part of the team that finalized
12 it and prepared it.

13 MR. ALBRIGHT: Your Honor, may I provide
14 Mr. Feldman with a copy of Exhibit 28-P?

15 THE COURT: Yes.

16 (Pause.)

17 THE WITNESS: I have it in front of me.

18 BY MR. ALBRIGHT:

19 Q Mr. Feldman, do you know what Exhibit 28-P
20 is?

21 A Yes.

22 Q What is it?

23 A It's the general ledger of Reserve Casualty
24 Corporation for 2008.

25 Q And how is it that you know what Exhibit

1 28-P is?

2 A It's prepared by Capstone, ultimately under
3 my guidance. I reviewed it and the results of the
4 general ledger, in the context of preparing part of
5 125-P, and lots of other reports to regulators.

6 Q Were the entries in Exhibit 28-P made at or
7 near the time by or from information transmitted by
8 someone with knowledge?

9 A Transmitted by someone with what?

10 Q With knowledge.

11 A Yes.

12 Q Were the entries in Exhibit 28-P made and
13 kept in the course of a regularly conducted activity
14 by Capstone or the regularly conducted activities of
15 Reserve Casualty Corporation?

16 A Yes.

17 Q Was the making of entries in Exhibit 28-P a
18 regular practice of Capstone on behalf of Petitioner,
19 Reserve Casualty Corp.?

20 A Yes.

21 Q Mr. Feldman, as the CEO of Capstone, were
22 the records from which Exhibit 28-P maintained under
23 your direction and control?

24 A Yes.

25 Q Mr. Feldman, do you have any reason to

1 believe that Exhibit 28-P does not reflect the
2 transactions engaged in by Petitioner as recorded by
3 Capstone on behalf of Petitioner?

4 A I have no basis for that at all.

5 Q Mr. Feldman, is Exhibit 28-P a printout of
6 the general ledger that is maintained by Capstone for
7 Petitioner on Capstone's computer system that is used
8 to record the transactions that are reflected on the
9 printout?

10 A Yes.

11 MR. ALBRIGHT: Your Honor, I move Exhibit
12 28-P into evidence.

13 MR. MARKLEY: No objection.

14 THE COURT: 28-P is admitted.

15 (The document referred to, having been
16 previously marked for identification as
17 Petitioner's Exhibit 28-P, was received in
18 evidence.)

19 BY MR. ALBRIGHT:

20 Q Mr. Feldman, could you turn to Exhibit 29P.

21 A I am there.

22 Q And what is Exhibit 29-P?

23 A It's the general ledger of Reserve Casualty
24 Corp. for 2009.

25 MR. MARKLEY: Assuming that the -- Your

1 Honor, assuming the questions and answers are the
2 same, I would not object to this, assuming it's being
3 offered.

4 MR. ALBRIGHT: I'm happy to lay a
5 foundation, Your Honor. But I'm also happy to offer
6 it in evidence.

7 THE COURT: Okay. Why don't you offer it
8 into evidence.

9 MR. ALBRIGHT: Well, let me ask this
10 question, though, just for the record.

11 BY MR. ALBRIGHT:

12 Q Mr. Feldman, if I were to ask you the same
13 series of questions that I asked you about Exhibit
14 28-P, would your answers be the same with respect to
15 Exhibit 29-P?

16 A Yes.

17 MR. ALBRIGHT: Your Honor, Petitioner
18 offers Exhibit 29-P into evidence.

19 MR. MARKLEY: No objection, Your Honor.

20 THE COURT: 29-P is admitted.

21 (The document referred to, having been
22 previously marked for identification as
23 Petitioner's Exhibit 29-P, was received in
24 evidence.)

25 BY MR. ALBRIGHT:

1 Q Mr. Feldman, would you please turn to
2 Exhibit 30-P.

3 A I'm there.

4 Q And what is Exhibit 30-P?

5 A It is the general ledger of Reserve
6 Casualty Corp. for the calendar year 2010.

7 Q And if I asked you the same series of
8 questions that I asked you about the 2008 general
9 ledger, that was Exhibit 28-P, and I asked you those
10 questions with respect to Exhibit 30-P, would your
11 answers be the same?

12 A Yes, sir.

13 MR. ALBRIGHT: Your Honor, I offer Exhibit
14 30-P into evidence.

15 MR. MARKLEY: No objection.

16 THE COURT: 30-P is admitted.

17 (The document referred to, having been
18 previously marked for identification as
19 Petitioner's Exhibit 30-P, was received in
20 evidence.)

21 BY MR. ALBRIGHT:

22 Q Now, Mr. Feldman, if I -- can you -- do you
23 still have Exhibit 28-P in front of you?

24 A Yes.

25 Q And can you tell by looking at Exhibit 28-P

1 what the losses that were paid to -- on the CreditRE
2 reinsurance by Reserve in 2008?

3 A (Perusing document.) Yes.

4 Q And what were those losses?

5 A I just want to confirm --

6 MR. MARKLEY: Could we have a page number,
7 please.

8 THE WITNESS: Yes. Just give me a second
9 here. (Perusing document.) I'm on page 4 of that
10 exhibit, 4 of Exhibit 28-P. Top right-hand corner
11 has the number 4, and I'm now at general ledger
12 account number 50100, loss expense, journal entry for
13 -- as of December 31, an AJE or general ledger --
14 general journal entry of \$61,160.

15 BY MR. ALBRIGHT:

16 Q And just to be clear, the \$61,160 was paid
17 -- what did that represent?

18 A Paid losses for the Credit Reassurance
19 Corp. program.

20 Q And these are amounts that were paid by --

21 A Yes. This is in the expense portion of the
22 general ledger. That was the payment made.

23 Q And if you would, please, would you turn to
24 Exhibit 29-P.

25 A Yes.

1 Q And in reviewing Exhibit 29-P, can you tell
2 from reviewing this what the losses that were paid in
3 the CreditRE reinsurance program by Petitioner in
4 2009?

5 A Yes. It would be the sum of the quarterly
6 amounts.

7 Q Okay. And where would you find that in
8 Exhibit 29-P?

9 A Account number 50100, which is loss
10 expenses, looking on page 9 --

11 Q Page 9?

12 A -- continuing on page 10. It'd be the sum
13 of the first quarter amount, which is \$16,830, bottom
14 of page 9; the second quarter amount, which is booked
15 at June 30, 2009, of \$17,682. I'm eliminating the
16 cents.

17 Q 98 cents?

18 A Yes. I was going to eliminate the cents,
19 but if you want the cents, \$17,682.98. The third
20 quarter, which is booked at September 30, 2009, of
21 \$18,207.00; and the fourth quarter, booked at
22 12/31/09, of 17,612.21.

23 Q Okay. And if you would, please, would you
24 turn to Exhibit 30-P.

25 A Okay. I'm there.

1 Q In looking at Exhibit 30-P, can you tell me
2 what losses or what amounts were paid by the
3 Petitioner under the CreditRE reinsurance program.

4 A Okay. Under the CreditRE reinsurance
5 program, page 11 of the general ledger, account
6 number 50100 is likewise divided into four quarters,
7 because there's quarterly cessions. At 3/31/10,
8 there's 11,025.52. On 6/30/10, there's a second
9 quarter amount of 13,193.89. On the third quarter,
10 9/30/10, there's 12,779.58. Fourth quarter, there's
11 19,400.82, booked at 12/31/10.

12 Q And so if you added those four sums, would
13 you get the amount that was paid that was paid to
14 CreditRE by Petitioner under that reinsurance
15 program?

16 A Plus the reinsurance commissions.

17 Q Plus the reinsurance commissions. Can you
18 find the reinsurance commissions in this -- in
19 Exhibit 30-P?

20 A Account 50000.

21 Q Okay.

22 A They're listed right out. For the year, it
23 was \$9,435.19.

24 Q Okay. And so if we went back to -- could
25 you do that for the other years. If we went back to

1 29-P, would you also add the reinsurance commissions?

2 A If the question were, what's the amount of
3 expenses associated with the program --

4 Q Yes.

5 A And then I'd add the reinsurance
6 commissions on page 9 of Exhibit 29.

7 Q 29-P?

8 A 29-P. It's account 50000, reinsurance
9 commissions of \$5,976.56.

10 Q Where is that number?

11 A Page 9. It's the sum of the whole year, of
12 the four quarters.

13 Q Oh, I see.

14 A Do you see that?

15 Q Yes. Okay. And go back to 28-P, and if I
16 were to ask you the same question with regard to 28-
17 P, how would you answer it, if you could?

18 A Reinsurance commission's on page 9 -- I'm
19 sorry. 28-P? I'm on 29. I'm sorry.

20 Q 2008.

21 A Yes. Page 3 of 28-P, bottom of the page,
22 reinsurance commissions, \$8,166.25.

23 Q Okay. Mr. Feldman, does -- for the
24 Capstone-administered captives, captive insurance
25 companies, in the period 2008, '9 and '10, who

1 maintained the bank accounts for those captive
2 insurance companies?

3 A I believe the accounts were at American
4 Bank, which became Banner Bank, and D.A. Davidson,
5 which was a regional financial institution.

6 Q But did Capstone have the authority to
7 withdraw funds from those accounts?

8 A No, no, no, no. We just received copies of
9 the statements. We're the bookkeepers on that issue,
10 so we didn't make the investment decisions or have
11 copies of the checks or have wire transfer authority,
12 anything like that.

13 Q Mr. Feldman, Respondent in his pretrial
14 memorandum states that Petitioner did not prepare
15 annual accounts audited by an independent auditor.
16 Do you know whether this is an accurate statement for
17 the years 2008, '9 and '10?

18 A Sir, once again?

19 Q Respondent in his pretrial memorandum
20 alleges that Petitioner did not prepare annual
21 accounts audited by an independent auditor. Do you
22 know whether this is an accurate statement?

23 A It's false. I mean, we've looked at the
24 audited reports.

25 Q Okay.

1 A Actually I thought they were in the 1024
2 filing.

3 Q Mr. Feldman, Respondent in his pretrial
4 memorandum alleges that Petitioner did not prepare
5 annual actuarial valuation of its assets and
6 liabilities as required by the Anguilla Insurance
7 Act. Do you know whether this is an accurate
8 statement?

9 A Well, the premise is wrong. It's not
10 required by Anguilla.

11 Q So then --

12 A Let me explain it. You wouldn't do an
13 actuarial evaluation of assets.

14 MR. MARKLEY: Well, excuse me. I'm sorry.
15 I'm not sure if Mr. Feldman is actually being kind of
16 indirectly asked to testify as an Anguillan law
17 expert, so I don't think he's qualified to do that.
18 He might know about Anguillan law, but he hasn't been
19 offered as an expert. And I think that's where this
20 question is going to, so I object.

21 THE COURT: I think you can clarify the
22 question.

23 BY MR. ALBRIGHT:

24 Q Respondent in his pretrial memorandum
25 alleges that Petitioner did not prepare annual

1 actuarial valuation of its assets and liabilities as
2 required by the Anguilla Insurance Act. Do you know
3 whether that's an accurate statement?

4 MR. MARKLEY: It's the same objection. I
5 think he has to be an expert to give that opinion,
6 contrary opinion to what the pretrial memo said, I
7 guess.

8 BY MR. ALBRIGHT:

9 Q Mr. Feldman, would Reserve, Petitioner,
10 have ever prepared actuarial -- annual actuarial
11 valuation of its assets and liabilities? Do you know
12 whether it would have been required to do that?

13 A It's not required. I'm glad to explain
14 why, based upon having managed a hundred captives in
15 Anguilla, as a captive -- as a licensed manager.

16 MR. ALBRIGHT: Your Honor, I believe that
17 Mr. Feldman is qualified to answer the question.

18 MR. MARKLEY: That might have been true if
19 he'd been offered as an expert, but he really wasn't.

20 MR. ALBRIGHT: But this is not even a
21 question of law. This is a question of fact --

22 THE COURT: He's asking the question based
23 on his experience.

24 THE WITNESS: So having run a hundred
25 captives in Anguilla over the years, first,

1 respectfully, I don't think -- as you read the
2 statement to me, it doesn't make any sense, because
3 first of all, an actuarial opinion would be of
4 liabilities, not of assets. Actuaries deal with
5 estimating liabilities, not assets. Assets are hard.
6 They're on the balance sheet. They're cash. They're
7 securities.

8 There's an NAIC -- well, first of all,
9 Anguilla doesn't require that of small captives.
10 They look to the National Association of Insurance
11 Commissioners, which recognizes it's uneconomical in
12 the case of small captives.

13 Notwithstanding that, we do draw upon a
14 variety of actuarial data for the line of business.
15 And Anguilla always has accepted that. In fact, our
16 application for Reserve that we looked at a few
17 minutes ago.

18 The initial application to the country to
19 form an insurance company explained that ad hoc
20 actuarial report was not being prepared for Reserve
21 but the methodology that was being followed was
22 described in utmost detail.

23 And I said a hundred. It may be 60
24 captives that we've managed there over the years.

25 MR. ALBRIGHT: Your Honor, may I have this

1 document marked for identification as Petitioner's
2 Exhibit next in order?

3 THE COURT: Yes.

4 MR. ALBRIGHT: And please let the record
5 reflect that I'm handing a copy to Respondent's
6 counsel. (Handing document.)

7 THE CLERK: A letter dated February 2,
8 2009, to Mr. Crabtree, Graham Crabtree, is marked for
9 identification as Exhibit 133-P.

10 (The document referred to was
11 marked for identification as Petitioner's
12 Exhibit 133-P.)

13 MR. ALBRIGHT: Your Honor, may I provide
14 Mr. Feldman with a copy of Exhibit 133-P?

15 THE COURT: Yes.

16 BY MR. ALBRIGHT:

17 Q (Handing document.) Do you have a copy of
18 Exhibit 133-P in front of you?

19 A I do.

20 Q Do you know what this is?

21 A Yes. It was a letter to Graham Crabtree
22 who worked for us in -- on this matter in Anguilla.
23 He's a chartered accountant down there. With a copy
24 to me.

25 Q And what is this about?

1 A This restates or states the policy of the
2 Government of Anguilla that if a company is --

3 MR. MARKLEY: Well, I'm sorry. I have to
4 object as to the witness testifying about a document
5 that has not yet been moved to be in evidence.

6 THE COURT: I'm going to overrule that
7 objection at this time, because I think the questions
8 are trying to lay a foundation.

9 MR. ALBRIGHT: Yes, Your Honor.

10 BY MR. ALBRIGHT:

11 Q So, Mr. Feldman, what is Exhibit 133-P?

12 A It's a letter from the Anguilla Financial
13 Services Commission to Mr. Crabtree, who works for
14 Capstone down in Anguilla, with a copy to me.

15 Q With a copy to you?

16 A Yes.

17 Q Do you know what this letter is about?

18 A Yes.

19 Q And what is it about?

20 A It's about a restatement of the
21 Government's policies that if a company is
22 incorporated in the fourth quarter of a year, that
23 there's no need to have an audited financial
24 statement done for that particular year. And they
25 waive that requirement.

1 Q And so would that have applied to
2 Petitioner?

3 A Yes. We went beyond that, but --

4 Q What did you do?

5 A We actually had an audit done. We rolled
6 it into the next year, so we went beyond that,
7 because we always want to have independent set of
8 eyes from the independent CPA firm offer an opinion
9 audit on the books and records of the company. So
10 that's why you had a stub period from inception
11 through December 31, 2009.

12 MR. ALBRIGHT: Your Honor, I would offer
13 Exhibit 133-P into evidence.

14 MR. MARKLEY: Your Honor, I'd have to
15 object, because it would seem that, if you look at
16 the middle paragraph, it says, "Also note that we
17 have waived the 2008 audit requirement for the eleven
18 companies listed as being incorporated in the last
19 quarter of 2008."

20 Now, I believe we do have a copy of this
21 letter that was provided by counsel, but I don't know
22 that we have anything about these eleven companies,
23 and I would not know who these eleven companies are,
24 so we'd have a completeness problem that hasn't been
25 accomplished by Petitioner, and there's no way we

1 could complete it. We could not get the rest of
2 those documents, because we don't have a clue what
3 they are as to these eleven companies.

4 MR. ALBRIGHT: Your Honor, can I ask one
5 more question?

6 THE COURT: Yes.

7 BY MR. ALBRIGHT:

8 Q Mr. Feldman, do you know whether Petitioner
9 was one of the eleven companies that this letter
10 makes reference to?

11 A Yes. I've seen in the documents, the legal
12 papers from Anguilla that shows it was incorporated
13 in the fourth quarter of 2008. I don't know if you
14 admitted into evidence, but I've seen it among these
15 papers. It was in the 1024 application.

16 MR. ALBRIGHT: Your Honor, I offer Exhibit
17 --

18 THE WITNESS: And there was also no --

19 MR. ALBRIGHT: -- 133 --

20 THE WITNESS: -- enclosure.

21 MR. ALBRIGHT: I'd offer 133-P into
22 evidence.

23 THE COURT: 133-P is admitted.

24 (The document referred to, having been
25 previously marked for identification as

1 Petitioner's Exhibit 133-P, was received
2 in evidence.)

3 BY MR. ALBRIGHT:

4 Q Mr. Feldman, what is PoolRe Insurance
5 Corporation?

6 A It's an Anguillan-licensed -- United
7 Kingdom, Territory of Anguilla, licensed property and
8 casualty insurance company, operating under Section
9 831(a) of the Internal Revenue Code.

10 Q And do you know who owns -- who owned
11 PoolRe Insurance Corp. in 2008, 2009, and 2010?

12 A Yes.

13 Q And who was that?

14 A Stephen L. Friedman.

15 Q And was PoolRe Insurance Corporation a
16 client of Capstone during 2008, 2009, and 2010?

17 A Yes.

18 Q What did Capstone do for PoolRe Insurance
19 Corporation during 2008, 2009, and 2010?

20 A Whatever PoolRe asked Capstone to do, which
21 was to administer the company, to handle the day-to-
22 day administrative and clerical operations pursuant
23 to the guidelines that its board laid out.

24 Q Do you own an interest in PoolRe Insurance
25 Corp.?

1 A Do I?

2 Q Yes.

3 A No. No, I never have.

4 Q You say, you've never owned an interest in
5 PoolRe --

6 A No.

7 Q -- Insurance Corp. What about CreditRE
8 Insurance Corporation? What is that?

9 A I think it's called Credit Reassurance
10 Corp.

11 Q It's assurance, not insurance. Is that
12 right?

13 A I have a mental block now. We call it
14 CreditRE.

15 Q Okay.

16 A It's a company owned by Mr. Fagg who's an
17 actuary in Dallas with a national reputation in
18 credit life, credit disability, contractual liability
19 insurance.

20 Q I've asked you a lot of questions about
21 CreditRE today.

22 A Yes, you have.

23 Q And this is the CreditRE that participates
24 or that Reserve reinsures coverages from CreditRE
25 through, I guess it is, PoolRe --

1 A Could I take a cut at that?

2 Q Please.

3 A Okay. The business originates with Linden,
4 which is a subsidiary of, I think, Progressive. I
5 forgot the name of its parent company. They generate
6 the original policies or policy, and they cede it --
7 it's called retroceding in the reinsurance industry.

8 They retrocede it down the chain, and some
9 of it is acquired by CreditRE or an affiliate
10 thereof. And they retrocede a portion of that to
11 PoolRe, and PoolRe retrocedes some of that to Credit
12 -- to Reserve and to lots of other people, and some
13 of it's held by PoolRe. Is that okay?

14 Q Now, just to be clear, and who owns
15 CreditRE?

16 A Gary Fagg.

17 Q Have you ever owned an interest in
18 CreditRE?

19 A No.

20 Q Does Capstone provide any services with
21 respect to CreditRE?

22 A No.

23 Q And that's true during 2008, '9 and '10?

24 A True since the beginning of time through
25 today.

1 (Pause.)

2 MR. ALBRIGHT: Your Honor, to speed things
3 up, if I might, could I provide Mr. Feldman with a
4 series of exhibits, 126-P, 127-P, 128-P, 129-P? I
5 believe that's it.

6 THE COURT: Yes.

7 BY MR. ALBRIGHT:

8 Q (Handing documents.) Mr. Feldman, do you
9 know what Exhibit 126-P is?

10 A Yes. It's another copy of the general
11 ledger for Reserve Casualty Corp. for the year 2009
12 and as of December 31, 2009. I guess it's another
13 copy, similar to what we looked at before. Maybe
14 not.

15 Q Well, and if you'd take a look at Exhibit
16 127-P --

17 A Yes.

18 Q Could you tell me what it is.

19 A A general ledger for Reserve Casualty Corp.
20 for the 2010 and as of year end, Reserve Casualty
21 Corp.

22 Q And what about 128-P?

23 A 128 is a -- I guess it's a notice of a
24 claim. It is a notice of a claim that came from Peak
25 Mechanical to Reserve Casualty Corp. Date of the

1 notice was April 6, 2009.

2 Q And what about Exhibit 129-P?

3 A It's the write-up of the incurred loss for
4 Reserve.

5 Q And if I received these documents from
6 David Liptz, would you know where these documents
7 came from originally?

8 A Well, let's start with the back. That's
9 easy. The back part of it is a -- it's a report from
10 Capstone that Capstone maintains for Reserve Casualty
11 Corp.

12 Q And you're speaking about which exhibit
13 now?

14 A The last three pages of Exhibit Number 129-
15 P. I don't see any Bates numbers on this. The last
16 three pages.

17 Q Yes.

18 A And that's a running total for 2008, 2009
19 of the reported losses to Reserve Casualty Corp. on
20 the direct written policies, totaling \$414,820.

21 Q Okay. How much?

22 A Well, I'm at the bottom on page -- on the
23 last page. There's a total losses reported of
24 414,000. That's composed of the paid claim, plus the
25 IBNR, incurred but not reported. It's the incurred

1 loss report, and it's also showing reported losses.

2 Q Okay. And if you could turn back to
3 Exhibit 128-P, do you know whether Peak Mechanical &
4 Components, whether there was a claim in 2009 or --

5 A There was.

6 Q There was. And do you recall what the
7 claim concerned?

8 A It was a loss of a major customer. I don't
9 recall the facts of it. I remember there was a loss
10 of a major customer. It was reported to Capstone.
11 Capstone helped Reserve adjudicate the claim, and
12 payment was made from the captive to the insured for
13 the amount of the claim.

14 MR. ALBRIGHT: Your Honor, I would move
15 Exhibits 126-P, 127-P, 128-P, and 129-P into evidence
16 without any restriction.

17 MR. MARKLEY: Okay. Without any
18 restriction. I remember was not -- this was this
19 morning with Mr. Liptz, but the restriction was that
20 he relied --

21 THE COURT: The restriction was --

22 MR. ALBRIGHT: Or limitation.

23 THE COURT: It was more of a limitation,
24 that these were documents received from Capstone.

25 MR. MARKLEY: I'm not sure that Mr. Feldman

1 has really gone through the type of activity that he
2 would be required to do -- he's explained what they
3 might say, but I don't think he's been qualified as a
4 witness appropriate to say that these are really
5 admitted without restriction as being -- well,
6 they're records that were prepared, I guess, by
7 Capstone.

8 MR. ALBRIGHT: Your Honor, these are
9 documents that were maintained by Capstone as the
10 administrator for Reserve Casualty Corp. They're
11 business records that were provided to Mr. Liptz in
12 connection with the audit work that he was doing.

13 MR. MARKLEY: And -- I'm sorry. I didn't
14 mean to interrupt. These records, would they be --
15 Your Honor, would they be records that were prepared
16 by Capstone in its Texas or Houston office? Is that
17 what we're talking about? Is that where they were
18 prepared and made?

19 THE WITNESS: Ask me.

20 BY MR. ALBRIGHT:

21 Q Were these records originally -- without
22 the notes that were put on them --

23 A Yes. I don't know whose annotations they
24 are.

25 Q Yes. Were these records -- did these

1 records originate from Capstone?

2 A Yes. I thought I said that the last -- I
3 was cut off, but the last four pages is a report from
4 a Capstone database maintained by the insurance
5 department of IBNR plus paid claims and the reserves.

6 Q And would --

7 A And the first two pages is a methodology
8 that explains how IBNRs -- basically how IBNRs is
9 reported, incurred but not reported. It's the
10 explanation or the part of our kind of policy manual
11 for the insurance department that explains how the
12 calculations are made.

13 THE COURT: 129-P is admitted without an
14 objection to it.

15 MR. ALBRIGHT: Your Honor, 129-P is
16 admitted?

17 THE COURT: Without -- because that's the
18 one the witness just described, with the four pages,
19 so 129-P is admitted without an objection -- I should
20 say, without a limitation.

21 THE WITNESS: Actually it's six pages.

22 THE COURT: Right. The exhibit's admitted
23 without any limitation.

24 (The document referred to, having been
25 previously marked for identification as

1 Petitioner's Exhibit 129-P, was received
2 in evidence without limitation.)

3 MR. MARKLEY: And this -- okay. I'm not --
4 this is not an objection, just trying -- a
5 clarification. The witness just said that on some
6 page, because we don't have the benefit of page
7 numbers, I guess, on this, there's an explanation of
8 the incurred loss, what IBNR means. Is that correct?
9 And it's somewhere in here, in Exhibit Number 129,
10 but I'm not sure what page it's on.

11 THE WITNESS: Page 1.

12 THE COURT: Page 1 and 2 are an explanation
13 --

14 MR. MARKLEY: Okay.

15 THE COURT: -- and then there's the
16 document. And I admitted without reservation 129,
17 but I didn't do the other three, because it's unclear
18 to the Court, because when you discussed 128-P, which
19 was the claim, I was unclear who prepared this
20 document.

21 MR. ALBRIGHT: If I may ask a few questions
22 --

23 THE COURT: Yes.

24 BY MR. ALBRIGHT:

25 Q Going back to Exhibit 128-P, Mr. Feldman --

1 A Yes, sir.

2 Q -- would this be a record that would have
3 been maintained by Capstone for Reserve?

4 A More than maintained, it would have been
5 generated by Capstone --

6 Q Now, if you --

7 A -- for Reserve, based on information that
8 Capstone got from Reserve.

9 Q If you look at the second page of Exhibit
10 128-P --

11 A Yes.

12 Q -- you see a note in a block there.

13 A Yes.

14 Q What -- would that be a note that Capstone
15 would have put on there?

16 A No, no. I assume that's part of the audit.
17 Someone mentioned that this is part of the auditor's
18 work papers. When I was in public accounting, we
19 didn't do this, but nowadays public accounting --
20 everything is on a computer, and they don't hand-edit
21 anything. They do pasties or annotations to
22 documents on the computer, so that's probably where
23 that came from. L&A is Liptz & Associates.

24 Q So but for that, this would be a record
25 that would be generated by Capstone?

1 A Yes.

2 Q And would it be a document that would be
3 regularly maintained by Capstone for Petitioner?

4 A Yes.

5 Q And it was -- was it the business of
6 Capstone to remain -- to maintain this document for
7 Petitioner?

8 A Yes. That's what we're paid for to do.

9 MR. ALBRIGHT: Your Honor, I offer 128-P
10 into evidence.

11 THE COURT: 128-P's admitted without its
12 previous limitation.

13 (The document referred to, having been
14 previously marked for identification as
15 Petitioner's Exhibit 128-P, was received
16 in evidence without limitation.)

17 BY MR. ALBRIGHT:

18 Q And, Mr. Feldman, if you would, back to --

19 MR. ALBRIGHT: Well, Your Honor, 126-P and
20 127-P, I still need to deal with them?

21 THE COURT: I think if you could just ask
22 one question about them jointly.

23 MR. ALBRIGHT: Okay.

24 BY MR. ALBRIGHT:

25 Q Mr. Feldman, looking at Exhibits 126-P and

1 127-P, do you know what these are?

2 A They're the general ledgers of Reserve
3 Casualty Corp. for -- one's for the year 2010, and
4 one is for the year 2009.

5 Q And is this essentially the same general
6 ledger that we talked about in Exhibits 28-P? Do you
7 have 28-P there still?

8 A I do. 28-P is '08.

9 Q Okay. I'm sorry. 29-P.

10 A I'm just scanning it down. It looks to be
11 exactly the same, other than it's printed sideways as
12 opposed to vertical. Do you want me to go through
13 and do some test-checking or something?

14 THE COURT: That's -- if it's the same --
15 earlier testimony was that that document, 126 and
16 127, were prepared by Capstone.

17 THE WITNESS: Yes, ma'am.

18 BY MR. ALBRIGHT:

19 Q So --

20 THE COURT: Yes.

21 MR. ALBRIGHT: So are they admitted without
22 limitation?

23 THE COURT: They're admitted without
24 limitation.

25 MR. ALBRIGHT: And that's 126-P and 127-P.

1 THE COURT: Yes.

2 (The documents referred to, having been
3 previously marked for identification as
4 Petitioner's Exhibits 126-P and 127-P,
5 were received in evidence without
6 limitation.)

7 MR. ALBRIGHT: Your Honor, may I have this
8 document marked for identification as Petitioner's
9 Exhibit next in order?

10 THE COURT: Yes.

11 MR. ALBRIGHT: And just let the record
12 reflect that I am handing Respondent's counsel a copy
13 of this document. (Handing document.)
14 May I approach?

15 THE COURT: Yes.

16 MR. ALBRIGHT: (Handing document.)

17 THE CLERK: The document is marked for
18 identification -- titled, Full Structure 2008 to
19 2010, for Insurance Corp. is marked for
20 identification as Exhibit 134-P.

21 (The document referred to was
22 marked for identification as
23 Petitioner's Exhibit 134-P.)

24 MR. ALBRIGHT: Your Honor, may I provide a
25 copy of Exhibit 134-P to Mr. Feldman?

1 THE COURT: Yes.

2 BY MR. ALBRIGHT:

3 Q (Handing document.) Mr. Feldman, what is
4 Exhibit 134-P?

5 A It's a graphical depiction or summary of
6 how the insurance program works from the standpoint
7 of -- focused on Peak and its affiliates.

8 Q Focused on who?

9 A Peak, Peak Mechanical and its affiliates.
10 That's page 1, and page 2 shows how the premiums are
11 paid.

12 Q And do you believe that Exhibit 134-P
13 accurately describes the relationships involved in --
14 as it's depicted?

15 A Yes. I helped prepare this. I checked the
16 numbers. I helped prepare it.

17 MR. ALBRIGHT: Your Honor, we'd like to use
18 this as a demonstrative exhibit with Mr. Feldman to
19 explain the structure of the insurance arrangements.

20 MR. MARKLEY: If it's in a demonstrative --
21 I'm sorry. If it's a demonstrative exhibit, I don't
22 really have a problem with it, but I'm not sure how
23 the difference between this coming in as a summary
24 from a demonstrative exhibit would be any different
25 as to anybody we might call for the same reason.

1 So I don't object as the demonstrative
2 exhibit, but I don't know what the foundation would
3 be for these, quote, 150 unaffiliated insureds and 51
4 to 56 unaffiliated captives. But if it's a
5 demonstrative exhibit, it's not really evidence, so -
6 -

7 THE COURT: So the Court just wants to be
8 clear. You're not offering this into evidence.

9 MR. ALBRIGHT: No, Your Honor.

10 THE COURT: You're using this as a
11 demonstrative.

12 MR. ALBRIGHT: No, Your Honor.

13 THE COURT: Okay. You may proceed.

14 MR. ALBRIGHT: Okay.

15 BY MR. ALBRIGHT:

16 Q So, Mr. Feldman, if you would, please, turn
17 to page 1 of Exhibit 134-P, and can you explain this
18 diagram, please.

19 A Yes, sir.

20 Q Okay. And please refer to names or -- so
21 the record will be clear as to what you're saying for
22 later on purposes.

23 A Okay. So you start with Peak and its
24 affiliates as the insureds in the green book in the
25 upper right-hand corner. They're paying directly to

1 their captive, Reserve Casualty Corp. in the green
2 box in the lower right corner, depending on the year,
3 between 80.1 and 81.5 percent of the direct written
4 premiums.

5 Actually, they're paying the direct written
6 premiums which equal between 80.1 and 81.5 of the
7 total premiums. Actually, I take that back. It's
8 80.1 to 81.5 of the total direct written premiums,
9 plus the quota share portion.

10 Q Okay.

11 A And that's paid just directly. It's paid
12 usually quarterly, monthly, annually in advance, kind
13 of whatever schedule is worked out.

14 Q So wait a minute. Would you back up a
15 minute. You might have -- the 80.1 and 81.5 --

16 A It depends on the year.

17 Q What -- so in -- 80.1 percent of what is
18 what?

19 A The denominator would be the total of the
20 premiums written.

21 Q Total premiums written?

22 A On a direct basis.

23 Q On a direct basis.

24 A Yes. So it's a stop -- if the denominator
25 were the stop-loss premium plus direct written, the

1 numerator would be the amount paid directly to
2 Reserve.

3 Q Okay. So it's the total of the stop-loss
4 premium and the direct written premium.

5 A Yes, sir.

6 Q Okay. That's 100 percent.

7 A Yes. I'm rounding it now. Yes. I'm
8 rounding it.

9 Q Okay. So go ahead.

10 MR. MARKLEY: Well, I'm sorry. I know this
11 is not for evidence. I know it's an attempt to
12 explain what's going on, but I'm not sure that I can
13 determine from the question and the answer that don't
14 seem to jibe as to this 100 percent, because, I
15 guess, there's 100 percent coming out of Peak and
16 RocQuest going -- 80 percent going to Reserve, and
17 18-some percent going to PoolRe.

18 But I thought I heard Mr. Feldman say a
19 little while ago that Peak was paying to Reserve, you
20 know, this amount, plus part of the quota share, and
21 this diagram shows the quota share going from PoolRe
22 to Reserve. So there's something that's not
23 correlating here.

24 THE WITNESS: Sure.

25 MR. MARKLEY: It's not exactly an

1 objection. It's a clarification.

2 THE WITNESS: Can I --

3 THE COURT: Well, if Mr. Albright could ask
4 a question --

5 MR. ALBRIGHT: Yes.

6 BY MR. ALBRIGHT:

7 Q So, Mr. Feldman, the 80.1 percent for the
8 direct written premium --

9 A Correct.

10 Q -- is 80.1 percent of what?

11 A If you take 80.1 percent and 19.9 percent
12 of the stop-loss premium, that adds up to 100
13 percent.

14 Q Okay.

15 A So it's 80.1 -- because it's reversed. One
16 number is going up, and one number's going down. So
17 in different years, it's different amounts, so rather
18 than burdening everyone with three diagrams, we
19 decided to do it in one summary diagram.

20 So in a particular year, if you look at the
21 total amount of stop-loss premium, not quota share,
22 not quota share, stop-loss premium -- and let's say,
23 you know, in that particular year it's 19.99 percent.
24 Add that to 80.1 percent.

25 The numerator is the amount going from the

1 circle in green to the rectangle in green, and the
2 denominator is the total going from the circle in
3 green to the rectangle in green, plus the amount
4 going from the stop-loss premium.

5 So what you would call it would be -- what
6 we would usually call it in our lingo would be the
7 affiliated premiums. That's the denominator.

8 Q The affiliated premiums are the
9 denominator.

10 A Yes.

11 Q Okay.

12 A And that's 100 percent.

13 Q So in other words, there's a policy that --
14 policies are written by Reserve Casualty Corp. in
15 2008, for example, and there's a total premium paid
16 on those policies, the direct written premium.

17 A Can we work off of one policy?

18 Q Sure.

19 A One policy is written, and let's say, it's
20 for ABC coverage, commercial general liability gap.
21 That policy is paid -- 80.1 percent of the total
22 dollars for that policy are paid directly to the
23 captive, and that policy has an endorsement on it
24 from the pool that says, We will -- the pool will pay
25 a stop-loss, will limit the losses of Reserve by

1 endorsing the policy with a stop-loss for which the
2 pool gets a premium of 19.99 percent.

3 So every policy has the endorse -- well,
4 every policy that's accepted into the pool has an
5 endorsement on the policy. So there we're calling it
6 affiliated premiums, because the premiums are coming
7 from the Peak affiliates. And I'm sorry if I wasn't
8 that articulate, but we're working on percentages and
9 not numbers.

10 Q Okay.

11 A Should I go on?

12 Q Yes, please.

13 A So at the same time, looking on the left
14 side, there's about -- anywhere between 429 and 575
15 other insurance contracts from totally unaffiliated -
16 - generally from unaffiliated people out there
17 throughout the United States that are also paying
18 money in for stop-loss premiums at the same time.
19 They're writing policies through their own
20 unaffiliated captives.

21 And as it affects PoolRe, money is coming
22 in to PoolRe for the stop-loss premium, about \$30
23 million in a particular year. Let's just say it's
24 \$30 million. PoolRe takes all this money and
25 homogenizes it and blends it -- it's like a big

1 Mixmaster -- and then sends back out a quota share of
2 the overall risks that PoolRe has assumed from these
3 429 to 575 different Kansas, from 150 affiliated
4 insureds, and sends that back to Reserve Casualty,
5 and that's the 1.35 to 1.55 of the total premiums of
6 PoolRe.

7 At the same time, PoolRe is retroceded
8 insurance from Credit Reassurance which has been
9 generated by Linden, and PoolRe takes that and
10 divides that up and sends some of it down to Reserve
11 and some of it to 51 to 56 other unaffiliated
12 captives, and some of it it keeps itself.

13 Q Okay.

14 A That's it.

15 Q Okay. And if you'd turn to page 2, what
16 does that represent?

17 A That's a, I guess I'd say, a simplified
18 version of it, looking at it a little differently,
19 where Peak is paying 70 percent of the premiums down
20 to Reserve, and then it's getting 30 percent of its
21 premiums from PoolRe. PoolRe premiums constitute
22 both the stop-loss and the third-party insurance.
23 Actually a traditional structure out there in the
24 world. We didn't invent it.

25 MR. ALBRIGHT: Can I have just one moment,

1 Your Honor?

2 THE COURT: Yes.

3 (Pause.)

4 MR. ALBRIGHT: Pass the witness, Your
5 Honor.

6 MR. MARKLEY: Could I have five minutes?
7 Is that possible?

8 THE COURT: Okay. We'll take a five-minute
9 recess.

10 MR. MARKLEY: Thank you.

11 THE CLERK: All rise.

12 (Whereupon, a short recess was taken.)

13 THE CLERK: All rise.

14 Please be seated.

15 CROSS-EXAMINATION

16 BY MR. MARKLEY:

17 Q Hi, Mr. Feldman. It's my turn.

18 A How are you?

19 Q How you doing? We've already been talking
20 in the hallway, so we won't go through any more of
21 that till after you're done. Okay.

22 So would it be a correct characterization
23 to say that in terms of the status or the person who
24 is most involved with the day-to-day activity or the
25 responsibility of Capstone would be you? Would that

1 be fair?

2 A The most of everyone?

3 Q Yes.

4 A No. No, I'm not a full-time -- it depends
5 on the area.

6 Q Yes.

7 A I'm not a full-time person for Capstone. I
8 work on other business activities.

9 Q Sure. And you're also an attorney on
10 things that have nothing to do with Capstone. Isn't
11 that correct?

12 A That's correct. When you say -- that's
13 correct.

14 Q Okay.

15 A Well, I was assuming when you say, at
16 Capstone day to day, I guess I was including kind of
17 legal work for Capstone, but maybe you were
18 distinguishing between the two.

19 Q Well, you know, I know nothing's 100
20 percent on any one day, and, you know, if you were to
21 kind of even it out over a course of, let's say, a
22 week or a year, would you say you do most of your
23 work in regard to Capstone-related activities,
24 whether it's an employee for Capstone or an attorney
25 in your law firm? How would you characterize that?

1 A I'd have to look at my hours.

2 Q Yes. Okay. All right.

3 A I do lots of different things, but I'm very
4 much involved in Capstone.

5 Q Right. Is there anybody at Capstone that
6 would be a person who could overrule you on any
7 decision you would make there?

8 A Yes.

9 Q And who would that be?

10 A Of course. It depends on what the area is.
11 I mean, if it's an insurance decision, I'm not the
12 final decider. Certainly I would be overruled by the
13 head of the insurance department on insurance issues,
14 and the clients --

15 Q Okay.

16 A -- ultimately would overrule anything that
17 Capstone does or says.

18 Q Sure. For example, like Mr. Zumbaum would
19 have the final determination as to whether or not he
20 would agree to sign off to the policies that really
21 came about in this case. Would that be true?

22 A He'd have the final say on everything.

23 Q All right.

24 A Policies, pricing, which coverages,
25 everything. It's his company.

1 Q Sure. Of course, you were not here during
2 the testimony of anybody else, so you were not aware
3 of what anybody else said. Like, for example, Atlas,
4 you don't know what that gentleman said. Right?

5 A No idea.

6 Q Okay. So at some point in time, was Atlas
7 doing work with Capstone?

8 A Yes.

9 Q Okay. And at some point in time, that
10 changed, and you no longer used -- when I say, you, I
11 mean, Capstone -- no longer used Atlas. Is that
12 correct?

13 A Yes. And generally when we moved to
14 Anguilla, we stopped using Atlas, and certainly when
15 we moved to Delaware and Tennessee and Utah, we've
16 never used Atlas.

17 Q Right.

18 A Atlas was there really for the BVI
19 purposes.

20 Q Now, I've looked through your feasibility
21 study, and we're going to talk about that. When I
22 say, your, I mean the feasibility study that's 16-J
23 that's in this matter.

24 A Yes, sir.

25 Q We'll talk about that in detail. But as I

1 understand it, you would go out on a lot of
2 feasibility studies, or did you go out on all
3 feasibility studies for captives?

4 A I'd say I probably -- well, as I think I
5 said, I probably have done 150 on-sites. I didn't go
6 back and count it. Maybe it's 125.

7 Q Right. I'll be in Florida next week or the
8 week after. I was in Birmingham ten days ago. So
9 I'm --

10 Q Does Capstone -- I'm sorry. I didn't mean
11 to cut you off.

12 A Yes. So the answer is certainly far side
13 of a hundred.

14 Q Does Capstone have any kind of ads in trade
15 papers or any kind of place where, let's say, someone
16 like me -- you know, I have a small business and I
17 was interested in something, a type of insurance, and
18 I could find out about Capstone, or is it just by
19 word of mouth?

20 A There may be a few situations where we have
21 a placement ad in the context of me giving a speech
22 at a industry event, but typically the ads are to
23 show the regulators that we're in business, so to
24 speak.

25 So it would be like, if I may, if I were a

1 law firm having an advertisement in the American Bar
2 Association Journal, which is primarily reviewed by
3 lawyers, other practicing lawyers, at least in my
4 mind --

5 Q Yes.

6 A -- as opposed to having an advertisement in
7 the Wall Street Journal. We wouldn't have an
8 advertisement in the Wall Street Journal or a
9 magazine from the American Association of
10 Manufacturers. We might if there were a convention
11 and we said, Stop by our booth, or see my speech.
12 But generally our ads are really just educational,
13 webinars and presentations at professional groups.

14 Q Okay. So in this instance --

15 A AICPA. You know, I speak to the AICPA. I
16 spoke last year. Their big convention was 500
17 people. I drew a hundred people.

18 Q So as I understand it in this instance,
19 prior to you going out to Idaho, to scenic Osburn,
20 Idaho, off of Interstate 90, which I'm sure you and I
21 know about very well, the contract, as you understood
22 it from Mr. Zumbaum to your firm, to Capstone, was
23 through a client that you already had who was in
24 Montana, I believe, Mr. Poe.

25 A No. He was in Durango, Colorado, with a

1 manufacturing facility in Farmington, New Mexico, and
2 in China.

3 Q Okay. And you had said you charge about
4 15- -- I think you said around 15,000 for the study.

5 A In those years, yes.

6 Q Yes. Okay. During the -- as far as
7 Reserve, that's all I really care about. As far as
8 Reserve, was there any money that Capstone charged
9 Reserve for the continuation of Capstone's assistance
10 work? Bookkeeping, I think you've mentioned at some
11 point in time. All the work that you did in regard
12 to the Reserve insurance company and the Peak policy,
13 was there an ongoing yearly fee or any kind of fee?

14 A Of course. Yes.

15 Q Okay. And what was that?

16 A I could take a guess.

17 Q Well, what's your best estimate?

18 A Including disbursements where we paid all
19 the disbursements for them, the auditors and the
20 regulators and that, probably \$15,000 a quarter.

21 Q 15,000 a quarter?

22 A A quarter.

23 Q Okay. So I'm not real good at math, but I
24 guess I can handle that. So it's about \$60,000 a
25 year.

1 A That's my guess.

2 Q Okay. Was that a direct charge to Reserve
3 or Peak? How did that work?

4 A The accounting for that?

5 Q Yes. If you know.

6 A Yes. It's borne partly by Reserve -- well,
7 in the usual sense, it's borne partly by Reserve and
8 partly by the insureds. It's an allocated --

9 Q Okay. So partly Mr. Zumbaum and Mr. Weikel
10 for Peak, and partly by Reserve?

11 A Correct. I think I saw a memo in here --

12 Q Uh-huh.

13 A -- that was referred to as a clean-up memo,
14 and it was cleaning up the inter-company accounts
15 between the two companies.

16 Q Okay. And so it would be about 60,000 a
17 year. Was that done by, if you know, check or wire
18 transfer or something else?

19 A I couldn't tell you.

20 Q Okay. All right.

21 A I hear if someone doesn't pay, not if they
22 paid and how they paid.

23 A Right. So life's not a free lunch on this
24 situation. Right?

25 A Well, they don't have to hire us to manage

1 it. They don't have to hire us to form it. They can
2 -- we've had situations where we do the feasibility
3 study, and they go elsewhere, and that's okay, too.

4 Q I'm trying not to jump around a lot, but it
5 sometimes happens, because, you know, you're an
6 attorney. You've seen that in action, haven't you?
7 We heard before -- and I won't tell you what we heard
8 -- about a manuscripted policy. Can you tell me what
9 a manuscripted policy is.

10 A Well, the term "manuscripting" refers to
11 the drafting of a policy.

12 Q Okay.

13 A It's a term of art that's used in the
14 insurance industry. Manuscripted policy would mean
15 to me that it is a custom or semi-custom policy,
16 directed at that particular business.

17 Q Okay. So in this --

18 A If I can just --

19 Q I'm sorry. Go ahead. Go ahead.

20 A And that would be in contrast to a file
21 policy, for instance -- you said you live in
22 Illinois, so in Illinois, GEICO or SAFECO or
23 Nationwide would file an approved policy with the
24 State for standard, everyday coverages, fire,
25 automobile, vehicle issues, homeowners, whereas when

1 you start dealing with commercial policies,
2 especially unique commercial policies, especially in
3 a captive or very large policies, they would be
4 manuscripted.

5 So that if Consolidated Edison in Chicago
6 needed a policy to insure one of its power plants
7 against going down because of a natural calamity,
8 they're not going to pick up a policy that's out
9 there in the marketplace. they want a policy that's
10 directed at their business, so that if there's a
11 loss, they stand a better chance of it being paid.

12 Q So, for example, with Peak, when you were
13 out there on the feasibility study, one of the
14 policies -- would this be true, that one of the
15 policies regarding the issues with potential -- the
16 EPA site issue with the pollution -- do you remember
17 that being part of a problem that the company had,
18 that Peak had with serious pollution out there?

19 A Well, I remember that from the feasibility
20 study and looking through the documents, yes, that
21 the Peak main office and, I think, maybe all their
22 offices are located on a Superfund site.

23 Q Okay. And would that be -- the policy that
24 was created for that, was that like a manuscripted
25 policy?

1 A I can't tell you. It would be a pollution
2 policy directed at their business. I don't know if
3 we crafted that specifically for their business or we
4 had something that was close. I just don't know.

5 Q Well, that kind of leads me to the next
6 question. Would there -- and I don't say this in
7 regard to PoolRe or anything else. But would there
8 be a pool or conglomeration of types of various
9 policies that might be available when Capstone met
10 with an insured, potential insured, that they -- that
11 Capstone could say to that potential insured, Here's
12 the kind of policies we have available? Is that how
13 the business worked at all?

14 A No. No. It's the other way around.

15 Q Okay. So the other way around, then, is so
16 like, for example, on Mr. Zumbaum and Mr. Weikel, and
17 I tell whoever's coming out there for the feasibility
18 studies what type of policy I want, or what do I tell
19 them?

20 A They don't tell us anything. We don't --
21 they're not telling us things. The feasibility study
22 is a fact-finding --

23 Q Right.

24 A -- to determine what their insurance
25 policies are viewed against the operations of the

1 business and the risks of the business.

2 Q Okay.

3 A And when you put the two together and see
4 where they meet and where they don't meet.

5 Q So let's assume there's risk of a business
6 --

7 A But --

8 Q Go ahead. Were you going to say something
9 --

10 A Yes.

11 Q Go ahead.

12 A For instance, you look at the business.
13 It's on an EPA site.

14 Q Right.

15 A They don't have any pollution coverage.
16 There's no match. They have commercial general
17 liability insurance that excludes pollution. That's
18 --

19 Q Right.

20 A That's not a good idea.

21 Q Okay. So let's continue to use the
22 pollution issue or question. You go out there, do
23 the feasibility study. You see that problem with the
24 EPA site, the pollution. Do you then, meaning you,
25 meaning Capstone, craft or come up with a policy that

1 would cover that, that, for example, Allstate or, you
2 know, whoever wouldn't cover? Is that what Capstone
3 does?

4 A You're talking about in the Reserve
5 situation?

6 Q Yes.

7 A The Reserve situation, we understood that
8 Rossi, which was the insurance broker, provided the
9 full range of coverages that they were able to
10 provide for Reserve. It was quite understandable to
11 us -- I grew up in Superfund -- I grew up right by
12 Superfund site number one in the United States.

13 Q The canal in --

14 A Love Canal in Niagara Falls.

15 Q Okay.

16 A I grew up there. It was an unbelievably
17 polluted site, so I'm unfortunately pretty familiar
18 with the business risks associated with that. It was
19 quite understandable to us why Rossi -- why we were
20 hearing what we heard from our client. If you're an
21 insurance company and your insured is located on an
22 EPA site, the last thing you're ever going to insure
23 is pollution. It would be like issuing a life policy
24 after someone passed away.

25 Q How about the other types of policies that

1 Peak signed up for? Were you as familiar on a
2 personal basis or an occupational basis with the
3 types of reasons that they might need other policies,
4 other than this pollution --

5 A What other -- you have to tell me the
6 policies or show me the policies.

7 Q Well, for example, you know, protection
8 against tax audits, things of that nature.

9 A Again, if you just show me the --

10 Q Okay. Well, I'll do it a different way.
11 We'll go -- 16-J, I think, is the feasibility study.

12 A Okay.

13 Q Do you have that up there? That's --

14 A I do not have that here. If it's 16-J, I
15 do not have it.

16 MR. MARKLEY: Do you mind -- do you want me
17 to get it or --

18 THE COURT: Yes. You can get it, or
19 someone can assist him either.

20 MR. MARKLEY: Someone without a bad leg
21 will get it for you.

22 THE WITNESS: It's been a week, and it's
23 still uncomfortable.

24 (Pause.)

25 BY MR. MARKLEY:

1 Q So when you get to 16-J, go ahead and tell
2 me.

3 A I am there, sir.

4 Q You're there. Okay. All right. So
5 feasibility study -- the title says, Captive
6 Insurance Company Feasibility Study for Peak
7 Mechanical & Components, Inc., initial site visit,
8 August 13, 2008. Do you see that?

9 A Yes.

10 Q Okay. And let's go past the table of
11 contents and go to what's labeled as page number 1.
12 Do you see that?

13 A What's the Bates number?

14 Q Well, I don't -- is there a Bates number on
15 that? Because on mine --

16 A Yes. 5997.

17 Q Okay. Thanks. Okay. So are you there?

18 A Yes, sir.

19 Q Going to paragraph number 1, it says,
20 "characterize has met on site with the proposed
21 insured." Do you know who that meant as to Capstone,
22 who that person was that's mentioned in here?

23 A Yes. It was Lance McNeel and myself.

24 Q Oh, okay. All right. Let's turn to -- and
25 I think this is something you talked about before on

1 page -- the Bates number, which is 5998. Can you
2 turn to that page. It's also got a 2 at the bottom,
3 page 2 at the bottom.

4 A Yes, sir.

5 Q All right. You had talked about the
6 501(c)(5) question. Do you recall those questions
7 from Mr. Albright?

8 A 501(c)(15).

9 Q Yes, yes. 501(c)(15). I think my eyes are
10 giving out. Do you recall that conversation with Mr.
11 Albright earlier?

12 A Yes, sir.

13 Q Okay. Would this be true as to this type
14 of policy and as to this type of company, that if the
15 premiums paid to the policy -- I'm sorry -- to the
16 insurance company, meaning Reserve, were more than, I
17 believe -- what? -- \$600,000 --

18 A Yes.

19 Q -- that they would not be tax-exempt. Is
20 that correct?

21 A No. That's not the case.

22 Q Okay. What would the case be?

23 A If it were, say, \$600,001 --

24 Q Right.

25 A -- then the company would file probably,

1 you know -- you're asking me to speculate. The
2 company would file under 831(b), in which the
3 underwriting premium is tax-exempt and the investment
4 income is taxable, and in fact, the company did file
5 under that provision for several years.

6 Q At a later time?

7 A Well, later than --

8 Q Later than our years.

9 A -- than 16, because on 16, it hasn't been
10 formed.

11 Q I'm sorry. Somebody sneezed at the same
12 time you just said something. What?

13 A On Exhibit 16 --

14 Q Right.

15 A -- 16-J, it hadn't been formed, so
16 certainly at a later time than that. It operated as
17 a 501(c)(15) for a couple of years, and then it
18 reported under 831(b). So, you know, it's not a big
19 deal to be under 831(b) as opposed to 501(c)(15).
20 It's just that 501(c)(15) is a mandated provision.
21 If you have premiums under \$600,000 and you met the
22 criteria for 501(c)(15), there's no exception. You
23 have to file under that.

24 Q Are there any tax benefits -- you know, you
25 were giving advice to Capstone regarding the entire -

1 - to Reserve and to Peak regarding tax issues. Is
2 that correct?

3 A Tax issues and liability issues, litigation
4 issues, corporate issues.

5 Q Okay.

6 A I think, even on some buy/sell issues for
7 their business, when they were working on selling
8 their business. Lots --

9 Q So --

10 A -- of things.

11 Q -- would there be more of a negative tax
12 effect to either Peak or Reserve if the premiums were
13 higher than 600,000?

14 A Would there be more of a tax --

15 Q Would they have to pay more -- would either
16 Peak -- well, Peak would get a deduction, no matter
17 what it was, assuming it was a legitimate deduction
18 for insurance. Is that right?

19 A Yes, sir.

20 Q Okay. And would there be higher taxes as
21 far as you understood it, when you were giving advice
22 to Reserve if the premiums were more than \$600,000?

23 A I guess, by definition, if the premiums
24 were higher, using your hypothetical --

25 Q Yes.

1 A -- that they're all for bona fide premiums,
2 the higher the premiums, the higher the deduction;
3 the more I'd pay in rent, the more I deduct; the more
4 I pay in salaries and payroll, the more I deduct. So
5 if the premiums were higher, under an 831(b), it
6 would even be more of a benefit.

7 Q Well, I'm not talking about whether the
8 deductions would be more beneficial to Peak. I'm
9 talking about whether or not there would be a tax
10 effect on Reserve having more than \$600,000 coming in
11 to it in Anguilla as a premium from Peak.

12 A I apologize. I'm not -- you want me to
13 look at it from the standpoint of Reserve.

14 Q Right. That's whose the case really --

15 A And if Reserve has more premiums coming in,
16 would it get more of a tax benefit?

17 Q No. Actually what I'm asking you is if
18 Reserve has more premiums coming in that more than
19 \$600,000 -- okay? Let's say it's \$601,000 --

20 A Right.

21 Q -- for the sake of argument. As you
22 understood it, as you understand it, would that
23 affect whether they would be able to be -- to have a
24 tax-free situation regarding the 501(c)(15)
25 determination?

1 A I think I -- I'll take a stab at it.

2 Q Go ahead.

3 A If they have more than \$600,000 of premium
4 revenue --

5 Q Uh-huh.

6 A -- the company is then -- would be --
7 probably would be taxed, and in fact, was taxed under
8 831(b), which has a zero percent tax rate on
9 underwriting profits, so zero relative to zero is
10 still zero, so it's the same. The investment income
11 is taxed separately, but the investment income is
12 insignificant in this company. It just started.

13 You know, the investment income -- we're
14 talking about 2008, financial crisis. Interest rates
15 are zero, so the investment income -- I'm sure we
16 could look at the income statement for that or the
17 tax returns, but that -- you know, it's probably the
18 cost of a steak dinner.

19 Q Bear with me. I'm sorry. I'm not stopped.
20 I'm just trying to figure out what I want to ask
21 next, because I have so many.

22 Why was Anguilla picked to be the domicile?

23 A Well, there's a discussion of that in the
24 feasibility study.

25 Q Right.

1 A So do you want to hear the long answer or
2 the short answer?

3 Q Whatever you want to say.

4 A Okay. It's kind of an interesting subject.
5 If you go back, the UK -- Anguilla is a UK territory.
6 It's controlled by the UK, United Kingdom.

7 Q Right.

8 A And actually, the head of my school at the
9 London School of Economics used to be the number two
10 guy at the Bank of England, who actually regulated
11 all the home territories' financial services. We've
12 had many discussions on that. So the UK provided a
13 structure by which Bermuda, Cayman, Gibraltar, BVI,
14 and Anguilla conducted their financial services,
15 overseen from England.

16 England historically is much more
17 sophisticated than the United States is in insurance.
18 They've been doing it since the 1600s, so they have a
19 much more established specialty insurance industry
20 than in the United States. Obviously post-World War
21 II, it gravitated towards the United States, but
22 historically they're much more sophisticated, much
23 more -- well, much more experienced and really
24 historically had more capital.

25 And that trickled down to the territories,

1 because England made the decision, UK made the
2 decision, to promote the economic growth of the
3 territories to empower them in the financial services
4 areas.

5 Anguilla, being a British territory, picked
6 that up and developed a financial services authority,
7 which would be like our equivalent of the Service and
8 the controller of the currency and the state
9 insurance departments rolled into one. In England,
10 the regulatory authority is called the FSA, Financial
11 Services Authority. In the territories, it's usually
12 called the Financial Services Commission.

13 They empowered them, and they got into this
14 business of regulating insurance. Now, why did we
15 choose Anguilla versus the United States? Because in
16 the United States, in 2008, there really was only --
17 there really wasn't a good opportunity, a good
18 option. So you had Howard Dean, who was governor of
19 Vermont, was the one that picked up the mantle and
20 ran with forming captives, started captive
21 legislation in Vermont about 1980.

22 Q Okay.

23 A And beyond Vermont, there was really not
24 much beyond that in 2008. South Carolina, a little
25 bit. Vermont really didn't want to have small

1 captives, and they were uneconomical, so your cost of
2 doing business in Vermont would be two or three times
3 the cost of doing it in Anguilla.

4 So it was a combination of a dearth of
5 domiciles in the United States in 2008 and a
6 sophisticated structure in the British territories,
7 Bermuda, Cayman, the British Virgin Islands, and
8 Gibraltar and Anguilla.

9 Q Okay. Let's --

10 A Sorry for the long answer.

11 Q No, no. That's okay. Let's go to -- we're
12 still in your report -- page 6002, which also at the
13 bottom says, Page 6, of the feasibility study.

14 A Yes.

15 Q And you see the paragraph in the middle,
16 more or less, "With the recognition that the proposed
17 insured is considered a small captive" -- do you see
18 that?

19 A Yes.

20 Q Okay. And you go down to that third line,
21 it says, "There are limited domiciles available that
22 cater to the needs of a small captive."

23 A Exactly what I was saying.

24 Q Okay. Is that what you're saying?

25 A Yes.

1 Q So when you say, cater, is that what you
2 mean by what you just said?

3 A Facilitate, cater, allow, recognize.

4 Q Okay.

5 A For instance, Vermont said specifically,
6 We're not interested in small captives; don't come
7 here; we don't want to license them or regulate them,
8 in those years.

9 Q Going to page 6004 again of your
10 feasibility study, do you see at the top of the page,
11 it says, Small and intermediate captives? Do you see
12 that?

13 A Yes.

14 Q It's in bold print.

15 A Yes.

16 Q And in there, there's a discussion about
17 501(c)(15) and also IRC Section 831. Do you see
18 that?

19 A 831(b). Yes.

20 Q 831(b). Right. Further down in there it
21 talks about, "a turnkey type of administration to
22 overcome the transaction costs associated with such a
23 captive." What's your understanding of what a
24 turnkey type of administration means?

25 A Well, I can tell you what it means from our

1 standpoint --

2 Q Okay.

3 A -- from Capstone. We give the clients an
4 option of -- first of all, they have to make a
5 decision whether they want to proceed after the
6 feasibility study, and then they have to decide who
7 they want to do what. They can hire someone else to
8 do whatever they want and not bother us and not
9 retain us. They can hire us to do the legal work.
10 They can hire Capstone to do the administrative
11 insurance work or anything in between.

12 One thing that we offer clients if they
13 wish is that we will do a lot of the work under the
14 turnkey arrangement on a fixed-fee, so as to
15 distribute those costs in a more economical manner
16 among several clients.

17 Q A question that doesn't relate directly to
18 the feasibility study per se, what's in the report,
19 but were you aware of any kind of losses that Peak
20 had had in the type of categories that wound up being
21 insurance policies that they signed on to? I think
22 there was a snow pile that fell on the roof. Right?

23 A Yes. I apologize. I'm glad to look at
24 that or if you give me some documents, but I'm not
25 really here as the insurance group.

1 Q Uh-huh.

2 A I do have a recollection that these were
3 areas of -- well, I have a specific recollection that
4 these were areas of concern to Peak and its
5 affiliates. In terms of the losses that had occurred
6 historically --

7 Q Right.

8 A -- I don't have any recollection sitting
9 here today.

10 Q Okay.

11 A Yes. It may be in the feasibility study.
12 I do remember there was, I think, one area where they
13 had a significant loss. It was a defalcation or
14 something like that that was not insured, but you're
15 at the limits of my recollection.

16 Q Okay. So you don't even know about the
17 snow falling and crushing the roof or anything about
18 that?

19 A I have a vague recollection of it, but, you
20 know, I'm not the insurance professional on the team.

21 Q Well, what professional would you have been
22 on the team that went out for the feasibility study
23 and in regard to your business in general?

24 A Well, let me try it this way. Lance McNeel
25 would be the insurance professional on the team. I

1 would focus more on the structure, the legal aspects
2 of it, the risk associated with their business, where
3 I looked at where they're a manufacturer of products
4 that has -- they have all the liability for the
5 design and the fabrication and the use of the
6 products, and relatively poor limitations of
7 liabilities in their terms and conditions, as I
8 recall --

9 Q Okay.

10 A -- and they were sitting there with that
11 exposure. So they were -- give an example. They
12 were General Motors. They built cars. They built
13 trucks, and they dropped them down 7,000 feet to
14 operate underground. They've got all the liability.
15 It's not like they bought it from General Motors and
16 dropped it down there. They took a chassis and built
17 the vehicle.

18 Q Okay. Were -- and I understand what you're
19 saying, but --

20 A As a lawyer, that's what I did.

21 Q Right. Okay. So you did -- would it be
22 correct to say that you didn't have anything to do
23 and are not aware of any losses that they had prior
24 to that, that would literally cause them to say, I
25 absolutely need to have this policy, because I've had

1 this kind of loss in the past and it wasn't covered?

2 A No. I can't say that. I'm just -- I
3 didn't refresh my memory on that issue coming here
4 today, and I wasn't the --

5 Q Okay.

6 A That also wasn't the focus back then, but,
7 I mean, I've seen that stuff in the report. It's
8 just that I'm not involved in the insurance area in
9 that much of a granular level. I'd be more involved
10 in the financials as a result of the insurance as
11 opposed to a loss that occurred five years before as
12 to why they wanted the policy --

13 Q Okay.

14 A -- because we concurred on the bona fides
15 of the policy. So if there was anything that didn't
16 make sense -- let's say they were worried about a
17 tsunami in Idaho. Then we'd start asking and I'd get
18 involved in saying, Have you ever had a tsunami loss
19 a thousand miles from an ocean? So that never came
20 up for me.

21 Q Okay. Going to page 6009 -- or maybe we're
22 already there, but 6009, which is also number 13 of
23 your feasibility study. Do you see that?

24 A Yes.

25 Q Okay. So we have the big paragraph, heavy

1 print, Increased control.

2 A Yes.

3 Q Go to the second paragraph within that bold
4 point, and towards the end it says, "In a captive
5 structure, the owners of the captive do not have to
6 depend upon the third-party insurer to promptly honor
7 their claims." Do you see that?

8 A Yes.

9 Q In the situation with Peak and Reserve,
10 were the same two gentlemen that essentially ran Peak
11 also the same two gentlemen that essentially ran
12 Reserve, too?

13 A Sure. By definition. It's a captive.

14 Q Okay.

15 A By definition.

16 Q From your experience in the insurance
17 business in general, granular or big picture,
18 whichever, were you aware of situations where the
19 insured being the same person as the insurer would
20 have an issue about getting their claims paid
21 promptly or being honored promptly on that kind of
22 circumstance?

23 A I can recite you a dozen examples of that,
24 a dozen examples.

25 Q So what I'm saying is, if I'm on both ends

1 of the insured and insurer transaction, you can cite
2 me a dozen examples of where I as the insurer would
3 be not honoring the claim of me as the insured?

4 A No. I'm sorry. That's why you form a
5 captive, because in the conventional markets, when
6 you -- practically speaking, when you put in a
7 commercial claim, you don't get a callback from a
8 company saying -- AIG calling you up, saying, Thank
9 you very much for calling me on your \$40 million
10 pollution loss; I can't wait to pay it.

11 You get the opposite. You get a dec
12 action. And I can cite you a dozen examples of that
13 happening, where the clients took years and years and
14 years to get paid.

15 Q And would --

16 A And that's why they form captives.

17 Q Okay. So that's what I'm getting at. In a
18 captive, basically would you have the same people on
19 both ends of the transaction, just wearing different
20 hats, but it's the same people?

21 A Well, you're asking -- let me respond.
22 Basically as of January 1, 2017, the Internal Revenue
23 Code mandates that. The Internal Revenue Code
24 mandates that people be the same on both sides of the
25 transaction. It's required under the Path Act, the

1 Consolidated Appropriations Act of 2015, effective
2 January 1, 2017.

3 Q Okay. But --

4 A In 2008, practically speaking, the whole
5 definition of captives is there's a relationship
6 between the insurer and the insured. So a General
7 Motors captive is owned by General Motors. IBM's
8 captive is owned by IBM. AT&T's captive, which is
9 based in Austin, is owned by AT&T. So whether
10 they're the same people or part of the same corporate
11 chain, of course, by definition.

12 Q Okay. So not to denigrate their business
13 in Idaho or their business in Anguilla, but wouldn't
14 you consider Mr. Zumbaum and Mr. Weikel running a --
15 essentially a mom-and-pop type operation in terms of
16 both, you know, the mining company and the things
17 related to it, and the insurance company, too?
18 Wasn't it a small situation?

19 A Well, they had 50 employees by that time --

20 Q Right.

21 A -- or -- between 50 and 70 employees.

22 Respectfully, it's not like the -- and I'm not trying
23 to denigrate anyone, but it's not like the cafeteria
24 at 515 Rusk in Houston, which has two employees; it's
25 open for four hours a day.

1 Q It's not at that level of mom and pop.

2 A No. I mean, you know, they had -- one
3 company alone had 9 or \$10 million in sales, you
4 know, 50 to 70 employees, a couple million dollars, I
5 believe, in profits. I mean, that's --

6 Q Would it be true that --

7 A But the mom-and-pops that I know are a
8 little different nature than that.

9 Q Okay. Would it -- but the mom-and-pops
10 that you know and the mom-and-pops that may or may
11 not be the people involved in this case are not GE or
12 some other large corporation, are they?

13 A No, no.

14 Q Okay. That's really what I was going --

15 A Well, captives are not limited to -- I
16 mean, it's not like captives are limited only to ones
17 that have a hundred million dollars in premium.

18 Q Right.

19 A Right? Just like the Internal Revenue Code
20 doesn't say, Unless you have \$100 billion in revenue,
21 you don't pay tax. Everyone pays tax. Everyone --
22 the provisions apply up and down the vertical
23 spectrum of dollars.

24 Q Okay. Let's go back to the -- I think --
25 I'm sorry. I need to correlate my page numbers,

1 because I have -- let's go to page 6029. Tell me
2 when you get there.

3 A Okay. I'm there.

4 Q Okay. So look at letter (f), exposures
5 identified for possible captive insurance.

6 A Yes.

7 Q Okay. Did you assist in trying to come up
8 with those potential exposures? I guess that's the
9 word I should use, because that's in here.

10 A I think that's a fair statement. I was
11 part of the team.

12 Q Okay. So if I ask you the question, Did
13 you know anything about whether they had had prior
14 losses in regard to those type of exposures, would
15 your answer be, you really don't know, because you
16 were not involved in the granular part of the
17 investigation of the feasibility study?

18 A Well, let's go over one by one.

19 Q Okay. That's fine.

20 A Regulatory changes, as a for instance, that
21 was a concern of theirs, because of cost burdens that
22 were being imposed upon them from regulatory changes.

23 Q Did you receive any information that there
24 had already been cost burdens imposed upon them by
25 specific regulatory changes when you did the

1 feasibility study?

2 A Yes. I remember discussing that with them.
3 Yes.

4 Q Okay. And what did they say? That some
5 investigator had been out there and they had to pay
6 for somebody to do something or what?

7 A I mean, you want the specifics that --

8 Q Yes, I do actually.

9 A The specifics that led to that, I can dig
10 deep into my memory and tell you, but I don't have a
11 perfect recall. But I can tell you the result of the
12 conversations were that that was an area that was
13 ripe for coverage.

14 Q That was an area that -- I'm sorry.

15 A That was ripe, R-I-P-E, for --

16 Q Ripe for coverage?

17 A Right.

18 Q But hadn't come to fruition yet.

19 A No, no, no, no. Where they had experienced
20 -- I'm saying the contrary. Where they had
21 experienced losses in that area.

22 Q But you don't specifically recall what they
23 were at this moment.

24 A I don't recall the conversation, but the
25 result of the conversation was, that's an area that's

1 of serious concern or significant concern, that calls
2 for a policy on that.

3 Q Okay.

4 A And that's a policy that would be difficult
5 to buy in the conventional markets.

6 Q Any of the others?

7 A Well, product recall was a concern -- well,
8 that's probably an understatement. Again, on the
9 truck side where they're manufacturing trucks, which
10 are then flowing -- some of the trucks and the pumps
11 -- work was flowing from other -- from some other
12 companies back to Peak Mechanical, and Peak was
13 selling that and installing those and maintaining
14 that equipment.

15 So they had some issues there in the past,
16 and they were moving more into the manufacturing
17 business or remanufacturing business, and at that
18 point, less into the area of being a distributor. So
19 obviously the costs of getting a truck out from 7,000
20 feet down or it potentially breaking down and
21 shutting down a mine for an hour or for a couple of
22 days was something that was of concern to them, and
23 they just weren't sensitive to the fact that they
24 were manufacturers.

25 Q Let's go to page 4- --

1 A Do you want me to go on or not?

2 Q Well, not really, but I'm sure your counsel
3 might want you to. I don't know. Let's go to page
4 6038. Can you turn to that. It's a projected
5 balance sheet.

6 A Yes, sir.

7 Q Okay. So --

8 MR. ALBRIGHT: Your Honor, maybe Mr.
9 Markley is inviting an objection. I'll get prepared.

10 (Page 792 and subsequent pages are
11 enclosed under separate cover.)

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1 CERTIFICATE OF TRANSCRIBER AND PROOFREADER

2 CASE NAME: Reserve Mechanical Corp, f.k.a. as

3 Reserve Casualty Corp. v. Commissioner

4 DOCKET NO.: 14545-16

5 We, the undersigned, do hereby certify that the
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10 the United States Tax Court at its session in
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12 provisions of the current verbatim reporting contract
13 of the Court, and have verified the accuracy of the
14 transcript by comparing the typewritten transcript
15 against the verbal recording.

16

17 _____

18 Anita Tyler 05/24/2017

19 (Transcriber) (Date)

20

21 _____

22 Laurel H. Stoddard 05/25/2017

23 (Proofreader) (Date)

24

25

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IN THE UNITED STATES TAX COURT

In the Matter of:)
)
RESERVE MECHANICAL CORP., f.k.a.)
RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
v.)
)
COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

Volume: 10
Pages: 792 through 823
Place: Houston, Texas
Date: May 1, 2017

1 IN THE UNITED STATES TAX COURT

2

In the Matter of:)

3

RESERVE MECHANICAL CORP., f.k.a.)

4

RESERVE CASUALTY CORP.,)

5

Petitioner,) Docket No. 14545-16

6

v.)

7

COMMISSIONER OF INTERNAL REVENUE,)

8

Respondent.)

9

Room 7006
Casey U.S. Courthouse
515 Rusk Avenue
Houston, Texas

10

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May 1, 2017

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13

The above-entitled matter resumed for
trial, pursuant to recess, at 9:13 a.m.

14

15

BEFORE: HONORABLE KATHLEEN KERRIGAN
Judge

16

APPEARANCES:

17

For the Petitioner:

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1 APPEARANCES: (continued)

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C O N T E N T S

WITNESSES:	DIRECT	CROSS	REDIRECT	RECROSS	DIRE	VOIR
For Petitioner:						
Stewart Feldman		796				
For Respondent						
None						

1 E X H I B I T S

2 EXHIBITS: IDENTIFIED RECEIVED

3 135-R 803

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1 P R O C E E D I N G S

2 MR. MARKLEY: I really don't know that I'm
3 inviting anything, but we'll see.

4 CROSS-EXAMINATION (CONTINUED)

5 BY MR. MARKLEY:

6 Q Going to page 6038 of the feasibility
7 study, where it says, Reserve Casualty Corp.
8 projected balance sheet, do you see that page?

9 A I do, sir.

10 Q Okay. And when you take a look at that --
11 oh, you know, I'm sorry. I'm sorry. I got the wrong
12 page, because I'm trying to do two documents at the
13 same time. One has stickies on it for questions for
14 you and the other doesn't. Page 6037. I'm sorry.
15 Do you see that page?

16 A I do.

17 Q Reserve Casualty Corp. projected income
18 statement. Do you see that?

19 A Yes.

20 Q So would it be accurate to say that
21 according to this, which is part of the feasibility
22 study, that you and Mr. McNeel did in '08, you had --
23 when you looked across the line for direct written
24 premiums to this insurer, the amounts, no matter what
25 year is listed in that line, are the same. You can

1 just answer that yes or no.

2 A Yes.

3 Q Okay. Same with Credit Reassurance

4 assumed, same amounts are the same?

5 A Yes.

6 Q Also reinsurance assumed from the pool is

7 the same.

8 A Yes.

9 Q And net written premiums is the same.

10 A Yes.

11 Q Okay. And when you go down to expense, you

12 have credit reinsurance commissions that are the same

13 --

14 A Yes.

15 Q -- for each year. And losses and loss

16 adjustments expenses, they are the same for each

17 year.

18 A Yes.

19 Q And, you know, so -- okay. That's pretty

20 much what I want to ask about that. And -- I think

21 you used the word "quality control," one of my

22 favorite kind of words. What do you mean by quality

23 control? What did you do in terms of quality

24 control?

25 A At Capstone?

1 Q Yes. Not in general, but at Capstone.

2 Right.

3 A I'm a lawyer and CPA. I'm the poster child
4 of reviewing documents and editing documents and
5 being very anal when it comes to quality. I've
6 gotten to where I have in this life by doing
7 excellent work, and I've long been recognized in
8 doing that in a lot of -- in several different
9 fields.

10 I want to make sure that Capstone is one of
11 those, so I want to ensure that policies -- not
12 insurance policies, but policies and procedures are
13 in place, people are in place, to do a first-class
14 job. And I'm sure if you ask the regulators in
15 Anguilla or Delaware where we've done a lot of
16 business over the years, they would probably say we
17 do excellent work at the highest level, so that's
18 what quality control means to me.

19 Q Sure. I would assume that, but, yes.
20 Thanks for explaining it. So you had mentioned, you
21 know, who knows when, because we've been here for a
22 couple hours, to put it mildly, you had talked about,
23 I think, I believe -- correct me if I'm wrong. Okay?
24 Because my words aren't necessarily what you said.
25 Did you say you were involved or Capstone was

1 involved in designing coverages? Is that something
2 you said?

3 A Well, sure. They're involved in that.

4 Q Okay. And what would that mean? Would
5 that mean anything different than what you've already
6 testified about?

7 A I don't think I explained what designing
8 coverages means.

9 Q Okay. What does it mean?

10 A Well, I can tell you context of the labor
11 union that I worked on last week. You have an ERISA
12 preemption that overtakes state law, but only -- but
13 it doesn't overtake state law in -- for state-
14 mandated coverages, like workers' comp.

15 So the union has developed a program of not
16 just workers' comp but it's an enhanced workers'
17 compensation program that moves into the area of
18 employee benefits to take advantage of the ERISA
19 preemption, so that the union can offer that without
20 having to go to a major insurance company in the
21 state of Texas or California. So we're assisting
22 them and helping to design that policy.

23 Q Okay.

24 A I mean, it's -- there's a lot involved.

25 Now, we're not the only one on the team. We won't be

1 the only one on the team. There'll be ERISA lawyers.
2 There'll be regulatory lawyers in California and
3 Texas and ourselves, and then we'll prosecute that
4 policy through a particular insurance department to
5 get approval to issue that.

6 Q Okay.

7 A And I'm sure it'll get aggregated by the
8 State of California who will not recognize the ERISA
9 preemption.

10 Q I'm not 100 percent sure that I ever asked
11 you what -- I'm sorry for jumping a little bit
12 myself. But we were talking about the turnkey
13 before, the turnkey question. Is there a cost to
14 somebody for your participation in establishing a --
15 being a turnkey, establishing a turnkey?

16 A Yes.

17 Q And what is that? Is that more or less
18 than what we talked about before, about your expenses
19 or your fees rather?

20 A Well, we didn't talk about what our -- the
21 number that I gave you was what Reserve was paying,
22 based upon my recollection.

23 Q Right.

24 A But it's not the same for every client. It
25 depends on the work. We have clients that provide

1 capitation work with \$4 million of premiums for CMS
2 and Medicare, and they've got 10,000 capitated
3 patients in Orlando. That work is a much higher
4 level and more -- and a broader level, so there's a
5 different fee associated with that. But it's still
6 turnkey fee.

7 Q So is there a turnkey fee above and beyond
8 the fees that you had mentioned before for Peak in
9 this case? Would it be correct to --

10 A A turnkey fee is negotiated with each
11 client --

12 Q Right.

13 A -- for that project.

14 Q Okay.

15 A And for this project, it's not the same as
16 that project is not the same as this project.

17 Q Okay. I understand that, but we had talked
18 about, you know, \$15,000 to go out there to Idaho.
19 Right?

20 A That's for the feasibility study.

21 Q And then \$60,000 a year after that, more or
22 less.

23 A For Peak.

24 Q For Peak.

25 A For Peak.

1 Q Okay. And then is a turnkey cost more than
2 that, or is --

3 A No. That is the turnkey cost.

4 Q That is the turnkey cost. Okay. That's
5 all I wanted really to know.

6 A And a lot of what we're paying -- what
7 we're paid, we give to the independent auditors and
8 the actuaries or the domicile or the company manager.
9 You know, a lot of the money just flows in and out.

10 Q Okay. Was PoolRe --

11 A PoolRe.

12 Q PoolRe.

13 A Reinsurance.

14 Q Okay. Was that a captive of Capstone? Do
15 you know?

16 A Captive of Capstone?

17 Q Yes.

18 A It was Mr. Friedman's captive.

19 Q Right.

20 A And he hires us, I think, on an annual
21 basis to administer it.

22 Q Okay. Bear with me a second.

23 A Yes.

24 (Pause.)

25 MR. MARKLEY: May I have something marked,

1 Your Honor? I'll give counsel -- it's called, Master
2 consulting agreement. May I come up and --

3 THE COURT: Yes.

4 MR. MARKLEY: (Handing document.)

5 THE CLERK: A document entitled, Master
6 consulting services agreement, dated February 2008,
7 is marked for identification as Exhibit 135-R.

8 (The document referred to was
9 marked for identification as
10 Respondent's Exhibit 135-R.)

11 MR. MARKLEY: May I approach the witness,
12 Your Honor?

13 THE COURT: Yes.

14 BY MR. MARKLEY:

15 Q (Handing document.) So I've given you
16 something that's marked as 135-R. And have you ever
17 seen this document before?

18 A (Perusing document.) Yes. I --

19 Q Okay.

20 A I don't have any specific recollection, but
21 the answer's yes.

22 Q Okay. And if you go -- it probably doesn't
23 have any Bates number on it, but if you go to pages 6
24 and 7 in tiny, tiny print, in the lower right-hand
25 side, is that your signature on there?

1 A Yes.

2 Q Okay. And if you go to -- actually it
3 says, Page 1 for -- no -- page I, actually, Exhibit
4 A, List of captives. Do you see that?

5 A Yes.

6 Q Okay. Bear with me. I'm sorry.

7 (Pause.)

8 BY MR. MARKLEY:

9 Q Here it is. Okay. There's a lot of people
10 here at my table can't see, including me. If you go
11 to page ii -- okay? -- and do you see the words,
12 PoolRe Insurance Corporation, there?

13 A Yes.

14 Q As being a, "one of the so-called older
15 formation client companies list of captives." Do you
16 see that?

17 A Yes.

18 Q So does that refresh your recollection as
19 to whether or not PoolRe was a captive of Capstone?

20 A No. I've already said that. I didn't need
21 this to refresh my memory. I already said it's a
22 captive owned by Mr. Friedman. He hires Capstone to
23 administer it.

24 Q But would you agree with me that this is a
25 agreement that has nothing to do with Mr. Friedman

1 but has your signature on it in regard to Capstone
2 and lists that PoolRe as a entity, as a captive of
3 Capstone?

4 MR. ALBRIGHT: Objection, Your Honor. Mr.
5 Markley's question assumed a fact which has not been
6 demonstrated yet. First of all, I'm not sure where
7 this document came from. Secondly, there's a lot of
8 blank spaces on here. I'm not even sure it's an
9 agreement. I don't see where it's been signed by all
10 the parties, so -- and there are unsigned exhibits.
11 There are blank dates for the -- blanks where the day
12 should be shown. We don't know that this is an
13 agreement.

14 MR. MARKLEY: Well, I can ask a different
15 way.

16 THE COURT: Okay. Proceed.

17 BY MR. MARKLEY:

18 Q Mr. Feldman, going through the total amount
19 of this document, do you see your signature, as I had
20 indicated or asked you before, on pages 6 and 7 of
21 this, as by Stewart Feldman, Partner, in The Feldman
22 Law Firm, and also Stewart Feldman, CEO for Capstone?

23 A Yes.

24 Q Okay.

25 A As the advisors.

1 Q Right. Do you have any reason to believe
2 that this document is inaccurate as to anything
3 that's in it, since you signed it?

4 A Yes.

5 Q And what's your reason for believing it's
6 not accurate?

7 A I don't know that it was ever executed, it
8 was every put into place.

9 Q Oh, no. I didn't actually ask you that.
10 That's the objection. I'm not asking you that. I'm
11 asking you: Is this a document that you signed and
12 you believed -- that you had no reason to believe is
13 inaccurate as to the fact that your signature is on
14 it and what's in the information that's within it?

15 MR. ALBRIGHT: Objection, Your Honor.
16 That's very confusing.

17 THE COURT: Mr. Markley, if you could
18 clarify your question, and also, I thought initially
19 you were using this document to refresh --

20 MR. MARKLEY: Well, I was originally.

21 THE COURT: And I'm not quite --

22 MR. MARKLEY: I was originally using it to
23 refresh his recollection, and since --

24 THE COURT: This still is not an admitted
25 exhibit.

1 MR. MARKLEY: That's correct. All right.

2 So I'll ask it this way.

3 BY MR. MARKLEY:

4 Q Mr. -- okay.

5 A Feldman.

6 Q So let me do it this way. Is this a
7 document that you've ever seen before?

8 A Well, obviously -- well, assuming that it
9 was assembled in one piece, that is my signature, so
10 I've obviously seen it before.

11 Q Okay.

12 A But it's dated ten years ago. If I've seen
13 it in the last ten years, I'd be surprised.

14 Q Right.

15 A And I don't know that it was ever -- I have
16 no idea whether it was ever executed or followed
17 through on.

18 Q Okay. So you don't know whether it was
19 ever executed or followed through. Was -- what was
20 Mr. Glicksman's role in regard to Capstone?

21 A Mr. Glicksman was one of several actuaries
22 we've used over a number of years. I just don't know
23 whether it was under this agreement or not. I'm sure
24 there's an agreement that he signed.

25 Q Okay.

1 A This is not that.

2 Q All right. I won't offer it. You said you
3 didn't recognize it -- okay -- in terms of that being
4 accurate, so leave that alone. Hopefully I only have
5 a few more. I have your chart here. Do you have
6 that up there?

7 A Yes. Sure.

8 MR. MARKLEY: Can you help him move that --

9 THE WITNESS: I'm okay.

10 BY MR. MARKLEY:

11 Q Have you got room up there?

12 A Yes.

13 Q Okay. I believe that --

14 A You should see my desk.

15 Q Yes. You see mine right here. Okay. So -
16 - and, again, I don't want to put words in your
17 mouth, but amounts of money -- we'll do it that way.
18 Okay? I should put a big dollar sign and just put
19 money up there. Amounts of money start out with
20 Peak, ZW and RocQuest, and then go on their merry way
21 down to this -- these various entities. Is that
22 correct? Very simple.

23 A Okay.

24 MR. ALBRIGHT: Your Honor, I'm not sure
25 about the merry way part.

1 BY MR. MARKLEY:

2 Q Amounts of money are paid from Peak and
3 RocQuest and ZW to PoolRe or Reserve Casualty
4 Company. Is that correct?

5 A Yes, sir.

6 Q Okay. And then the amounts that are listed
7 in here as to the various amounts of premiums, some
8 go to Reserve directly from Peak, ZW, and RocQuest.
9 Is that correct?

10 A Yes, sir.

11 Q And some go to PoolRe.

12 A Yes, sir.

13 Q All right. Now, so that part I'm able to
14 comprehend, and then we get PoolRe and Credit
15 Reassurance involved, and then as a result of that,
16 can you explain? Monies come back to Reserve.
17 Monies come back to PoolRe. Where do monies come
18 after they have come out of Peak and RocQuest and ZW?

19 A I'm not sure I follow the question, but --

20 Q What I'm asking is --

21 A What's the flow of money?

22 Q Well, I'm asking what the flow of money is,
23 but I don't necessarily need you to answer that,
24 because you've already answered a lot of questions.
25 I'm just trying to confirm a couple things.

1 A Okay.

2 Q So money starts out with Peak, ZW, and
3 RocQuest in the payment of premiums.

4 A Because they're the insureds.

5 Q Okay.

6 A Right. Insureds pay premiums --

7 Q Right.

8 A -- for transferring risk.

9 Q And some of that goes to Reserve, and some
10 of it goes to PoolRe.

11 A Yes, sir.

12 Q All right. Now, after --

13 A For transferred risk.

14 Q Okay. And after all the other activities
15 that take place within PoolRe and Credit Reinsurance
16 and the other unaffiliated insureds, what then
17 potentially comes back to Reserve as both money from
18 those other entities and also risks assumed from
19 those other entities? Does that question make sense
20 to you?

21 A Yes. Well, first let me start with the
22 risks that come back to --

23 Q Okay.

24 A -- Reserve. Can I do that?

25 Q Yes. Either way is fine with me actually.

1 A Okay. So Peak issues direct written
2 policies, and then gets an endorsement on the policy
3 for stop-loss.

4 Q Okay.

5 A Because they want to reduce their risk.
6 It's like a reinsurance agreement. In exchange for
7 the stop-loss endorsement, money goes to PoolRe. At
8 the same time, 400 other companies do the same thing.
9 They're paying premiums directly to their captives,
10 and they're paying PoolRe for the stop-loss. PoolRe
11 blends those dollars, which are associated with risks
12 from 429 to 575 policies and 150 unaffiliated people.

13 It blends those risks, like in a Mixmaster,
14 and sends them out to all the captives, so that
15 Reserve is picking up risks associated with all these
16 429 to 575 unaffiliated people. And it receives
17 premiums for that. Similarly, each of these other 51
18 through 56 captives receive dollars from PoolRe for
19 which that captive picks up risks from all these
20 other 429 to 575 companies, which is what insurance
21 is. You're transferring risk and distributing it.

22 Q Okay. So let me ask a couple more
23 questions, and hopefully that'll be about it. The
24 record -- you had mentioned the Mixmaster, which, I
25 guess, some of us even know what that is, but making

1 whatever it is you make in a Mixmaster --

2 A Osterizer.

3 Q That, too. So --

4 A Back to the '60s.

5 Q -- the records for that blending that go
6 on, where would they be? Would there be like
7 computer -- in a big computer somewhere? On hard
8 paper? I guess not anymore.

9 A It's in here.

10 Q No. I mean, if it weren't in here and we
11 weren't in court here today, where would it be?
12 Where would that type of record be? would it be in
13 Capstone facility somewhere?

14 A No. Peak's got a copy. Reserve's got a
15 copy. The 500 other companies have a copy. The
16 unaffiliated captives have a copy. You've got a copy
17 in the documents here. It's a stop-loss and the
18 quota share agreements.

19 Q So this -- and as far as PoolRe records are
20 concerned, do you know if any of them would be like
21 in Anguilla? Do you know?

22 A Of course. They have to be in Anguilla.

23 Q Okay. And in terms of the records for
24 Capstone, are any of those records in Anguilla, if
25 you know?

1 A Of course. They have to be in Anguilla
2 under the -- it's required by the -- by our licensing
3 that we keep our financial records there.

4 Q So when you say financial records, I mean,
5 can you tell me what financial records would be in
6 Anguilla for what -- for Capstone, if you know.

7 A When you say, Capstone, as distinct from
8 Reserve?

9 Q Yes.

10 A Sitting here right now, I couldn't, because
11 I'm really here as defined with regard to Reserve. I
12 didn't refresh my memory as to what records Capstone
13 for Capstone keeps in Anguilla.

14 Q Okay.

15 A Capstone is a licensed captive insurance
16 manager in Anguilla. For a time, we were a licensed
17 company manager as well. So we have to keep records
18 there.

19 Q Okay. Now, the unaffiliated insureds that
20 are -- do you still have -- yes, you have it. Of the
21 unaffiliated insureds that you have on your chart,
22 are any of those, if you know, managed by Capstone,
23 or all of them? Do you know?

24 A Well, they all should be. That's the terms
25 of the pool --

1 Q Okay.

2 A -- is to require Capstone to homogenize the
3 risks, so we would have similar risks within the
4 pool.

5 Q Excuse me.

6 A Did you want me to continue on that?

7 Q No, no. We're just having -- I'm trying to
8 figure out to ask you two more questions or three.

9 (Pause.)

10 BY MR. MARKLEY:

11 Q Do you have 28-P up there? It's the
12 general ledger from 2008. It's just a short one --
13 well, not that short, but --

14 A 28-P.

15 Q Yes. It's the general ledger.

16 A Yes.

17 Q Okay. And counsel had asked you --
18 Petitioner's counsel, Reserve's attorney, had asked
19 you some questions about payments made. Do you
20 recall that? Monies -- for example, charges being
21 made for other reinsurance, things of that nature,
22 losses. Do you recall that? Do you recall those
23 kind of questions?

24 A Yes. The general --

25 Q Yes.

1 A I'm not sure it was charges, but it was --
2 losses were incurred and paid.

3 Q Right. So were they -- how were they paid?
4 Was there -- were there checks involved? Were there
5 wire transfers involved? Do you actually know?

6 A Yes.

7 Q And how was that done?

8 A And for what are we talking about? What
9 loss?

10 Q Well, I don't really know, because I'm
11 looking at your --

12 A Let me give you a for-instance.

13 Q Well, hang on a second, because I'd rather
14 ask a question than you give me a for-instance. So
15 for 28-P, if you go to, for example, the third page
16 of that where it's like the account ID is 50,000
17 reinsurance commissions. Do you see that?

18 A Yes.

19 Q Okay. And then you go on, you know, to
20 other pages later on, but we'll just stick with that
21 for the moment. What would be the evidence that you
22 would be looking at in order to determine, you know,
23 in your company, in Capstone, would be the evidence
24 that you would look at to get to the number, which I
25 think is on the next page, \$8,166.25?

1 A There's a cession statement --

2 Q A what statement?

3 A Cession, C-E-S-S-I-O-N.

4 Q C, as in cede. Okay.

5 A Cede. Right. In the insurance industry,
6 it's called a cession.

7 Q Okay.

8 A So when the insurance comes from Linden,
9 when it goes down each level, it's called retroceded
10 insurance.

11 Q Right.

12 A And there's usually a cession statement
13 that goes along with that, that explains at one point
14 in time what is being ceded, and there's an
15 accounting for that at the end of the program or on a
16 month-end or quarter-end basis, what the results of
17 the program are.

18 Q So would it be correct to say that it would
19 be booked, so to speak, and would show on the ledger,
20 but would that be the same kind of evidence that
21 would indicate that it actually was paid out, third-
22 party record paid out?

23 A Well, that's a third-party record. That
24 cession is a statement that comes under the quota
25 share program. So if you look at the quota share

1 agreement --

2 Q Go ahead.

3 A The quota share agreement is between PoolRe
4 and Reserve, and there's another quota share
5 agreement between PoolRe and the people it gets it
6 from, Aria, all the way up to Linden. So those --
7 there's your third-party evidence. There's insurance
8 coming from Linden to a -- there's a chart here that
9 shows the various levels, a vertical chart.

10 Q Okay.

11 A So those are signed by third parties, and
12 then they do cession statements down to PoolRe, and
13 then PoolRe calculates how much each captive gets.
14 Different captives get different amounts. Some
15 captives don't get anything. It just depends.

16 Q Okay.

17 A Not everyone wants to take on third-party
18 risk.

19 Q I hope this is the last question or at
20 least related to. 132, which is the documents that I
21 was objecting to for quite a while, but I think
22 eventually came in, it's the notebook.

23 A I don't have that here, but okay.

24 Q Do you have that? Is it a small one?

25 A It's over here. I'm glad to get it.

1 THE COURT: I don't think it's over there.

2 (Pause.)

3 THE WITNESS: Yes, sir.

4 BY MR. MARKLEY:

5 Q Okay. The very first one in that notebook
6 -- and I don't know how many pages in there; it
7 doesn't matter. But the very first one, all it
8 really says is, 2000, and then property and casualty
9 insurance company. It's a letter from the Department
10 of Treasury. Do you see that?

11 A Yes.

12 Q All right. And down -- actually it's the
13 third line from the bottom, you see where it says,
14 "This ruling." Do you see that?

15 A Yes.

16 Q "This ruling is not effective unless you
17 actually operate as represented, that we are not
18 ruling on the issues other than exempt status." Is
19 that correct?

20 A Yes.

21 Q So would it be correct that the -- well,
22 that -- do you have any dispute with the fact that
23 that's what it was taken to mean, that it was still
24 required to be -- the company was still required to
25 be operated as represented?

1 A I have no issue with that, and I don't
2 think that's an issue that I know of that anyone's
3 contesting.

4 Q No, no. What I'm -- well, I'm not sure
5 what exactly is being contested regarding this. But
6 -- because I'm not familiar with this case at all.
7 But are you actually familiar with what case this
8 even is?

9 A Yes. It says -- if you go up about three
10 paragraphs --

11 Q Yes.

12 A -- it says, Oilfield Property --

13 Q Oh, okay. So somebody forgot to take that
14 out. Okay. Fine. So then, in other words, the
15 ruling on this required that the entity in question
16 needed to operate as represented, but if it didn't
17 operate as represented, then things would change
18 regarding the exempt status. Would that be correct?

19 A I think that's a fair statement.

20 Q As you understand it.

21 A Sure.

22 Q Probably as in seceding, although this is -
23 - you know, the secession records and --

24 A C-E-S-S-I-O-N, cession.

25 Q Yes. Where would they be, other than in

1 books in front of us or whatever?

2 A Other than --

3 Q Yes.

4 A -- books --

5 Q Would they be in Capstone's records? Would
6 they be some other location?

7 A I mean, they're right here. I mean --

8 Q Okay. So --

9 A They're right here, and then they're with
10 Capstone. They're with the client. I mean, they're
11 lots of places.

12 Q So if they were -- so they're with a client
13 and with Capstone.

14 A I think they're with -- just my guess is --
15 well, of course, the client signed the documents.

16 Q Okay.

17 A Now, whether they saved them or not, I
18 don't know, but they signed them, and I --

19 Q No. I understand.

20 A I save things I sign. Maybe other people
21 don't.

22 Q Okay. Thank you.

23 MR. MARKLEY: I'm finished, Your Honor,
24 with this part.

25 MR. ALBRIGHT: Your Honor, could we take a

1 five-minute break and get organized?

2 THE COURT: Okay. We'll take a five-minute
3 recess. And I assume this is just not going to be
4 too long after we -- with this witness.

5 MR. ALBRIGHT: No, Your Honor.

6 THE COURT: Okay. Thanks.

7 THE CLERK: All rise.

8 (Whereupon, a short recess was taken.)

9 THE CLERK: All rise.

10 Please be seated.

11 THE COURT: You may proceed.

12 MR. ALBRIGHT: No questions, Your Honor.

13 THE COURT: Okay. You may step down.

14 THE WITNESS: Am I dismissed?

15 MR. ALBRIGHT: No questions.

16 THE WITNESS: May I go back and make a
17 living?

18 MR. MARKLEY: We'll release Mr. Feldman
19 from our subpoena. So, yes, you can go make a living
20 as far as I'm concerned.

21 THE WITNESS: Wonderful. Thank you, Your
22 Honor.

23 (Whereupon, the witness was excused.)

24 MR. ALBRIGHT: Your Honor, I don't believe
25 we have any more witnesses, do we? We only have

1 rebuttal witnesses at this point, and --

2 THE COURT: All right.

3 MR. MARKLEY: I'll let one of my co-counsel
4 who has the next witness for our side, I believe.

5 THE COURT: All right. We'll go off the
6 record and --

7 (Discussion held off the record.)

8 THE COURT: The Court is adjourned till
9 nine o'clock tomorrow.

10 THE CLERK: All rise.

11 THE COURT: Oh, back on the record for a
12 second.

13 There were so many -- just to clarify,
14 Exhibits 126-P through -- wait. I should start at
15 the beginning. 118-R through 122-R were admitted.
16 123-P through 125-P were admitted. 126-P through
17 129-P were first admitted with a restriction, but
18 then they were -- the restriction was removed later.
19 130-P through 132-P was admitted. 28-P through 30-P
20 were admitted. And 133-P was admitted.

21 Now the Court is in recess until 9:00
22 tomorrow. Thank you.

23 (Whereupon, at 6:43 p.m., the above-
24 entitled matter was concluded.)

25

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3 Reserve Casualty Corp. v. Commissioner

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19 (Transcriber) (Date)

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IN THE UNITED STATES TAX COURT

In the Matter of:)
)
RESERVE MECHANICAL CORP., f.k.a.)
RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
v.)
)
COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

Volume: 11
Pages: 824 through 919
Place: Houston, Texas
Date: May 2, 2017

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 RESERVE MECHANICAL CORP., f.k.a.)
 RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
 v.)
)
 COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

Room 7006
 Casey U.S. Courthouse
 515 Rusk Avenue
 Houston, Texas

May 2, 2017

The above-entitled matter resumed for trial, pursuant to recess, at 9:00 a.m.

BEFORE: HONORABLE KATHLEEN KERRIGAN
Judge

APPEARANCES:

For the Petitioner:

VAL J. ALBRIGHT, Esquire
 MICHELLE Y. KU, Esquire
 Gardere Wynne
 2021 McKinney Avenue, Ste. 1600
 Dallas, Texas 75201
 214-999-3000

1 APPEARANCES: (continued)

2 For the Respondent:

3 G. ROGER MARKLEY, Esquire
4 THOMAS F. HARRIMAN, Esquire
5 NASEEM J. KHAN, Esquire
6 JUSTIN D. SCHEID, Esquire
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9 200 W. Adams Street
10 Chicago, Illinois 60606
11 312-368-8243

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C O N T E N T S

WITNESSES:	DIRECT	CROSS	REDIRECT	RECROSS	DIRE	VOIR
For Petitioner:						
None						
For Respondent						
Donald J. Riggin	838	869				

1		E X H I B I T S	
2	EXHIBITS:	IDENTIFIED	RECEIVED
3	136-R	855	857
4	137-R	855	861
5	138-P	905	912
6	139-P	913	918
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1 P R O C E E D I N G S

2 (9:00 a.m.)

3 THE CLERK: Docket Number 14545-16, Reserve
4 Mechanical Group, formerly known as Reserve Casualty
5 Corp. Please state your appearances.

6 MR. MARKLEY: Good morning, Your Honor.
7 Roger Markley for Respondent.

8 MR. SCHEID: Justin Scheid for Respondent.

9 MR. HARRIMAN: Tom Harriman for Respondent,
10 Your Honor.

11 MS. KHAN: Good morning, Your Honor.
12 Naseem Khan for Respondent.

13 MR. ALBRIGHT: Good morning, Your Honor.
14 Val Albright for Petitioner.

15 MS. KU: Good morning, Your Honor.
16 Michelle Ku for Petitioner.

17 MR. ALBRIGHT: Your Honor, we have one
18 preliminary matter.

19 THE COURT: Okay.

20 MR. ALBRIGHT: We discovered last night
21 that some of the exhibits are missing pages, in
22 particular in the insurance policies, and we've been
23 trying to work that out this morning with
24 Respondent's counsel, but we don't have it resolved
25 yet. And we're find with going ahead with the

1 witnesses, but I'd like to reserve the right, we
2 might even have to call a witness to resolve some of
3 these issues. I would hope that we could work it out
4 by stipulation, but I'm not certain that that can be
5 the case.

6 THE COURT: Okay. The Court wants to be
7 clear. Is this exhibits that were already stipulated
8 to?

9 MR. ALBRIGHT: Yes, ma'am.

10 THE COURT: How many exhibits is it?

11 MR. ALBRIGHT: They're primarily the
12 insurance policies. For example, there's a general
13 endorsement that is not included. We had sent these
14 documents to Respondent back a long time ago and then
15 when they did the stipulation, we didn't realize that
16 they used some other documents for stipulation
17 purposes and we actually discovered that last night,
18 and actually, some of the policies are missing pages.

19 MR. HARRIMAN: Your Honor, the documents we
20 used for stipulation were all provided by Petitioner,
21 and further, we exchanged the documents that we
22 intended to incorporate into the stipulation with
23 them. They had ample opportunity to review them, and
24 they did, as you can see by the signed stipulation of
25 facts that they agreed to those documents.

1 THE COURT: The Court does have some
2 concern because you did sign the stipulation, and if
3 you think it's an error that some pages are missing
4 that do exist, I think that is different.

5 MR. ALBRIGHT: And so, Your Honor, if we
6 proceed, Respondent hasn't started his case in chief
7 but if we had to, we could call another witness now,
8 I believe, to present these documents if we couldn't
9 work out a stipulation.

10 MR. HARRIMAN: Your Honor, this is new
11 information that just happened this morning. Also, I
12 believe that Petitioner rested last night when the
13 Court went into recess. It's now Respondent's turn
14 to present their case in chief and we're just still
15 sorting out these alleged new problems with 45
16 exhibits that Petitioner already agreed to.

17 MR. MARKLEY: Well, may I say something to
18 in addition to that? What Mr. Albright has said
19 doesn't make any sense because if we can agree to
20 something, why would he need to call a witness. That
21 doesn't make any sense at all. So if we can agree to
22 something one way or the other, or not agree to
23 something, then he might be able to determine if he
24 needs the witness. We have an expert witness that is
25 ready to go, we have another witness that is ready to

1 go, we're on a fairly tight schedule, all this is
2 going to do is potentially -- from Mr. Albright is
3 saying, this could spend and spend another couple of
4 hours on clearing up whatever it is that they believe
5 be a problem which is a complete interference with
6 what we're trying to do. If they want to do that and
7 we can work things out before they need to formalize
8 witnesses, that's fine, but it shouldn't be right
9 now.

10 MR. ALBRIGHT: Your Honor, could I just
11 give you an example?

12 THE COURT: Yes.

13 MR. ALBRIGHT: Exhibit 60-J, for example,
14 it has page 1 and then page 5, it's missing four
15 pages.

16 MR. HARRIMAN: And we would be fine with
17 incorporating those additional pages, however, what
18 Petitioner is attempting to do, from the conversation
19 that I've had, is bootstrap an additional attachment
20 to each individual policy.

21 MR. ALBRIGHT: Your Honor, that's not
22 exactly correct. There is a general endorsement
23 that's referred to in all these policies. We sent
24 the documents, we sent the copies of these policies
25 to Respondent's counsel a long time ago and

1 Respondent chose not to include that. Now,
2 obviously, I should have caught that, Your Honor, but
3 that general endorsement, we would like to have that
4 in the record for 2008, 2009 and 2010. It's part of
5 the policy.

6 And then on the special risk punitive wrap
7 policy, Exhibit 69-J, there are schedules missing,
8 there are pages missing, a general change endorsement
9 are missing. We'd like to add those documents to
10 make these policies complete.

11 MR. HARRIMAN: Your Honor, the documents
12 that we used as a basis for the stipulation were the
13 ones that were provided pursuant to the TEGE
14 examination that's in the administrative record. I
15 believe Mr. Albright is the representative on the
16 TEGE portion of that case, and he is in the process
17 of agreeing to those documents as well for that
18 stipulation as to the administrative record. We've
19 been dealing with the same documents in both of those
20 cases, and so now for him to come in at the last
21 minute and suddenly say that there are problems with
22 the document, well, frankly, Your Honor, I don't know
23 how to respond to that.

24 THE COURT: Well, 60-P, can you tell me
25 where pages -- I know the Bates Numbers go in order,

1 but on 60-P it goes from policy, goes from page 106
2 to 506.

3 MR. ALBRIGHT: Yes, Your Honor.

4 THE COURT: And this is the excess
5 directors and officers liability insurance policy
6 coverage.

7 MR. ALBRIGHT: Yes, Your Honor.

8 MR. HARRIMAN: Your Honor, again, we were
9 just using the documents that were provided and that
10 we had available. If they had additional pages, we
11 would have incorporated them, and if they have
12 additional pages now that will be pages 2 of 6
13 through -- well, essentially the missing pages here
14 for this policy, we're happy to incorporate them.
15 What we're having an issue with is this common policy
16 coverages which is an entirely separate attachment
17 that they're trying to add to 45 of the exhibits.

18 THE COURT: That's not what the Court asked
19 you about; I just asked you about the pages right
20 now.

21 MR. HARRIMAN: Yes, Your Honor. We did not
22 have them available when we assembled the
23 stipulation, and we'd be happy to incorporate them
24 now.

25 THE COURT: And I believe, Mr. Albright,

1 when you exchanged documents, you did send a complete
2 policy.

3 MR. ALBRIGHT: Yes, ma'am.

4 THE COURT: I think that both sides are at
5 fault here, and the Court assumed these were complete
6 policies, and probably when I was back reviewing
7 this, you would have heard from me wondering where
8 these pages were. And I have concerns that when you
9 signed the stipulation on both sides, each party, was
10 it your understanding, did you think it was the
11 complete -- I'm using 60-P as an example, and the
12 stipulation says: Copies of each of the 2009
13 contracts are attached as exhibits as follows, and
14 60-J is excess directors and officers liability
15 insurance policy.

16 And I'll ask Respondent first, when you
17 signed the stipulation, did you believe it was a
18 complete policy?

19 MR. HARRIMAN: We believed it was the most
20 complete policy we had available to us.

21 THE COURT: But did you wonder why pages
22 were missing, or did you think they were all in
23 there?

24 MR. HARRIMAN: Your Honor, frankly, with
25 this particular example we were not aware of the

1 missing pages. We had our documents sorted to the
2 administrative record in the TEGE case and we used
3 those as the baseline for the stipulation, and we
4 sent the proposed binder over to Petitioner for his
5 review as well.

6 THE COURT: Mr. Albright, when you signed
7 the stipulation, did you believe that -- you just
8 assumed it was the full policy?

9 MR. ALBRIGHT: I assumed it was the full
10 policy, Your Honor.

11 THE COURT: How many exhibits are there
12 where there's pages missing like this?

13 MR. ALBRIGHT: Well, Your Honor, we might
14 be able to solve some of this by just putting the
15 general endorsement -- I believe it's called the
16 general endorsement --

17 THE COURT: I'm not asking about the
18 general endorsement right now. I just want to know
19 how many of these exhibits have pages missing the way
20 60-P does.

21 MR. ALBRIGHT: We have a stack of these, we
22 worked on these last night, but there's like eleven
23 policies and then also the common policy conditions
24 are missing from all of the policies.

25 THE COURT: So it's eleven -- all I want to

1 know is about missing pages right now.

2 MR. ALBRIGHT: Just missing pages?

3 THE COURT: Just missing pages, that's all
4 I want to know.

5 MR. ALBRIGHT: There's approximately eleven
6 exhibits that are either missing pages or they have
7 pages where the copy is cut off, the entire page is
8 not copied.

9 THE COURT: And have you had a chance yet
10 to show these exhibits to Respondent.

11 MR. ALBRIGHT: Your Honor, we were
12 discussing that with Respondent's counsel this
13 morning and we were showing Respondent's counsel
14 where these issues are. We were explaining it to
15 them but we didn't complete that discussion.

16 THE COURT: Okay. I'm going to let
17 Respondent go forward with their case now, but I
18 think these eleven documents just talking about the
19 pages missing or blank, that the parties can probably
20 work something out.

21 MR. HARRIMAN: I believe we can, Your
22 Honor.

23 THE COURT: And substitute on the
24 stipulation.

25 Now, the other, Mr. Albright, what was the

1 exact term you used, was it the common endorsement is
2 what you called it?

3 MR. ALBRIGHT: It's the common policy
4 conditions, and when we sent these policies to
5 Respondent's counsel for stipulation purposes, we
6 incorrectly ultimately believed that the common
7 policy conditions would have also been attached to
8 these policies because we had provided the policies
9 to them in that form.

10 THE COURT: You can talk to Respondent like
11 this, but I'll allow time after Respondent's case if
12 you need to call a witness to offer these. I think
13 this is something that you should have noticed
14 because it's a little different than a missing page
15 and I don't know if it was Respondent's intent not to
16 include it in the stipulation, and when you signed
17 the stipulation, I don't quite see this as a missing
18 page or a cut off part of a document.

19 MR. ALBRIGHT: But the Court will allow us
20 to discuss it if we have to?

21 THE COURT: After Respondent's case, I'll
22 allow you to call a witness.

23 MR. ALBRIGHT: Okay, Your Honor. Thanks.

24 MR. HARRIMAN: Thank you, Your Honor.

25 THE COURT: You may proceed.

1 MR. SCHEID: May we proceed?

2 THE COURT: Yes.

3 MR. SCHEID: Respondent calls Donald J.

4 Riggin.

5 Whereupon,

6 DONALD J. RIGGIN

7 having been first duly sworn, was called as

8 a witness herein and was examined and testified as

9 follows:

10 THE CLERK: Can you please state your name

11 and address for the record?

12 THE WITNESS: Donald Riggin, 2 Curtis

13 Street, Salem, Massachusetts 01970.

14 THE CLERK: You may be seated.

15 MR. SCHEID: Good morning, Your Honor.

16 Justin Scheid for Respondent.

17 DIRECT EXAMINATION

18 BY MR. SCHEID:

19 Q Good morning, Mr. Riggin.

20 A Good morning, Justin.

21 Q Mr. Riggin, where are you currently

22 employed?

23 A I'm employed at the Art of Captives, LLC.

24 Q And what is your title there?

25 A President.

1 Q And how long have you held that position?

2 A I founded the firm in 2013, about four
3 years.

4 Q And what is Art of Captives' business?

5 A Art of Captives is a captives consultancy.
6 We do captive feasibility work, captive reviews and
7 captive development and implementation.

8 Q Now, what are your primary responsibilities
9 with Art of Captives?

10 A I'm the lead consultant, basically. I do
11 the technical work, technical work being captive
12 feasibility studies, financial reviews, loss
13 analysis, loss reviews, I should say, pretty much it.

14 Q Now, can you describe the types of
15 feasibility analyses that you've worked on while
16 you've been with Art of Captives?

17 A Oh, absolutely. Basically large what I
18 like to call legitimate captives, with premiums
19 anywhere from a million dollars on up. Those are the
20 types of captives that have significant loss
21 information associated with them, significant
22 premiums associated with them, and generally they're
23 for lines of coverage that are basic, workers'
24 compensation, general liability, auto liability,
25 sometimes professional liability.

1 Q Now, have you had any experience with
2 captive formation while you've been with Art of
3 Captives?

4 A Absolutely.

5 Q Can you describe your experience with
6 captive formation?

7 A Sure. In my role as a consultant, I
8 basically hire a team of service providers. These
9 folks reside in the domicile that we've chosen for
10 the client and they consist of auditors, attorneys,
11 an actuary prior to creating this team, and a lawyer
12 and a captive manager within the domicile.

13 Q Now, you mentioned financial statements.
14 Have you worked with financial statements while
15 you've been with Art of Captives?

16 A Not final financial statements, that's the
17 captive manager's job. What I do, what we do is
18 create pro forma financial statements, such that the
19 client is able to see, in a vague sense, so to speak,
20 or in a less than specific sense, what the outcome
21 might be for this particular captive from a financial
22 standpoint.

23 Q Can you describe your process in preparing
24 these pro forma financial statements?

25 A Of course. We use a very basic model where

1 we input loss information, we input premium
2 information, and an estimate of the expenses in the
3 program which gives us, through the model process, an
4 idea of retained earnings, gives us an idea of the
5 cash flows involved.

6 Q Now, earlier you mentioned various
7 coverages that would be in a captive. Can you
8 describe your experience with captive insurance
9 coverages during your time with Art of Captives?

10 A Oh, absolutely. The main coverages in a
11 captive are workers' compensation, general liability,
12 auto liability and property. Every captive that I
13 have created over the time I've owned Art of Captives
14 has included one or more of those coverages. Usually
15 it's workers' compensation, sometimes it isn't;
16 sometimes it includes third party business, sometimes
17 it doesn't; very often it includes property
18 insurance. Property actually is the most significant
19 or the largest amount of coverage, the biggest item
20 of coverage in a captive or a blind.

21 Q Now, have you had insurance with captive
22 reinsurance structures?

23 A Yeah. We insure through a couple of
24 reinsurance versions. One is if the captive is
25 fronted, meaning if there is an insurance company

1 such as, pick one, CNA, Hartford, The
2 Travelers, if the captive is fronted, then the
3 captive is a reinsurer of that front. If the captive
4 is not fronted, then the captive is a direct writer,
5 meaning that the insured sends the premium directly
6 to the captive, where in a reinsurance captive, the
7 insured pays the front and the front then cedes the
8 risk to the captive and the captive becomes just like
9 any other reinsurer of the front.

10 Q Have you had experience with premium
11 creation or determination of premium reasonableness
12 while you've been with Art of Captives?

13 A Sure.

14 Q What's your experience.

15 A As I said before, we don't create premiums,
16 we work with actuaries who do create premiums.
17 Reasonableness, from my perspective, is that the
18 client expectations and the specifics of the client
19 in terms of its business, in terms of its expectation
20 to determine the degree to which the premium should
21 be credited or debited. There are very few instances
22 where we assign a debit to a program. Usually it's a
23 credit based on specific information, based on loss
24 management or loss control efforts by the client,
25 based on the market. If the client otherwise

1 qualifies for a specific credit, then we look to
2 market and we see if it makes sense. The market is
3 the market, so that if this client that otherwise
4 qualifies for a captive is not able to afford the
5 specific premiums, then we check to see if it makes
6 sense to provide a credit on those premiums.

7 Q What's the typical dollar value of
8 coverages provided by a captive while you've been
9 involved with while at Art of Captives?

10 A I work with large captives, anywhere from a
11 million dollars to 2-1/2 million to start. In this
12 captive world, large captives are real captives.
13 They come with loss experience, they come with a fair
14 amount of historical loss experience. We like to
15 work with ten years' worth, but often we only get
16 maybe five or six years. Premiums, minimum premium
17 anywhere from a million to a million and a half to
18 two million, depending in the risk. But the premium
19 level decides or actually it indicates the amount of
20 loss that the client has experienced, so that if we
21 have a client -- typically if we have a client that's
22 paying a million and a half dollars for captive-
23 specific lines, not for a lot of smaller ancillary
24 lines that are better covered in the conventional
25 markets, but for specific lines of coverage, and I

1 mentioned these before and I'll mention them again,
2 workers' compensation, property, general liability,
3 automobile liability.

4 Q Now, prior to forming Art of Captives,
5 where were you employed?

6 A I was employed at Aon which is a large
7 national broker.

8 Q What was your title with Aon?

9 A I was the associate director within the
10 captive consulting unit.

11 Q And you worked for Aon from October 2011 to
12 December 2012?

13 A I did.

14 Q What were your primary responsibilities at
15 Aon?

16 A Primary responsibilities were very similar
17 to my responsibilities now. I did captive
18 feasibility work, captive reviews. And a captive
19 review is a review of a mature captive, and the way
20 we describe mature captive is a captive that is five
21 years old or older wherein from a compliance
22 standpoint in terms of the solvency ratios, wherein
23 from a utilization standpoint, utilization is huge
24 here because if the capital has been sitting there
25 unused or underemployed, then that's not a good

1 thing, especially from the client's CFO's
2 perspective. Now, from the client's risk manager's
3 perspective, they very often like to have as much
4 capital as possible, but from a CFO's standpoint they
5 don't because it cuts into the return on invested
6 capital.

7 Q What experience did you have in that review
8 that you just described with captive financial
9 statements while you were at Aon?

10 A It's the same thing as now. We had models
11 that we would run the information through and come up
12 with retained earnings and come up with the cash
13 flows. And retained earnings is fine, retained
14 earnings is one thing, but these programs really live
15 and die on the cash flows so that if the cash flows
16 can be demonstrated as positive, then generally the
17 captive can be considered to be potentially healthy
18 from the financial perspective.

19 Q Now, prior to Aon, you worked at Spring
20 Consulting Group, LLC?

21 A I did.

22 Q Is that right?

23 A I did.

24 Q And what was your title with Spring
25 Consulting Group?

1 A I was the head of property/casualty
2 consulting, property and casualty being, well,
3 property and casualty, P&C, as opposed to employee
4 benefits. Spring Consulting Group is primarily an
5 employee benefits consultancy, and I was brought on
6 to do the property and casualty piece.

7 Q And you worked at Spring Consulting from
8 September 2009 to October 2011?

9 A Correct.

10 Q And you just described you were primarily
11 brought on to direct the property and casualty side.
12 Is that right?

13 A Yes.

14 Q And what specifically were your
15 responsibilities there in that regard?

16 A Two things: one was to interject a
17 property and casualty expertise wherein the Spring
18 clients that were just employee benefits in captive -
19 - Spring is specifically captives, captive
20 consultancy, similar to what I've been doing -- so
21 they had a significant number of clients, and still
22 do, that didn't have a property/casualty captive
23 arrangement, so what I would do is I would find those
24 clients and make sure that if it made sense for them
25 to pursue a property and casualty captive, that's

1 what I'd do, if it didn't make sense, then we would
2 know that that particular client was not a good
3 candidate for a captive.

4 Q Did you also perform captive reviews as you
5 just previously described while you were at Spring
6 Consulting?

7 A Absolutely. Spring does have a small
8 number of property and casualty captives. Reviewing
9 those captives was part of my job.

10 Q Now, prior to Spring Consulting you worked
11 at Albert Risk Management Consultants.

12 A I did.

13 Q And what was your title with Albert Risk
14 Management?

15 A I was the head of property/casualty
16 consulting.

17 Q And what experience while you were with
18 Albert Risk Management did you have in captive
19 feasibility or captive implementation?

20 A Basically it was captive feasibility work
21 and captive reviews. Two very specific clients that
22 I can mention, it's not a problem, is the Archdiocese
23 of New York, we put together a captive for some very
24 specific risks for them, and a REIT, real estate
25 investment trust with Chemco which is the largest

1 shopping center REIT in the country.

2 Q And prior to that you worked at Liberty
3 Mutual Alternative Markets.

4 A I did.

5 Q And you worked there from October 2004 to
6 January 2006?

7 A Correct.

8 Q What was your title with Liberty Mutual?

9 A I was a director of new product
10 development.

11 Q And what were your responsibilities in that
12 regard?

13 A It was a little bit different. Liberty
14 Mutual Alternative Markets did captives but in a
15 slightly different sense. We worked on nursing
16 homes, we worked on architectural engineers E&O, we
17 worked on healthcare, other healthcare besides
18 nursing homes. Liberty Mutual at the time was --
19 fancied themselves a good candidate for the
20 alternative markets. It turned out that they really
21 weren't, but my job with them was to create new
22 products and to literally create a captives awareness
23 within the unit.

24 Q Did you have experience with warranty
25 programs while you were at Liberty Mutual?

1 A Yes, yes. I formed a warranty program for
2 a group of field turf manufacturers. Field turf is
3 what is used in the NFL, it's used in almost every
4 high school and college football fields.

5 Q Now, prior to Liberty Mutual, you worked
6 with SKS Risk Services.

7 A Yes, I did.

8 Q And you were there from November 1999 to
9 October 2004?

10 A Indeed.

11 Q And what was your title with SKS?

12 A I was the manager of property and casualty
13 captives.

14 Q What experience did you have with captive
15 formation while you were at SKS?

16 A Captive formation, the most significant
17 captive that I formed there was a four-agency captive
18 agency captive, and an agency captive is a program
19 where an insurance agency literally assumes a portion
20 of its clients' risk. I put together a four-agency
21 captive throughout the State of Ohio. It didn't
22 include workers' compensation because that did not
23 apply in Ohio at the time.

24 Q Can you tell us about your educational
25 background?

1 A Sure. I have a bachelor's degree from
2 Towson University in Baltimore, I hold the CPCU and
3 ARM professional designations.

4 Q Let's focus on the ARM designation. What
5 is that?

6 A Associate in Risk Management.

7 Q And how long have you held that?

8 A Since 1987.

9 Q 1984, possibly?

10 A Oh, 1984. Yes. CPCU was 1987.

11 Q And what is the process to earn an
12 Associate in Risk Management?

13 A ARM is a three-semester program, three
14 separate courses, literally devoted to risk
15 management and risk financing. It doesn't pay a lot
16 of attention to coverages, insurance coverages, just
17 basically the profession of risk financing and risk
18 management.

19 Q And then you also mentioned the CPCU. What
20 does that stand for?

21 A Charter Property and Casualty Underwriter.

22 Q And you've held that since 1987, I believe?

23 A I have indeed.

24 Q And what's required to obtain the CPCU
25 designation?

1 A CPCU is a ten-part program, it generally
2 takes five years to complete. You can complete the
3 program in less than five years, I did actually, many
4 people do. It's basically a ten-semester program, so
5 each course is designed to be completed within a
6 single semester. CPCU is a generalized insurance
7 risk financing program. It covers everything you can
8 think of, from homeowners insurance right through
9 insurance accounting, right through ethics which is
10 the last section in the program.

11 Q Now, does the CPCU -- you said the CPCU
12 focuses on insurance accounting. Is that right?

13 A It does. There's a section devoted to
14 insurance accounting.

15 Q And what professional underwriting -- CPCU
16 is Charter Property and Casualty Underwriter.

17 A Correct.

18 Q What professional insurance underwriting
19 experience do you have?

20 A Early in my career I started as an
21 underwriter with the Rollo Insurance Company and then
22 proceeded to the Crum & Forester Insurance Company.
23 Underwriting is underwriting. Underwriting consists
24 of risk selection and risk pricing.

25 Q What professional affiliations do you

1 currently participate in?

2 A I'm a member of the Risk and Insurance
3 Management Society, the Society of Charter Property
4 and Casualty Underwriters, Captive Insurance
5 Companies Association, and Vermont Captive Insurance
6 Association.

7 Q Have you ever held any state insurance
8 licenses?

9 A Yes. In Ohio, Maryland and Pennsylvania.

10 Q Now, can you describe your experience with
11 conventional multi-line insurers calculation of
12 premiums?

13 A Absolutely. There are two ways, two basic
14 ways that premiums are calculated. One is if you
15 have enough loss information and enough --

16 mR. ALBRIGHT: Your Honor, I believe he's
17 getting into his expert testimony at this point, and
18 I believe that he should be qualified first before we
19 move into his testimony about his opinions in this
20 case.

21 MR. SCHEID: Your Honor, at this point I'm
22 still continuing to qualify him, I'm asking him about
23 his experience. We can certainly narrow the scope of
24 the response to purely his experience in doing this
25 calculation, but he's testifying from his experience.

1 THE COURT: I feel like this question was
2 getting into a gray area, so if you can qualify your
3 question.

4 MR. SCHEID: Sure, Your Honor.

5 BY MR. SCHEID:

6 Q Mr. Riggin, do you have experience in
7 calculation of premiums in connection with a
8 conventional multi-line insurer?

9 A I do.

10 Q How does that experience differ from what
11 an actuary does?

12 A Oh, it's a world of difference between
13 that. As I said before, I hire and work with
14 actuaries. Assuming there is enough loss information
15 so that the actuary can perform his or her
16 calculation, using his or her models, I work with the
17 output of that. If there is not enough loss
18 information in a smaller account -- now, this is not
19 in the captive context but in a smaller account where
20 you're in the \$300,000 range or \$400,000 range,
21 insurance underwriters use what is called the
22 Commercial Lines Manual, the CLM, to come up with
23 rates. The rates are based on actuarial information.
24 The CLM is published by the NCCI, the National -- no,
25 that's workers' compensation -- it's published by the

1 ISO, Insurance Services Office.

2 MR. ALBRIGHT: Your Honor, I renew
3 Petitioner's objection. All of this is in Mr.
4 Riggin's expert report and it formulates -- it's the
5 basis of his opinion, it's his opinion.

6 MR. SCHEID: And again, Your Honor, we're
7 going to the foundation for his opinions and based
8 upon his experience, the question was focused based
9 upon his experience.

10 THE COURT: I'm going to allow the question
11 but I recommend that Respondent's counsel move on.

12 MR. SCHEID: Thank you, Your Honor.
13 Your Honor, in that regard, Respondent, pursuant to
14 Tax Court Rule 143(g), offers Donald Riggin as an
15 industry expert in captive insurance.

16 MR. ALBRIGHT: Your Honor, Petitioner
17 renews the motion in limine that was filed prior to
18 the trial herein.

19 THE COURT: All right. The Court is going
20 to allow Mr. Riggin to be qualified as an expert.

21 MR. SCHEID: Thank you, Your Honor.

22 Your Honor, we intend to both introduce Mr.
23 Riggin's opening report and rebuttal report at the
24 same time, if the Court would allow.

25 THE COURT: The Court will allow it, but I

1 do want to raise a point when we get to the rebuttal
2 report.

3 MR. SCHEID: Yes, Your Honor.

4 May I approach to have two documents marked
5 for identification?

6 THE COURT: Yes.

7 MR. SCHEID: This will be the opening
8 report, expert report of Donald J. Riggin, dated
9 March 27, 2017, and the rebuttal expert report of
10 Donald J. Riggin, dated April 10, 2017. May I
11 approach, Your Honor?

12 THE COURT: Yes.

13 MR. SCHEID: And let the record reflect I'm
14 handing a copy of the aforementioned reports to
15 Petitioner's counsel.

16 THE CLERK: The expert report of Donald J.
17 Riggin is marked for identification as Exhibit 136-R,
18 and the rebuttal expert report of Donald J. Riggin is
19 marked for identification as Exhibit 137-R.

20 (The documents referred to were
21 marked for identification as
22 Exhibits 136-R and 137-R.)

23 MR. SCHEID: May I approach, Your Honor,
24 and hand the witness a copy of what's been marked as
25 Exhibit 136-R for identification and 137-R for

1 identification?

2 THE COURT: Yes.

3 BY MR. SCHEID:

4 Q Mr. Riggin, I've just handed you what's
5 been marked as Exhibit 136-R for identification. Do
6 you see that in front of you?

7 A I do.

8 Q Now, Mr. Riggin, you were asked to provide
9 opinions in this case?

10 A I was.

11 Q And you reached conclusions regarding this
12 case?

13 A I did.

14 Q And you prepared a report containing those
15 conclusions?

16 A Correct.

17 Q Mr. Riggin, is Exhibit 136-R for
18 identification the report you prepared in this case?

19 A Yes, it is.

20 MR. SCHEID: Your Honor, Respondent offers
21 the opening expert report of Donald J. Riggin, dated
22 March 27, 2017, which has been marked as Exhibit 136-
23 R for identification into evidence.

24 MR. ALBRIGHT: Your Honor, Petitioner would
25 object on the same grounds as set forth in the motion

1 in limine that was filed herein prior to the trial.

2 THE COURT: 136-R is admitted.

3 (The document referred to,
4 having been previously marked
5 for identification as
6 Respondent's Exhibit 136-R,
7 was received in evidence.)

8 BY MR. SCHEID:

9 Q Now, Mr. Riggin, I've also handed you a
10 copy of what's been marked as Exhibit 137-R for
11 identification. Do you see that in front of you?

12 A I do.

13 Q And you also reviewed the opening reports
14 of Petitioner's experts, Neil Doherty, Robert Snyder,
15 Lance McNeel, Gary Fagg, Esparanza Mead and Michael
16 Solomon, and those reports were all dated March 27,
17 2017. Is that right?

18 A That is right.

19 Q And you reached conclusions based upon your
20 review of those reports. Is that right?

21 A I did.

22 Q Is that correct?

23 A That is correct.

24 Q And you prepared a rebuttal report
25 containing those conclusions?

1 A I did.

2 Q And that rebuttal report is what you see in
3 front of you which has been marked as Exhibit 137-R
4 for identification?

5 A Correct.

6 Q And Exhibit 137-R for identification states
7 your conclusions that you reached after review of
8 those reports I just mentioned?

9 A It does.

10 MR. SCHEID: Your Honor, Respondent offers
11 Exhibit 137-R for identification, which is the
12 rebuttal report of Donald J. Riggin, dated April 10,
13 2017, into evidence, but since Mr. McNeel was not
14 offered as an expert, we would propose that the Court
15 strike that portion of Mr. Riggin's rebuttal report.

16 THE COURT: The Court is going to strike --
17 and this is the issue I wanted to raise with this
18 report.

19 MR. SCHEID: Yes, Your Honor.

20 THE COURT: My preference is I'm going to
21 strike it, and then I'll have the trial clerk show
22 you if you want to see what I actually struck from
23 the report. So the Court is striking on page 6,
24 paragraphs 19 through 21, and on page 7, paragraphs
25 22 through 25. That was the only thing the Court

1 noticed in the rebuttal in relation to Mr. McNeel.

2 MR. SCHEID: Your Honor, if I may? There
3 is in the summary of opinions on page 3 -- I guess we
4 didn't have one in there. I'm sorry. There was no
5 summary there.

6 THE COURT: Right. Because the only other
7 reference I noticed was just, and I'm striking, on
8 page 2, just the reference to section -- because I
9 did not notice anything in the summary opinion about
10 Mr. McNeel.

11 MR. SCHEID: Respondent has no objection to
12 those portions.

13 MR. ALBRIGHT: Your Honor, in addition to
14 the objection that we made in the motion in limine,
15 also, there's been no foundation laid to demonstrate
16 that Mr. Riggin is qualified to address the report of
17 Esperanza Mead or Michael Solomon. Mr. Riggin is not
18 an actuary and those are actuarial reports. I don't
19 believe he's qualified to testify about actuarial
20 methodology.

21 MR. SCHEID: Your Honor, again, he's not
22 offering an opinion with respect to any sort of
23 actuarial analysis, this is his professional analysis
24 from an industry perspective. His calculations as
25 related to the fundamental metrics are his own, based

1 upon his industry experience.

2 THE COURT: Yes, Mr. Albright.

3 MR. ALBRIGHT: Your Honor, page 7, Mr.
4 Riggin states: Ms. Mead's report is not an accurate
5 account of reserves, rates and premiums. And he is
6 critical of her related to the loss data that she
7 used. He also gets into the details of her report,
8 and he says: My conclusion is that in the absence of
9 actual loss information, none of the data in this
10 report should be considered to be an accurate
11 representation of reserves loss picture. These are
12 actuarial issues, Your Honor.

13 THE COURT: I think your issues can be
14 addressed on cross and the Court will give the report
15 the appropriate weight.

16 So I'm going to hand it back to the trial
17 clerk Exhibit 137-R, and he can show you the changes
18 I made to it, so both parties can see. And my
19 preference is if you want to initial it if you agree
20 with what was struck out. And I also did make a
21 strikeout on page 2 of the index.

22 MR. ALBRIGHT: And I would also have the
23 similar objection regarding Mr. Riggin's report in
24 rebuttal to the report of Michael Solomon, who is
25 also an actuary.

1 MR. SCHEID: Your Honor, just so Respondent
2 is clear, is 137-R for identification been admitted
3 in evidence with the redactions we've just discussed?

4 THE COURT: I was going to have you -- once
5 I got it back, I was going to admit it.

6 MR. SCHEID: Thank you. I'm sorry.

7 THE COURT: I also didn't think you had
8 offered it yet.

9 MR. SCHEID: Your Honor, Respondent offers
10 Exhibit 137-R which has been marked for
11 identification -- this is the rebuttal expert report
12 of Donald J. Riggin, dated April 10, 2017 -- with the
13 redactions as have been initialed by the parties and
14 discussed with the Court, into evidence.

15 THE COURT: Yes. And Mr. Albright?

16 MR. ALBRIGHT: Same objection as previously
17 stated.

18 THE COURT: The Court is admitting 137-P as
19 modified and the modifications agreed to by the
20 parties.

21 MR. SCHEID: And it's 137-R, Your Honor.

22 THE COURT: I'm sorry. 137-R.

23 MR. SCHEID: Thank you.

24 (The document referred to, having been
25 previously marked for identification as

1 Exhibit 137-R, was received in evidence.)

2 BY MR. SCHEID:

3 Q Mr. Riggin, we want to give the Court a
4 brief overview of your opinions and I also want to
5 discuss your views in rebuttal to the other experts
6 that have testified, so let's first focus on your
7 opinions in your opening report. Mr. Riggin,
8 generally, how does an insurance company compute
9 premiums?

10 A Insurance companies compute premiums in two
11 different ways, basically. One would be the
12 Commercial Lines Manual for small accounts, small
13 premiums anywhere from \$10 to anything, actually. It
14 doesn't really matter, just when you get to the
15 larger numbers, to the larger premium numbers, I
16 don't want to say there's a breakpoint, but there's a
17 point at which there's enough loss information that
18 an actuary can utilize to be able to create expected
19 losses, and if they can create expected losses, they
20 can create rates and premiums. When there isn't --

21 Q So -- I didn't mean to cut you off.

22 A Okay. When there isn't enough loss
23 information for an actuary to do this, underwriters
24 rely on what is called the CLM, the Commercial Lines
25 Manual, and that provides rates against which the

1 underwriter can use -- and it depends on the line of
2 coverage, for general liability it's per thousand of
3 sales, and for workers' compensation it's per hundred
4 of payroll, so in that sense it's a very easy
5 calculation. When we go back to the larger business
6 with a lot of loss history and a lot of premium
7 history, then an actuary -- what I'd do is I would
8 bring in an actuary to be able to make those
9 calculations.

10 Q Now, why is loss data so important to a
11 premium calculation?

12 A Loss data is the fundamental aspect of
13 expected losses. Without loss data it is possible to
14 create a scenario wherein expected losses are
15 calculable but those situations are one-offs, those
16 situations should not be used in a programmatic basis
17 as they are used here. Losses are the bedrock of
18 what we do, of what actuaries do. When I hire an
19 actuary, one of the first things that we talk about
20 is is there enough loss information to proceed in a
21 conventional sense. And if we're talking about
22 workers' compensation or general liability or
23 automobile liability or property, there really should
24 be in a large account -- it doesn't always work that
25 way, of course -- but there really should be enough

1 loss information to be able to adequately project to
2 some confidence level. And of course, actuarial
3 projections come at a range of confidence levels,
4 anywhere from 50 percent to 99 percent, you can't get
5 to 100 percent. And a confidence level is how
6 comfortable the actuary is with his or her
7 projection. So usually the confidence level in the
8 market is 50 to 55 percent.

9 Q So now I want to pivot from that to this
10 concept of homogeneity.

11 A Sure.

12 Q So how does the lack of risk homogeneity
13 impact, in this case the captive at issue here,
14 Reserve, from an insurance industry perspective, in
15 your view?

16 A Homogeneity exists basically in two places,
17 in two areas. One is class of business homogeneity
18 wherein you have a bakery, for example, or in a group
19 program, in a group captive program you will have 20
20 bakers, bakery is a class of business. The other is
21 homogeneity with regard to line of insurance. Line
22 of insurance is workers' compensation, automobile,
23 property, general liability, professional liability.
24 And I will add that all of the coverages that are at
25 issue here that Reserve covers, none of them are

1 particularly exotic, they are all potentially
2 ratable, assuming there's loss information.

3 Q Now I want to pivot to some of your
4 criticisms of some of the experts that you've heard
5 testify here and also you've reviewed their reports.
6 Professor Doherty appears to claim that risk
7 distribution can result from portfolio diversity. Is
8 that your understanding of one of his views?

9 A It is.

10 Q And why do you disagree with his view?

11 A Portfolio diversity cannot be used to
12 create premiums. Creating loss forecasts cannot be
13 done simply with portfolio diversity. What that
14 means is you have a group of heterogeneous risks, as
15 we do with Reserve. It is impossible, because we
16 don't have homogeneity of line of business, it is
17 impossible to slice and dice those individual totally
18 unrelated risks and come up with a premium. It's
19 simply not possible. Even if you have enough loss
20 information, there's no way to pull those individual
21 heterogenous risks together to be able to create a
22 loss forecast.

23 Q Now, you also reviewed Mr. Snyder's opening
24 report?

25 A I did.

1 Q And what are your criticisms of his views?

2 A Well, he tends to -- he did tell us that
3 the coverages in Reserve were simply augmentations,
4 they augmented Peak's other coverages. Well, that
5 simply isn't the case. In the cases where Peak's
6 coverages are excess, I think that's directors and
7 officers liability, employment practices liability,
8 in these cases the policy, if you read through the
9 policy carefully, you'll see that they say that in
10 the event that no other coverage exists, then these
11 coverages fall to first dollar. So there is no
12 augmentation of these things, and Peak is not covered
13 in any of the other coverages in its standard
14 insurance program. If it were, then there would be
15 no reason to concoct this captive.

16 Q You also reviewed Mr. Fagg's opening
17 report?

18 A I did.

19 Q And you had criticisms of his views. What
20 were those?

21 A Only in the sense that they -- Mr. Fagg, as
22 has been pointed out earlier in prior testimony, is a
23 well known expert in credit, financial reinsurance.
24 The applicability to this case, however, other than
25 to create something close to 30 percent of non-

1 related business -- which is all well and good,
2 that's a good thing because it conforms with the case
3 law and revenue rules -- but it really has little if
4 no impact on the fact that we have a diversified
5 portfolio, we don't have homogeneity of risk
6 exposures. So it is what it is, I should say.

7 Q And you also reviewed Ms. Mead's and Mr.
8 Solomon's reports, and what were your criticisms of
9 their views?

10 A Right. Start with Ms. Mead. Her
11 assumptions, it appeared to me because there was no
12 other data in her report to suggest otherwise --

13 Q And by data, what are you referring to,
14 what type of data?

15 A Any other substantiating numbers, figures.
16 It appeared that she made up some of these figures as
17 ultimate losses, and then proceeded to use ultimate
18 losses as the basis upon which to create a whole
19 range of metrics. I can cite hear, every single
20 coverage in Reserve has zero case incurred losses,
21 projected incurred loss ratio, all but cyber risk, is
22 at 18.4 percent. Where that came from, I have no
23 clue. But the more interesting piece of this is that
24 every single line of coverage is at 18.4 percent,
25 which makes absolutely not sense.

1 Q And you're referring to your chart on page
2 8?

3 A I am indeed.

4 Q Exhibit 137-R?

5 A 137-R, right.

6 Q Now, with respect to Mr. Solomon's --

7 THE COURT: This is your last question --

8 MR. SCHEID: I need to shift, I agree, I
9 have one more question.

10 THE COURT: But this is your last question.

11 MR. SCHEID: I understand.

12 BY MR. SCHEID:

13 Q Mr. Liptz has criticized you on your use of
14 FAS 113.

15 A Right.

16 Q How do you respond to that?

17 A His major criticism was that FAS 113
18 applies to nothing but reinsurance. In practice, in
19 practice we have expanded that -- I say we, the
20 general insurance community. We expand that to
21 include insurance because the difference between
22 insurance and reinsurance is very murky. As I said
23 earlier, if you have a fronted captive, then that
24 captive is a reinsurer. If you have a direct writing
25 captive, the captive is an insurance company. So in

1 order to incorporate as many circumstances as
2 possible, we, being the practitioner community,
3 broadened the definition of FAS 113 to include
4 insurance and reinsurance.

5 MR. SCHEID: Thank you, Your Honor. No
6 further questions.

7 MR. ALBRIGHT: Sorry, Your Honor. Mr.
8 Markley's stand here makes a little noise when you
9 move it.

10 CROSS-EXAMINATION

11 By MR. ALBRIGHT:

12 Q Mr. Riggin, in your report at paragraph 2,
13 you state: I am highly experienced and knowledgeable
14 in commercial insurance, including captive insurance.
15 You made that statement. Right?

16 A Yes, I did.

17 Q In your opinion -- is it your opinion that
18 commercial insurance includes captive insurance?

19 A Yes, it does.

20 Q It does? Commercial insurance includes
21 captive insurance?

22 A Insurance is insurance. Captive insurance
23 is another version of insurance, and you can break
24 that down to commercial insurance and captive
25 insurance, those are the distinctions.

1 Q But is captive insurance included in
2 commercial insurance, in your opinion?

3 A No. Commercial insurance involves going
4 into the commercial markets, the CNAs and the
5 Travelers and the Hartford.

6 Q So did you mis-speak when you said I'm
7 highly experienced and knowledgeable in commercial
8 insurance, including captive insurance?

9 A No.

10 Q So you didn't mean to say that captive
11 insurance is included in commercial insurance?

12 A Captive insurance is another way to create
13 insurance. Commercial insurance is a method to go
14 into the method used by the vast majority of
15 businesses because they can't qualify for a captive.
16 Commercial insurance is used by a vast majority of
17 insurers in this country to transfer risk wherein
18 they pay a premium to an insurance company.

19 Q But, Mr. Riggin, all I'm asking you is is
20 captive insurance included in commercial insurance.

21 A Well, your definition is too tight, it
22 splits hairs.

23 Q No, sir. I'm reading your words: I'm
24 highly experienced and knowledgeable in commercial
25 insurance, including captive insurance.

1 A Correct.

2 Q So captive insurance is not included in
3 commercial insurance?

4 A It's a term of art.

5 Q But just answer my question, please. Is
6 captive insurance included in commercial insurance?

7 A No.

8 Q Mr. Riggin, are you familiar with the
9 requirements that this Court has concerning expert
10 witness reports?

11 A I believe I am.

12 Q And are you aware that the report is
13 required to set forth the witness's qualifications,
14 including a list of all publications authored in the
15 previous ten years?

16 A I am indeed.

17 Q And did you include all publications in
18 your expert report that was filed herein, Exhibit
19 136-R?

20 A Let me check. Yes, I did.

21 Q You're sure about that?

22 A Yes.

23 Q Have you ever been involved with a
24 501(c)(15) captive insurance company?

25 A Yes, I have.

1 Q But I understood you to say that you had
2 only worked with captives with premiums exceeding \$1
3 million in premiums.

4 MR. SCHEID: Objection, Your Honor. That
5 mischaracterizes his prior testimony.

6 THE COURT: It doesn't mischaracterize what
7 the Court heard, so I'm going to allow the question.

8 THE WITNESS: I didn't say that I only work
9 on large accounts where there is enough loss
10 information, I said that primarily I work on large
11 accounts which is a little different.

12 BY MR. ALBRIGHT:

13 Q So you have worked with 501(c)(15)
14 captives?

15 A I have.

16 Q How many?

17 A Oh, good grief. Over the last 30 years,
18 oh, I don't know, maybe ten or twelve. They're not
19 particularly common.

20 Q Well, under your concept of a captive, can
21 you have a 501(c)(15) captive insurance company?

22 A Yes.

23 Q Now, you're not a certified public
24 accountant, are you?

25 A I am not.

1 Q But you say in paragraph 3 of your report
2 that the CPCU and ARM designations are multi-year
3 programs equivalent to the CPA designation.

4 A Equivalent in the sense that they are as
5 intellectually rigorous as the CPA designation.

6 Q But you're not suggesting that as a CPCU or
7 an ARM that you're the same as a CPA?

8 A Oh, no.

9 Q Now, Mr. Riggin, your report applies
10 insurance industry principles, doesn't it?

11 A It does.

12 Q Your report does not include tax matters.

13 A To the extent that I apply publicly
14 available, easily accessible tax information to my
15 clients, which I refer to as tax awareness because I
16 am not a tax expert.

17 Q But no, I'm asking your about your report,
18 exhibit 136-R. You're not applying tax principles in
19 this report, are you?

20 A No.

21 Q You're applying insurance industry
22 concepts?

23 A Yes.

24 Q Is the same thing true with Exhibit 137-R?

25 A It is.

1 Q Now, you're not a CPA. I believe we've
2 established that.

3 A Correct.

4 Q And you're not applying accounting
5 principles in your report either, are you?

6 A No.

7 Q Well, then don't you have a copy of FAS 113
8 attached to your report?

9 A I do.

10 Q So is FAS 113 an accounting concept?

11 A It is.

12 Q So are you interpreting FAS 113 in your
13 report?

14 A I am interpreting, yes.

15 Q You're interpreting it. But it's an
16 accounting concept.

17 A It is.

18 Q You're not applying regulatory principles
19 in your report, are you?

20 A No.

21 Q Would you agree with me that an insurance
22 contract is an agreement between an insurer and an
23 insured under which the insurer agrees to compensate
24 the insured for a specified loss in return for the
25 insured paying a premium?

1 A I would.

2 Q Does the amount of the premium that is paid
3 under the insurance contract determine whether the
4 contract is insurance?

5 A No.

6 Q So you can have an insurance contract with
7 a premium that's not actuarially determined, can't
8 you?

9 A It is possible and it occurs.

10 Q It is possible?

11 A Yes, sir.

12 Q But you have a contract whether or not the
13 premium is actuarially determined. Right?

14 A The premium -- that is true.

15 Q That's true?

16 A Yes. Not always true, but it's true.

17 Q You state in your report, I believe in
18 paragraph 5-A: Specifically I was asked to consider
19 whether the "so-called premiums paid by the insured
20 parties here to Reserve are actual premiums as would
21 be calculated by a conventional multi-line insurer."

22 A Correct.

23 Q But I thought you just told me that a
24 premium in an insurance contract does not have to be
25 actuarially determined.

1 A In specific one-off situations, that is
2 true. But it does not apply, should not apply to an
3 entire program of coverage where there's no loss
4 information.

5 Q But if you have a contract that says the
6 insurance company is going to pay for a loss, a
7 specified loss, in return for a premium, is that not
8 a contract?

9 A It is indeed a contract.

10 Q So if AIG issued a policy and they had no
11 information, they didn't go to the CLM -- what is
12 that, the Continuing Lines Manual?

13 A Commercial Lines Manual.

14 Q Commercial Lines Manual. And hey didn't
15 have actuarial data, AIG didn't have actuarial data
16 and they didn't have a wealth of information that
17 they could refer to, wouldn't that be a binding
18 insurance contract if the premium was just determined
19 by somebody based on judgment?

20 A Well, you assume that because they have a
21 wealth of data at their disposal that they haven't
22 used it. In that situation, I would fully expect
23 that in a situation where there's no historical loss
24 data against which to create expected losses and then
25 rates and so forth, premiums, that AIG, of all

1 companies, would use their data, use the aggregate
2 amount of data that they have to create a premium.

3 Q But what if they didn't have data? So you
4 think there would be a situation where they might not
5 have data --

6 A Sure.

7 Q -- from which they could determine a
8 premium?

9 A Absolutely, yes, absolutely. There's no
10 question about that. I've seen it happen. I work
11 with actuaries that have told me that because there
12 is -- usually there isn't no loss information,
13 usually loss information is either inadequate or is
14 on the edge of being inadequate, but there are
15 certain techniques that actuaries employ that based
16 on coverages, and these coverages are usually not
17 commercially available coverages. So yes, that
18 exists.

19 Q Have you ever heard of 9/11?

20 A Yes.

21 Q What happened on September 11?

22 A The Twin Towers came down based on a
23 terrorist action.

24 Q And had there been events like that prior
25 to 9/11 that occurred?

1 A No.

2 Q Nothing like that.

3 A Well, nothing as dramatic and as -- nothing
4 with that magnitude.

5 Q Do you know if there are policies that
6 insure against terrorism events?

7 A There are indeed.

8 Q And do you know whether terrorism events,
9 like what happened on September 11 with the World
10 Trade Center Twin Towers, would that have been in the
11 CL -- the Continuing -- what was that?

12 A Commercial Lines Manual.

13 Q Could you have looked in the Commercial
14 Lines Manual and determined a premium for that kind
15 of an event, insurance that would cover that kind of
16 an event?

17 A No.

18 Q Would there be actuarial data that you
19 could look to that would tell you how to determine a
20 premium for that kind of an event?

21 A No.

22 Q And would there be a wealth of data that an
23 insurance company might have that it could refer to
24 to determine a premium for that kind of coverage?

25 A I would seriously doubt it.

1 Q But that would still be insurance if an
2 insurance company used their best judgment to come up
3 with what a premium ought to be to write a policy
4 that would cover that kind of an event. Wouldn't you
5 agree with that?

6 A I would indeed agree with that.

7 Q So actually, the amount of the premium
8 doesn't have anything with whether you have an
9 insurance contract, does it?

10 A I don't believe I ever alluded to that, but
11 no, it does not.

12 Q It does not. You would agree with me.

13 A I agree with you in the sense that the
14 amount of the premium has little or nothing to do
15 with the fact that an insurance contract exists.

16 Q So why do you say the issue that you were
17 asked to address is whether the "so-called premiums
18 paid by the insured parties here to Reserve are
19 actual premiums as would be calculated by a
20 conventional multi-line insurer"?

21 A Why do you say that?

22 Q Yes. Why do you raise that question?

23 A Because there is no loss information. When
24 there's no loss information in a program -- let me
25 back up. You mentioned 9/11. 9/11 is a one-off.

1 Actuaries have some very interesting ways to deal
2 with one-offs and the do it all the time. Professor
3 Doherty even mentioned satellites which is a very
4 good example of a one-off. I'm talking about a
5 programmatic basis where every single coverage is
6 available in the commercial markets but there's no
7 loss information associated with that.

8 Q Well, would you agree with me that the
9 kinds of policies that the insurance industry or
10 insurance companies offer have changed over time?

11 A Most definitely they have.

12 Q There's a lot of growth and evolution in
13 the insurance industry, isn't there?

14 A I would say not a lot.

15 Q No?

16 A It's a pretty mature industry, actually.

17 Q So have you ever heard of Sputnik?

18 A Yes.

19 Q What was Sputnik?

20 A Sputnik was a Russian satellite from the
21 '50s.

22 Q About 1957?

23 A About that.

24 Q And how many satellites today are orbiting
25 the earth?

1 A Hundreds.

2 Q And do you know whether there are insurance
3 companies that write insurance policies to cover
4 losses associated with satellites?

5 A There certainly are.

6 Q And do you know whether there is actuarial
7 data available to determine expected losses with
8 regards to those kinds of policies?

9 A Probably not, and that's another one-off.
10 Probably not because there have been -- we can think,
11 and there are people that know this better than I do,
12 of how many satellites have been lost over the years,
13 and it isn't a big number. So no, there is no
14 reasonable -- when I say reasonable I mean usable
15 actuarial data -- for the loss of a satellite. I
16 would not imagine that there would be.

17 Q You said I believe that the 9/11 terrorism
18 event was a one-off event.

19 A Indeed.

20 Q Satellites are a one-off event. Correct?

21 A When it comes to being able to predict
22 losses from an actuarial standpoint, yes.

23 Q So that's two-off, not just one-off, one-
24 off, it's two-off, isn't it?

25 A Well, it's two separate examples.

1 Q And I believe you determined that the
2 premiums that are charged between Reserve and its
3 insureds are not actual insurance premiums as would
4 be calculated by a convention multi-line insurer
5 because Capstone and its pricing reviewers are not
6 able to utilize any of the three recognized sources
7 of insurance rate-making. Page 4 of your report, is
8 that what you said?

9 A I believe it is. Which paragraph,
10 Counselor?

11 Q Page 4.

12 A Paragraph number?

13 Q Well, you wrote the report, Mr. Riggin, I
14 didn't.

15 A You've just quoted from it but I would like
16 to be able to read it as well.

17 Q Look in paragraph 8-A.

18 A All right.

19 Q You did say that, didn't you?

20 A I did.

21 Q And the three permissible methods, in your
22 view, to determine insurance premiums are the
23 Commercial Lines Manual, or the CLM, actuarial
24 methodology is the second methodology. Right?

25 A Correct.

1 Q And then third, the wealth of supporting
2 data found in any commercial multi-line insurer.
3 Correct?

4 A Correct.

5 Q And so if you don't have access to one of
6 those three methods, you can't write an insurance
7 policy and determine a premium?

8 A You can write an insurance policy, yes, you
9 can, you can. Determining a premium is a whole
10 nother matter.

11 Q Well, wait a minute. You said I could
12 write an insurance policy, but to provide an
13 insurance policy, I need a premium, don't I?

14 A No.

15 Q I don't need a premium?

16 A You don't need a premium. It would be nice
17 to have supporting loss data to be able to create
18 that premium, but the premium in commercial insurance
19 and in captive insurance, the premium is separate
20 from the contract. Let me give you an example. In
21 your homeowners coverage, if you were to not pay your
22 premium for six months and then your house were to
23 burn down, the contract stands, the contract is the
24 contract, it has nothing to do with the fact that you
25 haven't paid your premium. Now, after the fire the

1 insurance company is going to come back to you and
2 say, you know, you were in arrears here for a while.
3 But there is a distinct difference between paying a
4 premium and having a contract of insurance.

5 Q So you're saying that the insurer doesn't
6 have to receive a premium from the insured, is that
7 right, to have an insurance contract?

8 A No. I agree with that, you're right.

9 Q You agree what?

10 A I agree.

11 Q That you do have to have a premium?

12 A No. You don't have to have a premium.

13 Q I mean don't have to have a premium.

14 A That's what you said and I agree with it.

15 Q So are you suggesting that maybe I should
16 just quit paying the premiums for my automobile
17 policies?

18 A No. That is far from what I said. I'm
19 saying if you were to become arrears in your auto or
20 your homeowners, the contract stands alone, the
21 contract is the contract, the insurance company must
22 honor the contract. At some point the insurance
23 company is going to come back to you and say: Mr.
24 Albright, you are in arrears here and we think you
25 ought to pay up or we're going to cancel you.

1 Q Well, if you don't have to have a premium
2 to have an insurance contract, why are you addressing
3 premiums in your report?

4 A Because the Capstone folks have created
5 premiums. I mean, if they weren't creating premiums,
6 I don't believe we'd be here.

7 Q But doesn't my automobile policy have a
8 stated premium in it?

9 A Of course it does.

10 Q And so does that stated premium have to be
11 actuarially determined to make it a binding policy?

12 A No. It is usually actuarially determined
13 on a much grander basis than just you and a couple of
14 other people, but it is not necessary for the
15 contract to exist, for the contract to be enforced.

16 Q But what if my insurance company -- what if
17 I drive a 950 horsepower supercharged Mustang Cobra
18 and my insurance company writes a policy and they
19 charge me a hundred dollar premium for the year,
20 they've got the wrong number.

21 A Oh, they've got the wrong number but that's
22 their problem.

23 Q That's their problem. I still have an
24 insurance contract.

25 A You still do.

1 Q And as an insurance industry expert, you
2 would agree that the amount of the premium doesn't
3 determine whether or not I have insurance.

4 A I would agree with that.

5 Q But it seems like you're applying a
6 slightly different standard to the Petitioner in this
7 case.

8 A How so?

9 Q Well, at page 9 of your report, in
10 paragraph 26, you state: It is clear that the
11 majority of Reserve's policies are such that they
12 could not be rated using the CLM as those risks are
13 not listed within the CLM. So these types of risks
14 that are being insured in this case are not listed in
15 the CLM. Would you agree with that?

16 A I would. That's what I said.

17 Q Strike one. Right?

18 A You mean in terms of being able to create a
19 premium?

20 Q And being able to come up with an insurance
21 policy. Strike one.

22 A You can come up with an insurance policy
23 with no premium. Now, no insurance company is going
24 to do that but as I keep saying, the policy is a
25 contract between the insurance company and the

1 insured and it stands alone, it's separate from the
2 creation of a premium.

3 Q But you're being critical of Capstone and
4 the Petitioner because the CLM was not used to come
5 up with a premium.

6 A No. I'm saying that it could not be used.

7 Q Could not be used.

8 A Yes. Because I don't believe that any of
9 these coverages, although these coverages are
10 available in the commercial markets, are probably not
11 part of the Commercial Lines Manual.

12 Q These coverages are not in the Commercial
13 Lines Manual?

14 A I believe they are not.

15 Q You believe they are not or you know
16 they're not?

17 A No. I believe they are not.

18 Q So you don't know that they're not in the
19 Commercial Lines Manual?

20 A No.

21 Q They're not in there?

22 A I believe that they are not.

23 Q But are they or aren't they? When you say
24 believe, it sounds like you're hedging. Are you
25 hedging?

1 A No. I think the word believe is a
2 reasonable term whereas I know what the Commercial
3 Lines Manual includes and what it doesn't include.
4 Commercial Lines Manual includes those risks that are
5 actuarially determined, so the manual is not going to
6 put a risk into it or a coverage where there is no
7 loss information to back it up.

8 Q Did you check the Commercial Lines Manual
9 to see if these kinds of policies would be that you
10 could determine a premium?

11 A No.

12 Q You didn't check it.

13 A No. From my experience rating insurance
14 and determining premiums based on the CLM.

15 Q Well, if you didn't check it, you don't
16 know for sure.

17 A No, I don't know for sure.

18 Q You do know for sure?

19 A I do not, but it's my belief that that's
20 the case.

21 Q You don't know for sure.

22 A That's what I said.

23 Q So why do you state on page 9 of your
24 report in paragraph 26, and I quote: "It is clear
25 that the majority of Reserves policies are such that

1 they could not be rated using the CLM as those risks
2 are not listed within the CLM"? That sound pretty
3 definite.

4 A It does.

5 Q So do you know whether these policies are
6 such that they could be rated with the CLM or not?

7 A I know enough about the CLM to know that
8 they are not in the CLM.

9 Q They're not in the CLM. You're absolutely
10 certain of that?

11 A I believe that they are not based on my
12 experience with the CLM.

13 Q When is the last time you looked at the
14 CLM?

15 A Oh, gosh, maybe a year ago.

16 Q Well, isn't this an important question in
17 this case?

18 A Why?

19 Q Well, you're making a statement about this,
20 you're making an issue out of it, but you didn't go
21 verify to see if these policies could be rated using
22 the CLM?

23 A It is my opinion that based on my knowledge
24 of the CLM, these coverages are not there.

25 Q But is that the way you do your work, you

1 don't go and verify something, a belief that you have
2 before you actually write it down very definitely in
3 your report?

4 A No, that is generally not the case.

5 Q But it was the case in this case?

6 A I keep saying I do not believe that these
7 coverages, based on their outlier status, are in the
8 CLM, and that is all I've said.

9 Q You say it is clear, you don't say I
10 believe, you say it is clear.

11 A I think it is clear.

12 Q I think it is clear or I know it's clear?

13 A I say it is clear which means to me that I
14 think it is clear.

15 Q So you're just speculating about what's in
16 the CLM.

17 A With good reason.

18 Q You don't know. You just told me you don't
19 know.

20 A I don't know for 100 percent but I am 99
21 percent certain that these coverages are not in the
22 CLM based on my experience.

23 Q So if you're 99 percent sure, is that
24 clear?

25 A I believe it is.

1 Q But there's a chance that you could be
2 wrong, so is it clear?

3 A I believe that the preponderance of the
4 percentage that I believe exists creates clarity.

5 Q Do you believe that experts should be able
6 to just speculate?

7 A This is not speculation.

8 Q It's not speculating?

9 A No, sir.

10 Q You haven't looked at the CLM in a year,
11 but you say that it's clear that the majority of
12 these policies could not be rated using the CLM.

13 A It's clear to me.

14 Q But you didn't check the CLM.

15 A Not in about a year's time.

16 Q Mr. Riggin, at page 9, paragraph 26, you
17 state that: In the absence of loss data, Reserve's
18 or industries, actuarial analysis could not be
19 performed. Do you see that?

20 A I do.

21 Q And you quote from Reserve's business plan
22 at page 9 the statement that: "No prior loss data is
23 available because this information has not been
24 tracked in the past." Correct?

25 A Which paragraph are you referring to?

1 Q Page 9, right at the top of page 9.

2 A Okay. That's a continuation of page 8.

3 Q Did you write this report, Mr. Riggin?

4 A Yes, sir, I did.

5 Q You didn't have any assistance writing this
6 report?

7 A No, I did not.

8 Q You don't have an assistant that helped you
9 write it?

10 A I have an assistant but no one that would
11 write or help me write a report of this magnitude.

12 Q So this quotation comes from Reserve's
13 business plan. Is that right?

14 A Correct.

15 Q So strike two, we can't determine a
16 premium. Right? That's your opinion.

17 A We cannot determine a premium. Correct.

18 Q Based on either the CLM or based on prior
19 loss data.

20 A That is correct.

21 Q At least loss data specific to the Capstone
22 program.

23 A That's right.

24 Q Well, now, you also state that Petitioner
25 did not have "access to the wealth of supporting data

1 found in any commercial multi-line insurer." Did you
2 say that?

3 A Yes, I did.

4 Q So strike three, we're out.

5 A I do not follow your line of reasoning,
6 Counselor.

7 Q Well, you said these are the three ways
8 that we could determine a premium, and since we can't
9 do any one of your three ways, we can't determine a
10 premium.

11 A We can determine a premium but the way the
12 premiums were determined do not conform with
13 standards and practices in the insurance business.

14 Q At least the standards and practices that
15 you're familiar with. Correct?

16 A I've been doing this a very long time, so
17 you are right.

18 Q So strike three, we're out, we can't
19 determine a premium. But again, in preparing your
20 report and for purposes of rendering your opinion,
21 you accepted the statements in the business plan
22 about how Reserve's premium pricing was done.
23 Correct?

24 A Yes.

25 Q So if you could, please turn to page 8 of

1 your report, and it looks like you're quoting here
2 from the business plan in paragraph 21.

3 A Correct.

4 Q You state: The pricing of risks involves -
5 - and I believe what you're doing is you're quoting
6 what the business plan says about how the premiums
7 were determined in this case. Is that right?

8 A That's right.

9 Q And it says: The pricing of risks involves
10 reliance on independent experts experienced in
11 standard and non-standard risks. Do you see that?

12 A I do.

13 Q And it also says: Among other sources, the
14 company relies on pricing recommendations from a
15 senior insurance professional with Hilb, H-I-L-B, and
16 Rogal, an insurance broker, in association with a
17 large national insurance brokerage company and
18 insurance consultant, Myron Steves & Company, Mid-
19 Continental Insurance Group, MSC. Do you know who
20 Hilb & Rogal is?

21 A I do. They no longer exist, it's Hilb,
22 Rogal and Hamilton.

23 Q What happened to Hilb, Rogal and Hamilton?

24 A They were purchased by Willis.

25 Q They were what?

1 A Purchased by Willis.

2 Q Purchased by Willis?

3 A Correct.

4 Q And then after they were purchased by
5 Willis, was Willis called Willis-HRH?

6 A It was.

7 Q Do you know how -- is Willis a prominent
8 insurance company?

9 A They are indeed.

10 Q And the Sears Tower in Chicago is now
11 called?

12 A The Willis Tower.

13 Q Willis Tower. That's the same Willis,
14 isn't it?

15 A It is.

16 Q It's a very large insurance firm, isn't it?

17 A It is. It's a broker.

18 Q So do you know whether Hilb & Rogal, was
19 that a prominent insurance firm?

20 A It was a small, I believe they're
21 Pittsburgh-based, insurance brokerage.

22 Q Were they capable?

23 A I cannot speak to that.

24 Q You don't know whether they're capable?

25 A No. But capable is a very, very broad

1 term.

2 Q Well, you don't know whether they're
3 capable. Right?

4 A Define capable, if you might.

5 Q Well, you don't know whether they're not
6 capable.

7 A Capable to do what?

8 Q Well, do you know whether that was a
9 competent insurance firm?

10 A No.

11 Q You don't know.

12 A All I know is what their reputation was
13 which was a pretty good one, but I don't have
14 personal knowledge of their capabilities in any area.

15 Q So they could have been very good in
16 determining premiums, couldn't they?

17 A It depends on --

18 Q But you just said you didn't know. I'm
19 asking you whether it was possible that they would be
20 very good at determining insurance premiums.

21 A Well, for risks that have loss experience,
22 they could be extremely good.

23 Q Well, wait a minute. I think you also said
24 that you could have, what was it, a wealth of
25 supporting data found in any commercial multi-line

1 insurer. Could they have had a wealth of supporting
2 data in their files?

3 A No, because they're not a commercial lines
4 insurer, they're a broker. Brokers do not keep a
5 wealth of supporting data in their files, they're not
6 an insurance company.

7 Q So do you know whether they had this kind
8 of data available to them?

9 A I do not know specifically but I know what
10 broker, in my experience, over 35 years of working
11 for brokers and consultants, I know what brokers do
12 and brokers do not hold enormous amounts of
13 underwriting data from which premium rates can be
14 developed.

15 Q But, Mr. Riggin, you don't have any
16 personal knowledge of what data Hilb & Rogal had in
17 their files, do you -- do you?

18 A No.

19 Q You don't know.

20 A No, I do not know.

21 Q So how can you formulate any opinion about
22 a premium that is determined by consulting with Hilb
23 & Rogal?

24 A Because in my experience, and that is the
25 only thing that I have to go on -- which is

1 significant -- I know that brokerage firms do not
2 hold that kind of data. That data is only held by
3 insurance companies so if an insurance company --
4 which Capstone does not have access to -- an
5 insurance company has a wealth of information. Now,
6 it might not have information about these particular
7 coverages covered by Reserve, but there is a
8 possibility that they might.

9 Q But, Mr. Riggin, come on, you're just
10 making assumptions, aren't you?

11 A I am assuming -- probably a good word --
12 based on my experience that a broker does not have
13 access to this information.

14 Q You're just assuming that Hilb & Rogal
15 wouldn't have this kind of information.

16 MR. SCHEID: Objection, Your Honor. This
17 has been asked and answered a number of times at this
18 point.

19 MR. ALBRIGHT: Well, Your Honor, Mr. Riggin
20 is being evasive on this point. I'm just trying to
21 understand exactly what he's saying.

22 THE COURT: I'll allow this question to be
23 answered, but then move on.

24 MR. SCHEID: Thank you, Your Honor.

25 THE WITNESS: Could you repeat the

1 question?

2 BY MR. ALBRIGHT:

3 Q You don't know what information Hilb &
4 Rogal had in their files back in this time frame, do
5 you?

6 A Correct.

7 Q You don't know.

8 A Correct.

9 Q And, Mr. Riggins, how do you know what data
10 Capstone has available to it?

11 A Based on what I wrote in this report,
12 Capstone apparently did not and does not have access
13 to loss information.

14 Q Apparently?

15 A Because there has been no loss information.

16 Q But apparently. You don't know, you really
17 don't know, do you?

18 A How can you have access to loss information
19 when there has been none?

20 Q But you don't know what Capstone had
21 available to it, do you?

22 A No, but if the question is what was
23 available to Capstone, what wasn't available to
24 Capstone was loss information.

25 Q Well, now, on page 8 of your report you

1 also make a reference to Myron Steves & Company. Do
2 you know who Myron Steves & Company is?

3 A I do.

4 Q Did you ever work there?

5 A Oh, no.

6 Q Do you know what kind of data Myron Steves
7 & Company would have had available to it?

8 A About the same amount that Hilb & Rogal
9 has. They're a broker.

10 Q But you don't know that, do you?

11 A I don't know that for an absolute fact, but
12 my experience tells me that Myron Steves, like Hilb &
13 Rogal, as brokers are not insurance companies where
14 there is a wealth of data from which to extract
15 premiums and expected losses.

16 Q So you and I could go for a ride around
17 Houston, Texas and you could say there's not a wealth
18 of data in that building. You would know that.
19 Right?

20 A It depends on who works in that building.

21 Q We could just do a windshield appraisal of
22 the kind of information that might be available in
23 Houston, Texas. Right?

24 A No. Incorrect.

25 Q What about Mid-Continental Insurance Group,

1 you ever work there?

2 A No

3 Q Do you know whether they have high quality
4 insurance professionals?

5 A I have no idea.

6 Q IN fact, you don't know whether there are
7 high quality insurance professionals at Myron Steves
8 & Company.

9 A I do not know, no.

10 Q Weren't all of these companies involved in
11 the insurance industry?

12 A They all are or were, yes.

13 Q All are and all were.

14 A Correct.

15 Q And so if I go and consult with one of
16 these companies and they tell me that I believe you
17 could set this as a reasonable premium for your
18 policy, wouldn't that be information from an
19 insurance industry's perspective?

20 A No. You're making an incorrect assumption.

21 Q So those insurance experts are less expert
22 than you, Mr. Riggin. Is that right?

23 A No. I did not say that. I said they do
24 not have access to the data that would be required to
25 create a premium. They are brokers, they are CPCUs,

1 they are experts, but they do not have access to
2 insurance company data.

3 Q Mr. Riggin, your report does not define --
4 I didn't see a list of multi-line insurers in your
5 report.

6 A Correct.

7 Q You don't really even provide a definition
8 of what it is, do you? In your report there's no
9 definition of a multi-line insurer, is there?

10 A I don't believe.

11 Q When was cyber insurance first quoted in
12 the CLM? Do you know?

13 A I don't think cyber insurance is in the
14 CLM, but if it is, it may have been -- no. the
15 answer to the question is no, I do not know.

16 Q You don't know whether cyber insurance is
17 included in the CLM?

18 A No, I don't.

19 MR. ALBRIGHT: Can I have a moment, Your
20 Honor?

21 THE COURT: Yes.

22 BY MR. ALBRIGHT:

23 Q So you don't know whether cyber insurance
24 is quoted in the CLM. Is that right?

25 A That's right.

1 Q Wasn't there a cyber insurance policy
2 involved in this case?

3 A I think so, if my memory serves correctly.

4 Q But your opinion is that the premiums that
5 Reserve charged were not real premiums. Right?

6 A Under the definition of what creates a
7 premium, correct.

8 Q But you didn't go and check the CLM to see
9 if there was a premium for cyber coverage.

10 A No.

11 Q In the CLM. You didn't.

12 A No.

13 Q You just assumed, Mr. Riggin, that the CLM
14 didn't have a premium suggested in it for that type
15 of coverage, did you?

16 A No, I didn't.

17 Q You just assumed it.

18 A No, I didn't. But I also am less than
19 confident that the individuals noted here have access
20 to the CLM. It's basically for commercial insurance
21 companies.

22 Q But you're giving your opinion here.

23 A I am.

24 Q And you didn't go check the CLM to see when
25 or if cyber coverages is referenced in the CLM.

1 A No. That's correct.

2 Q You didn't, did you?

3 A No. That's correct.

4 Q But you state categorically that this type
5 of coverage is not referenced in -- is not available
6 in the CLM.

7 A Where do I do that, if I might ask.

8 Q Page 9, paragraph 26: It is clear that the
9 majority of Reserve's policies are such that they
10 could not be rated using the CLM as those risks are
11 not listed within the CLM, and in the absence of loss
12 data, actuarial analysis could not be performed.

13 Q Mr. Riggin, have you ever written an
14 article wherein you suggested that you could develop
15 a premium for a captive insurance company where a
16 captive seems to be an ideal vehicle but funding is a
17 shot in the dark?

18 A I don't recall, but if you think that I
19 did, I probably did.

20 Q Well, did you or didn't you?

21 A I said I don't recall.

22 Q Are you suggesting that I'm right and I
23 know what I'm talking about?

24 A Wouldn't you?

25 MR. ALBRIGHT: Your Honor, if I could,

1 could I have this document marked as Petitioner's
2 exhibit next in order?

3 THE COURT: Yes.

4 MR. ALBRIGHT: And please let the record
5 reflect that I'm handing a copy to Respondent's
6 counsel. May I approach?

7 THE COURT: Yes.

8 THE CLERK: An article titled "Captive
9 Fundamentals" by Donald J. Riggin is marked for
10 identification as Exhibit 138-P.

11 (The document referred to was marked for
12 identification as Exhibit 138-P.)

13 MR. ALBRIGHT: Your Honor, may I hand Mr.
14 Riggin a copy of 138-P?

15 THE COURT: Yes.

16 BY MR. ALBRIGHT:

17 Q Mr. Riggin, do you have a copy of Exhibit
18 138-P in front of you?

19 A I do.

20 Q And do I see your picture on Exhibit 138-P?
21 It's kind of small.

22 A I knew you had a sense of humor, Counselor.
23 Yes, that would be me.

24 Q And is this an article that you wrote?

25 A It is.

1 Q Hopefully that's not a picture of your pet
2 fish on the front.

3 A No, just the one I wish I had.

4 Q Well, now, if I turn over to the second
5 page, and this is an article about ABC Company sells
6 underground high pressure piping. Is that right?

7 A It's mentioned in here, I believe. Yes,
8 there we go.

9 Q And the product has a one-year
10 unconditional warranty against defects, competition
11 in the business is keen, there are other companies
12 offering extended warranties, but they're trying to
13 figure out -- your hypothetical, you're trying to
14 figure out whether or not you can actually put this
15 risk in a captive. Is that right?

16 A That's right.

17 Q Cover it with insurance in a policy written
18 by a captive. And you state here, you say: A
19 captive seems to be an ideal vehicle. Do you see
20 that in the one, two, three, fourth paragraph down on
21 page 2?

22 A I do.

23 Q A captive seems to be an ideal vehicle but
24 the funding is a shot in the dark.

25 A Correct.

1 Q The company had only one warranty claim in
2 its 30-year history. A closer look at the risk
3 reveals that there is one scenario where the risk of
4 product failure is the greatest. Do you see that?

5 A I do.

6 Q Did you make that statement?

7 A I did.

8 Q And so you're saying that this wouldn't be
9 covered by the CLM. Right? You couldn't price this
10 using the CLM.

11 A Probably not, no.

12 Q Probably not?

13 A I didn't mention the CLM in this article so
14 I'm saying probably not.

15 Q Did you look at the CLM to see if you could
16 price this policy?

17 A No.

18 Q You didn't mention that.

19 A I didn't mention that, no.

20 Q Presumably that was not available in this
21 scenario.

22 A I believe that it is not available in this
23 scenario.

24 Q So there wasn't, what do you call it, a
25 wealth of data available that a commercial multi-line

1 insurer would have to make a determination of what a
2 premium is?

3 A Correct.

4 Q And there's no loss data.

5 A There is a little bit but nothing that is
6 credible.

7 Q But you still come up with a basis for
8 calculating expected potential losses in this
9 situation, don't you? You say that you can do that.

10 A I say that it is possible to do that.

11 Q You say it's possible to do that.

12 A Indeed.

13 Q So now, we had the one-off situation with
14 terrorism, we had the one-off situation with Sputnik,
15 and I guess cyber insurance is another one-off
16 situation. Is that right?

17 A Yes.

18 Q And now we have this pipeline scenario
19 which is another one-off situation. I assume you're
20 going to say it's a one-off situation.

21 A It is indeed, for a reason.

22 Q So now we have four one-off situations.

23 A We do.

24 Q Do you know whether this article is listed
25 in your report?

1 A I don't believe it is, no.

2 Q And what is the date of your report -- or
3 what's the date of this article in Exhibit 138-P?

4 A October 10, 2016.

5 Q Is that an article that you wrote within
6 the last ten years?

7 A It is indeed.

8 Q But I believe earlier that you testified
9 that you'd listed all of your publications in the
10 last ten years in your report.

11 A I listed all the publications that were
12 published by a third party. This is self-published.
13 I wrote this in LinkedIn. I have, oh, gosh, maybe 25
14 or 30 articles that I have written for LinkedIn, but
15 I didn't consider nor do I consider them to rise to
16 the level of published report or a published article.

17 Q Well, did Respondent's counsel discuss with
18 you what you needed to list in your report?

19 A Yes.

20 Q And were you told that you needed to list
21 all publications authored in the previous ten years?

22 A Yes.

23 Q Is Exhibit 138-P, it says -- on the first
24 page it says, right under Captive Fundamentals, do
25 you see that, published on October 10, 2016?

1 A I do.

2 Q But this particular publication you didn't
3 list in your report.

4 A No, because it was self-published, it was
5 not published by a third party.

6 Q Well, are the standards for what you self-
7 publish versus what is published by a third party,
8 are they different?

9 A No.

10 Q So if you made the statement in an article
11 like this one, Exhibit 138-P, it would have the same
12 standards. Right?

13 A What statement are you referring to?

14 Q Well, that you could determine a premium
15 without the kind of data, CLM data, actual loss data,
16 or a wealth of information like a multi-line insurer
17 would maintain in their files, you can determine a
18 premium in that context for a captive insurance
19 company.

20 A Not me. I'm saying that a premium could be
21 developed.

22 Q Could be developed.

23 A Another germane point here is that this is
24 a warranty program. Generally speaking, warranty
25 programs are highly specific to the circumstance, so

1 there are no published rates, and in warranty there
2 is generally no loss information. So there are
3 actuarial methods to come up with the premium, I've
4 never denied that.

5 Q But wouldn't you think that I would be
6 interested in reading your article that's in 138-P
7 concerning a situation where there's no loss data, no
8 actuarial data from which you could determine a
9 premium but yet you're still able to determine a
10 premium? Wouldn't you think that that would be
11 something that we would be interested in here in this
12 Court today?

13 A That's your decision.

14 Q Did you disclose this article to
15 Respondent's counsel when you were engaged?

16 A I did not.

17 Q Have you discussed this article with
18 Respondent's counsel since you were engaged?

19 A No.

20 MR. ALBRIGHT: Your Honor, I move Exhibit
21 138-P into evidence.

22 MR. SCHEID: May I have just a moment, Your
23 Honor?

24 THE COURT: You may have a moment.

25 MR. SCHEID: We have no objection to 138-P,

1 Your Honor.

2 THE COURT: 138-P is admitted.

3 (The document referred to, having been
4 previously marked for identification as
5 Exhibit 138-P, was received in evidence.)

6 BY MR. ALBRIGHT:

7 Q Mr. Riggin, I believe we've established
8 that you've never been an accountant. Is that
9 correct?

10 A That is correct.

11 Q But you state at page 6 of your report that
12 insurance and reinsurance contracts must conform to
13 the requirements of Financial Accounting Standard
14 113. Did you say that?

15 A I did.

16 Q Did you make any disclaimers in your report
17 about the fact that you're not an accountant?

18 A No.

19 MR. ALBRIGHT: Your Honor, we would ask
20 that this document be marked for identification as
21 Petitioner's exhibit next in order.

22 THE COURT: Yes.

23 MR. ALBRIGHT: And let the record reflect
24 that I'm providing a copy to Respondent's counsel.

25 May I approach?

1 THE COURT: Yes.

2 THE CLERK: An article by Donald J. Riggin,
3 dated February 2009, is marked for identification as
4 Exhibit 139-P.

5 (The document referred to was marked for
6 identification as Exhibit 139-P.)

7 MR. ALBRIGHT: Your Honor, may I provide a
8 copy of Exhibit 139-P to Mr. Riggin?

9 THE COURT: Yes.

10 BY MR. ALBRIGHT:

11 Q Mr. Riggin, what is Exhibit 139-P?

12 A It's an article that I wrote for
13 International Risk Management Institute on structured
14 insurance programs.

15 Q And if you would turn to page -- so if you
16 would turn to page 4, please, and you see the heading
17 Tax and Accounting Issues?

18 A I do.

19 Q And do you see the statement there that
20 says: Far be it from me to dispense tax and
21 accounting advice so the following comments are for
22 educational purposes only?

23 A I do.

24 Q So you're saying here you can't give
25 accounting advice.

1 A I do not give accounting advice.

2 Q And so then you're talking about FAS 113
3 right after your disclaimer.

4 A Correct.

5 Q There's no such disclaimer in the reports
6 that are filed in this Court from you, is there?

7 A No. There's no need for a disclaimer.

8 Q Well, when you wrote this article, you felt
9 like you needed to make a disclaimer.

10 A If you want to call that a disclaimer,
11 that's fine. I call it a poetic license, if you
12 would.

13 Q A what?

14 A Poetic license.

15 Q Poetic license?

16 A Yes.

17 Q What is that?

18 A Well, when you write an article such as
19 this, you're not writing for a specific audience,
20 you're writing for a very broad audience, so when I
21 say far be it from me to dispense tax and accounting
22 advice, it is exactly what I mean, but the term "far
23 be it from me" certainly isn't a disclaimer, it's a
24 usually in the greater scheme of things expression.
25 That's all it is.

1 Q So it's a meaningless expression?

2 A That's not what I said.

3 Q But it doesn't mean anything, I think is
4 what I understood you to say.

5 A No. It means I do not dispense tax and
6 accounting advice.

7 Q So you do not dispense -- let's focus on
8 accounting, you do not dispense accounting advice.

9 A Correct.

10 Q Did you include this statement to avoid
11 misleading the public?

12 A I included this statement to make it clear
13 to the public that I'm not an accountant nor am I a
14 tax expert.

15 Q But you make that statement right before
16 you start discussing FAS 113.

17 A I discuss -- that's correct -- I discussed
18 FAS 113 in a generalized observational awareness
19 perspective. I do not discuss FAS 113 as an
20 accounting expert.

21 Q So how is it that you're qualified to speak
22 to the FAS 113.

23 A It's not a question of being qualified,
24 it's a question of reading the statement.

25 Q But you're not an expert in addressing FAS

1 113, are you?

2 A You do not need to be an expert to be able
3 to read the statement, Counselor. That's the whole
4 point here.

5 Q So you don't have to be an expert to read
6 the statement but you give opinions in your report
7 concerning the application of FAS 113 in this case.

8 A I do.

9 Q And you didn't make a similar disclaimer in
10 your report as you did here in this article, did you?

11 A Correct.

12 Q So you can only talk about FAS 113
13 generally. Correct?

14 A That is all I talk about FAS 113.

15 Q But you're giving an expert opinion in this
16 case, are you not?

17 A I am.

18 Q But you can only talk about FAS 113
19 generally. You just said that.

20 A The way I refer to FAS 113 is basically the
21 things speaks for itself. If you read FAS 113, you
22 will see precisely what I quote from it, it is very
23 simple and very straightforward.

24 Q So you're just including general
25 information in your report about FAS 113. Is that

1 what you're doing?

2 A No. I'm including actual information in my
3 report that anyone who can read will read FAS 113 and
4 will be able to understand what it means. I've
5 quoted 113, it's very simple, it's very
6 straightforward.

7 Q So if FAS 113 speaks for itself, why does
8 this Court need to hear from you about FAS 113?

9 A Because it pertains specifically to the
10 coverages at issue covered by Reserve.

11 Q But you just said you're not an expert in
12 applying FAS 113.

13 A I don't have to be an expert in applying
14 113, I have to be able to read, which I can do.

15 Q So you're not qualified to give an opinion
16 as to whether FAS 113's requirements are met or not,
17 are you?

18 A That's incorrect, that's incorrect. As I
19 said, anybody with a brain can read 113 and can make
20 a determination as to what it means.

21 Q You must not have a high opinion of
22 accountants, Mr. Riggin.

23 A I have no opinion of accountants,
24 Counselor.

25 MR. ALBRIGHT: Your Honor, I'd move Exhibit

1 139-P into evidence.

2 MR. SCHEID: No objection, Your Honor.

3 THE COURT: 139-P is admitted.

4 (The document referred to, having been
5 previously marked for identification as
6 Exhibit 139-P, was received in evidence.)

7 (Page 920 and subsequent pages enclosed
8 under separate cover.)

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1 CERTIFICATE OF TRANSCRIBER AND PROOFREADER

2 CASE NAME: Reserve Mechanical Corp, f.k.a. as

3 Reserve Casualty Corp. v. Commissioner

4 DOCKET NO.: 14545-16

5 We, the undersigned, do hereby certify that the
6 foregoing pages, numbers 824 through 919, inclusive,
7 are the true, accurate and complete transcript
8 prepared from the recording made by electronic
9 recording by Leslie Berridge, on May 2, 2017, before
10 the United States Tax Court at its session in
11 Houston, Texas, in accordance with the applicable
12 provisions of the current verbatim reporting contract
13 of the Court, and have verified the accuracy of the
14 transcript by comparing the typewritten transcript
15 against the verbal recording.

16

17 _____

18 Nancy H. King 05/23/2017

19 (Transcriber) (Date)

20

21 _____

22 Laurel H. Stoddard 05/24/2017

23 (Proofreader) (Date)

24

25

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IN THE UNITED STATES TAX COURT

In the Matter of:)
)
RESERVE MECHANICAL CORP., f.k.a.)
RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
v.)
)
COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

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Pages: 920 through 1011
Place: Houston, Texas
Date: May 2, 2017

1 IN THE UNITED STATES TAX COURT

2

In the Matter of:)

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RESERVE MECHANICAL CORP., f.k.a.)

4

RESERVE CASUALTY CORP.,)

5

Petitioner,) Docket No. 14545-16

6

v.)

7

COMMISSIONER OF INTERNAL REVENUE,)

8

Respondent.)

9

Room 7006
Casey U.S. Courthouse
515 Rusk Avenue
Houston, Texas

10

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May 2, 2017

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The above-entitled matter resumed for
trial, pursuant to recess, at 9:00 a.m.

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BEFORE: HONORABLE KATHLEEN KERRIGAN
Judge

16

APPEARANCES:

17

For the Petitioner:

18

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1 APPEARANCES: (continued)

2 For the Respondent:

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6 JUSTIN D. SCHEID, Esquire
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C O N T E N T S

WITNESSES:	DIRECT	CROSS	REDIRECT	RECROSS	VOIR DIRE
For Petitioner:					
None					
For Respondent					
Donald J. Riggin		924	989	994	

	E X H I B I T S		
	EXHIBITS:	IDENTIFIED	RECEIVED
1			
2			
3	108-P	previously	958
4	140-P	944	946
5	141-P	947	950
6	142-P	994	995

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1 P R O C E E D I N G S

2 CROSS-EXAMINATION (CONTINUED)

3 BY MR. ALBRIGHT:

4 Q So, Mr. Riggin, if you would, please, could
5 we take a look in your report at Appendix D?

6 A Appendix D. Certainly. B or D? I'm
7 sorry.

8 Q Appendix D.

9 A Yes.

10 Q Can you point to any language in Appendix D
11 where it says that FAS 113 applies to insurance
12 generally?

13 A No. I described this earlier.

14 Q No, no, my question is --

15 A I'll answer.

16 Q No, but is it yes or no? Is there anything
17 in Appendix D that says that FAS 113 applies to
18 insurance contracts?

19 A No.

20 Q So you're not an expert in FAS 113. Right?

21 A Correct.

22 Q And so why do we need you to read FAS 113
23 to us then?

24 A Why do we need me? Because I wrote an
25 opinion based on eleven coverages within a program

1 covered, theoretically, by Reserve Casualty
2 Corporation, and I've described to you my
3 interpretation which is basically an industry
4 interpretation of FAS 113 and how it applies to
5 insurance and reinsurance. And it is specifically
6 applicable to the coverages at issue here.

7 Q Now, Mr. Riggin, you're also not an
8 actuary, are you?

9 A No.

10 Q In your report you did not actually
11 undertake to determine appropriate premiums for
12 Reserve's 2008, 2009 and 2010 insurance contracts,
13 did you?

14 A Absolutely not.

15 Q So you did not determine in your report
16 that the premiums were understated, did you?

17 A I have no basis upon which to make that
18 determination.

19 Q And you did not determine in your report
20 that the premiums were overstated, did you?

21 A Again, no.

22 Q But your report says: "These special risk
23 coverages are beyond normal coverages as the result
24 of purported needs for them."

25 A Where are you, Counselor?

1 Q If you look at page 17, paragraph 18.

2 A Okay.

3 Q The word purported.

4 A I'm sorry?

5 Q You used the word purported.

6 A I did.

7 Q Does that mean baseless?

8 A It certainly could.

9 Q But does it mean baseless here?

10 A Yes.

11 Q It does?

12 A It does.

13 Q It means baseless?

14 A I believe it does.

15 Q And so what information do you have to
16 conclude -- where in your report do you address the
17 information that would reflect that these coverages,
18 the needs for them are baseless?

19 A I don't recall where it is in my report,
20 but the need for these coverages are baseless because
21 the insured --

22 Q Wait, wait, wait, back up a second. Where
23 in your report do you make an analysis where you
24 conclude that the needs for this coverage are
25 baseless?

1 A I do not recall where in this report that
2 exists.

3 Q Did you just make that up?

4 A No. If you'll let me explain.

5 Q Isn't that kind of an advocate word? Are
6 you being an advocate for Respondent?

7 A Purported?

8 Q Purported.

9 A That's a very generalized opinion based
10 word.

11 Q Generalized opinion, so it doesn't mean
12 baseless?

13 A It certainly could mean baseless.

14 Q But you meant baseless in this context.

15 A I believe I did.

16 Q Well, why didn't you say baseless?

17 A Why didn't I say baseless? There's a lot
18 of words that I could have substituted for purported,
19 but I used the word purported. I have no explanation
20 for that.

21 Q Now, at paragraph 19 you say: Captive
22 managers/promoters are different from traditional
23 captive managers in one major respect.

24 A I did say that.

25 Q And so what is a traditional captive

1 manager? I don't see a definition in your report of
2 a traditional captive manager.

3 A I will explain. A traditional --

4 Q No, no, no, but first, did you define what
5 a traditional captive manager is in your report?

6 A I don't think so.

7 Q You didn't, did you? And your report
8 doesn't define what a captive manager/promoter is,
9 does it?

10 A No. I'm giving one example of how they
11 differ.

12 Q You're giving one example of how they
13 differ. Okay, thanks.

14 You state that: "Traditional captive
15 managers do not normally perform feasibility studies,
16 whereas, promoters do write feasibility studies."
17 That's what you said. Right?

18 A That is what I said.

19 Q But now, your report does not define what a
20 promoter is, does it?

21 A I don't believe it does.

22 Q Is promoter and insurance industry -- is
23 that a term you use in the insurance industry?

24 A No.

25 Q And you're testifying as an insurance

1 industry expert here in this case?

2 A I am. The term promoter has been basically
3 used by companies that do what Capstone does.

4 Q It's been used by companies -- you're
5 saying that Capstone uses the word promoter?

6 A I'm saying that Capstone, in the general
7 parlance of our business, has been known to be what
8 is known as a promoter.

9 MR. ALBRIGHT: Objection, Your Honor. It's
10 hearsay, Your Honor. I ask that it be stricken.

11 MR. SCHEID: Your Honor, the response is
12 based upon his personal knowledge and his personal
13 experience.

14 THE COURT: I'm going to allow the answer
15 to remain.

16 BY MR. ALBRIGHT:

17 Q But promoter, the term promoter is not a
18 term that you use in the insurance industry, it's not
19 an insurance industry kind of term.

20 A No, no, because promoter can apply to all
21 manner of companies or folks that have a specific
22 agenda and sell a specific product.

23 Q Well, now, you've done a lot of captive
24 feasibility studies, haven't you?

25 A I have.

1 Q Are you a traditional captive manager?

2 A Yes, I am, but I'm not a captive manager.

3 Q You're not a captive manager?

4 A No, sir.

5 Q And you're not a promoter either, are you?

6 A I am not.

7 Q So how are you different from Capstone when
8 you do a feasibility study, captive feasibility
9 study?

10 A I'm an entirely independent consultant. I
11 have no stake in what happens after I complete my
12 feasibility study. Capstone writes a feasibility
13 study within the context of creating a program for
14 the client for which it is writing the feasibility
15 study. Captive managers do not write feasibility
16 studies, very, very, very infrequently. So the
17 difference between me and a captive manager is I'm a
18 consultant, I hire captive managers, I hire actuaries
19 and I hire accountants and I hire lawyers to create
20 captives within individual domiciles. But in the
21 main scheme of things, captive managers do not create
22 captive feasibility studies because that would create
23 a conflict of interest.

24 Q Okay. So let me ask you a few questions
25 about this. When you do a captive feasibility study

1 for a client, is there a prospect that you might get
2 additional work that the client might want to consult
3 with you about the operation of the captive on an
4 ongoing basis?

5 A Yes and no. Yes, in that that may occur
6 and it does occur, but no, that is not what I do for
7 a living. I participate with the team that I have
8 assembled and that team is responsible for forming
9 the captive, responsible for developing the captive
10 and literally going and making application to the
11 domicile and forming the captive. I'm just a
12 quarterback.

13 Q You're the quarterback.

14 A I just create the team and the team takes
15 over at that point.

16 Q And so as the quarterback, you're off the
17 team after the captive is formed?

18 A I am.

19 Q You are?

20 A I am.

21 Q You don't continue to give any advice to
22 the client concerning the operation of the captive
23 insurance company?

24 A Ninety percent of the time I do not, no,
25 because my services are generally limited to

1 feasibility analysis. Once the captive is formed,
2 the captive is formed. I'm involved in the formation
3 process only insofar as I hire the team and the team
4 then goes into the domicile and creates the
5 application and answers all the questions from the
6 regulator and so forth. I am not a member -- I'm a
7 member of the team only in so much as I form them.
8 I'm not an actuary, I'm not an accountant, I'm not a
9 lawyer, so I do not do any of those jobs, I hire
10 these people to do those jobs.

11 Q So you're just a personnel manager?

12 A I like that one.

13 Q Well, no. I mean, you said you hire all
14 these people to do these jobs. What is your job?

15 A Personnel manager is a particularly --
16 what's the word? -- accurate way to describe it. But
17 someone has to hire these folks and I'm the one that
18 does the feasibility work, I'm the one that in
19 conjunction with the client, I'm the one that has
20 determined -- and I say in conjunction with the
21 client -- determined that the project is either
22 feasible or not feasible. But I go back to the
23 notion that if it's not feasible, I have nothing to
24 gain by it being feasible.

25 Q So once the captive is up and running, they

1 put the quarterback out to pasture. Is that correct?

2 A I love that, that's good, out to pasture.

3 I put myself out to pasture, I move on to other

4 opportunities.

5 Q But you said in 10 percent of the cases you

6 have some kind of an ongoing relationship with the

7 captive insurance company.

8 A Yes, because I've developed a relationship

9 with the risk manager or with the CFO, and I'm always

10 open to questions. Regardless of the circumstance,

11 I'm always there for questions.

12 Q So did you have a conflict of interest then

13 when you assisted in preparing the feasibility study?

14 A Not at all, not at all.

15 Q But you have an ongoing relationship.

16 A The relationship begins and ends based on

17 feasibility. If it makes sense --

18 Q Go ahead.

19 A -- if it makes sense to form the captive,

20 then it makes sense to form the captive and I have a

21 relationship with these folks because how could I

22 have not have a relationship with the people that I'm

23 forming a captive for or that I'm performing a

24 feasibility study for? If it doesn't make sense t

25 form the captive, it's sayonara.

1 Q But there is the prospect of an ongoing
2 relationship with this client in forming a captive,
3 isn't there?

4 A The prospect has nothing to do with -- it's
5 not financial.

6 Q You don't get paid for the work you do as a
7 consultant. Is that what you're saying?

8 A No, I did not say that. I get paid very
9 well for the work that I do as a consultant, what I
10 don't get paid for is the work that I would do -- and
11 there isn't any work really -- that I would do post
12 captive formation. If someone, one of my clients --
13 and I say my clients because they are once clients --
14 wants to stay in touch with me, that's wonderful. I
15 charge no additional premium for that, no additional
16 fee for that right.

17 Q Have you ever had a situation where you
18 were involved in forming a captive insurance company
19 and then you became an office of the captive
20 insurance company?

21 A No.

22 Q Mr. Riggin, if you would turn to page 19 of
23 your report.

24 A I retract my answer.

25 Q You retract your answer?

1 A I do. In this particular instance, I was
2 asked -- oh, by the way, let me explain this even
3 better, I was asked to stay on as the treasurer. If
4 you're referring to Agency Captive, the first bullet?

5 Q Yes.

6 A I was asked to stay on as treasurer of the
7 captive which is a non-paid position. No captive
8 officers or directors are paid for what they do.
9 These are honorary, basically, positions. So in this
10 case, yes, but I wasn't paid for it.

11 Q So in this case you were not a promoter?

12 A I never have been a promoter nor will I
13 ever characterize myself as a promoter.

14 Q Can you think of any other situations where
15 you had an ongoing relationship with the captive
16 after it was formed?

17 A Of course, of course, of course, but none
18 of those relationships --

19 Q Well, give me an example.

20 A Of course. I have done so. If after a
21 captive is formed, if the risk manager or the CFO is
22 interested in maintaining an ongoing relationship, I
23 will gladly do that because it is the right thing to
24 do, it's an ethical thing to do. I'm not going to
25 turn down a question from a former client, and let me

1 stress former. Part of my services are that I
2 provide feasibility analysis and if it looks like a
3 captive is feasible -- you know, feasibility is a
4 very, very broad concept. There's shades of gray
5 through this, so there's never a situation where we
6 absolutely have feasibility or we have no
7 feasibility, only in situations that are excluded
8 immediately from qualification -- so I believe Mr.
9 Feldman mentioned a number of those situations
10 yesterday, which I entirely agree with -- where it's
11 just not a good fit right out of the box so we're not
12 going to do a feasibility study on something that we
13 know doesn't make any sense downstream.

14 But my clients are all, other than the ones
15 that I have maintained relationships with for which I
16 charge nothing, my clients are all project-based,
17 specific and former.

18 THE COURT: Mr. Albright, I was thinking of
19 taking a quick break now, but I didn't know if you
20 were.

21 MR. ALBRIGHT: It would be fine, Your
22 Honor, if you want to take a break.

23 THE COURT: We'll take a break until
24 quarter of. The Court is in recess.

25 (Whereupon, a brief recess was taken.)

1 THE COURT: You may proceed.

2 BY MR. ALBRIGHT:

3 Q Mr. Riggin, if you would turn to page 18 of
4 your report which is Exhibit 136-R, and there's a
5 reference there. Are you at that page yet?

6 A I am, yes.

7 Q And there's a second bullet point there
8 that says: Captive feasibility and implementation of
9 two captive programs, Chemco Realty and the
10 Archdiocese of New York. So there you did more than
11 the feasibility study.

12 A No, I did not. Implementation is a very
13 broad term, and as implementation I mean that exactly
14 what I said earlier, I assemble the team, the team
15 goes forward, if there's questions, if there's issues
16 that I need to address along the way, I certainly
17 will. That is implementation, and another word for
18 it is formation. My role does not go beyond specific
19 feasibility analysis. With these two clients, in the
20 first instance I do have a relationship going forward
21 but it's not a financial relationship. I'm a friend
22 of the risk manager and I get calls every couple of
23 months, when he has a question, I'll answer it. In
24 the second instance I have no ongoing relationship
25 and I never did. My role in implementation is to

1 gather the correct people and to set them free in the
2 domicile and let them do their thing.

3 Q And did you get paid for the
4 implementation?

5 A No.

6 Q You didn't get paid for the implementation?

7 A No, I did not, and I specifically do not.
8 Implementation is part of what my team does. I back
9 out, as I said before.

10 Q So wait a minute, I want to make sure I'm
11 clear on this. So there's a single fee that you
12 charge. Is that right?

13 A I charge a single fee.

14 Q And that includes captive feasibility and
15 implementation?

16 A No. It includes captive feasibility. I
17 have no basis upon which to charge an additional fee
18 for implementation. And when I say implementation
19 here, I'm talking about exactly the same set of
20 circumstances that I referred to earlier. I assemble
21 the team, the team goes forward, I am the quarterback
22 for the team, I make sure that they do what they need
23 to do, I'm in contact with those folks right through
24 the process, but from a financial perspective, I have
25 no other interest in this client other than the

1 feasibility study.

2 Q So if somebody that you're working for, a
3 client, you've done a feasibility study and they come
4 to you and they say we would like you to do more than
5 the feasibility study, have you had that happen?

6 A I have.

7 Q Did you have a gross conflict of interest
8 in that situation?

9 A No, no, because if someone comes to me and
10 wants me to do additional work, it has to do with
11 additional feasibility work, it doesn't have to do
12 with anything wherein I would work for them on a
13 post-feasibility basis and then I would charge them
14 for that. It has to do with another piece of
15 feasibility work.

16 Q So you're never hired -- I believe I heard
17 you testify that you do have ongoing relationships
18 with some of these clients that you do feasibility
19 studies for.

20 A I do.

21 MR. SCHEID: Objection, Your Honor. This
22 line of questioning has already been asked and
23 answered thoroughly, I believe.

24 THE COURT: I'm going to sustain the
25 objection.

1 BY MR. ALBRIGHT:

2 Q In those cases where you have an ongoing
3 relationship after the feasibility study, do you have
4 a gross conflict of interest?

5 MR. SCHEID: Objection, Your Honor. It's
6 the same objection, this has all been asked and
7 answered.

8 MR. ALBRIGHT: Your Honor, I don't believe
9 he's answered this question yet.

10 THE COURT: I'm going to allow the answer
11 to this question.

12 THE WITNESS: No, absolutely not, I have no
13 conflict of interest. I would if I were being paid a
14 separate fee that would have bearing on the notion
15 that the feasibility study turned out to be positive.
16 If I charged a separate fee in the cases where the
17 feasibility study indicates that a captive should be
18 or could be formed and the client agrees with that,
19 and if I were to charge a separate fee on a go
20 forward basis, that would mean that I would have a
21 financial incentive to create the positive outcome of
22 that feasibility study. See, that's the point. I
23 cannot do that and I never have.

24 BY MR. ALBRIGHT:

25 Q Mr. Riggin, are you working for Respondent

1 in other cases?

2 A I am not.

3 Q You are not. So you're not involved in any
4 other litigation with Respondent?

5 A I guess I'm naive enough not to know how
6 you define Respondent. How do you define Respondent?

7 Q The Internal Revenue Service.

8 A Oh. I am, yes.

9 Q So you have -- you're doing other work for
10 the Internal Revenue Service.

11 A Yes, sir.

12 Q Are you being paid for that work?

13 A Yes, sir.

14 Q And how long have you been working for the
15 Internal Revenue Service?

16 A In this particular case we started document
17 review back in September.

18 Q In this case?

19 A In the case that I am referring to, not
20 this case.

21 Q Not this case.

22 A Right.

23 Q So you've been working for the Internal
24 Revenue Service in other cases since October of last
25 year?

1 A October of last year, correct.

2 Q And how many other cases are you working on
3 for the Internal Revenue Service?

4 A No others, just one.

5 Q Just one? Do you have a gross conflict of
6 interest then because you're working on another case
7 for the Internal Revenue Service?

8 A Would you explain how that is even
9 possible?

10 Q I'm just asking.

11 A No.

12 Q Have you discussed with Respondent's
13 counsel the prospect of working on some other captive
14 insurance cases for Respondent?

15 A Respondent's counsel in this room?

16 Q Respondent's counsel anywhere.

17 A Anywhere. No, I have not.

18 Q You would like to continue to work for
19 Respondent as an expert witness, wouldn't you?

20 A I would not turn down the opportunity if it
21 were presented to me.

22 Q Mr. Riggin, let me ask you to turn to
23 paragraph 33 of your report. You state in paragraph
24 33 that: "For the 2009 policy year, total premiums
25 for the eleven in force insurance policies were

1 \$448,127. Total limits of liability for the 2009
2 policy year were \$8 million. Clearly, the premiums
3 for the term cannot pay for a total limits claim
4 filed under all eleven policies." Do you see that?

5 A I do.

6 Q And you say the same thing in paragraph 34
7 on page 11 with regard to the 2010 policy year.

8 A I see that.

9 Q So if Reserve charged a premium of that
10 amount, you wouldn't need risk distribution or the
11 law of large numbers to simply required the insureds
12 to pay a premium equal to the total loss limits under
13 the policy. Right?

14 A If the insureds were to pay a premium of
15 total loss limits under the policy, you would not
16 have an insurance policy. You cannot have a premium
17 equal to the limit.

18 Q But why are you making this statement here?

19 A Because it's the truth.

20 Q But what is the relevance to this statement
21 to your opinion?

22 A I go on to say -- I go on to actually
23 explain how an \$8 million, as absurdly possible as
24 that would be, because it is not impossible, would be
25 paid through the various reinsurance arrangements.

1 MR. ALBRIGHT: Your Honor, may I have this
2 document marked for identification as Petitioner's
3 exhibit next in order?

4 THE COURT: Yes.

5 MR. ALBRIGHT: And please let the record
6 reflect that I am handing a copy to Petitioner's
7 counsel -- Respondent's counsel -- I'm sorry.

8 May I approach?

9 THE COURT: Yes.

10 THE CLERK: An article titled "Captive
11 Information on the Internet: Caveat Emptor" is marked
12 for identification as Exhibit 140-P.

13 (The document referred to was marked for
14 identification as Exhibit 140-P.)

15 MR. ALBRIGHT: Your Honor, may I provide a
16 copy of Exhibit 140-P to Mr. Riggin?

17 THE COURT: Yes.

18 BY MR. ALBRIGHT:

19 Q Mr. Riggin, do you have a copy of Exhibit
20 140-P in front of you?

21 A I do.

22 Q And if you'll turn to page -- what is
23 Exhibit 140-P?

24 A I'm sorry?

25 Q What is Exhibit 140-P?

1 A It's an article that I wrote quite some
2 time ago called "Captive Information on the Internet:
3 Caveat Emptor."

4 Q And if you turn to page 3, and you see
5 there there's a list of bullet points, and there's a
6 statement: The premium cannot match the maximum
7 limit of liability. Do you see that?

8 A Yes.

9 Q And you're making that comment, you're
10 saying that to qualify to use insurance accounting,
11 every captive must meet the following principles
12 first, and then one of those principles is that the
13 premium cannot match the maximum limit of liability.

14 A Correct.

15 Q So you're not saying that -- the statements
16 that you have in paragraphs 33 and 34, those are not
17 negative statements with regard to Reserve, are they?

18 A Oh, no, not at all.

19 Q You're just making an observation.

20 A Precisely.

21 MR. ALBRIGHT: Your Honor, I'd move Exhibit
22 140-P into evidence.

23 MR. SCHEID: No objection, Your Honor.

24 THE COURT: 140-P is admitted.

25 (The document referred to, having been

1 previously marked for identification as
2 Exhibit 140-P, was received in evidence.)

3 BY MR. ALBRIGHT:

4 Q Have you ever made the statement, Mr.
5 Riggin, that risks such as hurricanes that it's very
6 difficult to make an accurate loss prediction, that
7 it's almost impossible?

8 A Are you reading that from this article?

9 Q No. I'm asking you if you've ever made
10 that statement.

11 A Well, assuming it isn't in this article, I
12 don't recall ever making that statement.

13 Q You don't recall ever making that
14 statement?

15 A Not here.

16 Q Not here?

17 A Not in this Court.

18 MR. SCHEID: Objection, Your Honor. It's
19 been asked and answered. It's badgering the witness
20 at this point.

21 THE COURT: If you can move on.

22 BY MR. ALBRIGHT:

23 Q Have you ever made that statement outside
24 of this courtroom?

25 A I have no idea.

1 MR. SCHEID: Again, Your Honor, it's been
2 asked and answered.

3 MR. ALBRIGHT: Your Honor, may I have this
4 document marked for identification as Petitioner's
5 exhibit next in order?

6 THE COURT: Yes.

7 MR. ALBRIGHT: And let the record reflect
8 that I'm handing a copy to Respondents' counsel.

9 May I approach?

10 THE COURT: Yes.

11 THE CLERK: The article by Donald J.
12 Riggin, titled "Cyber Attack Insurance -- Is there a
13 Role for Captives?" is marked for identification as
14 Exhibit 141-P.

15 (The document referred to was marked for
16 identification as Exhibit 141-P.)

17 MR. ALBRIGHT: Your Honor, may I provide
18 Mr. Riggin with a copy of Exhibit 141-P?

19 THE COURT: Yes.

20 BY MR. ALBRIGHT:

21 Q And if you would look at Exhibit 141-P,
22 specifically the last sentence of the first
23 paragraph.

24 A Yes.

25 Q And Exhibit 141-P is an article that you

1 published. Is that right?

2 A That's correct.

3 Q And do you state there -- does that refresh
4 your recollection as to whether or not you've made
5 any statements that hurricanes are very -- it's very
6 difficult to make an accurate loss projection for
7 hurricane damage?

8 A Yes, with a proviso, a very bolded proviso,
9 for a particular company it is almost impossible. On
10 a broad scale, if a hurricane hits the south, hits
11 Florida, there's enough loss damage to be able to
12 substantiate what the premium may be the next time
13 around, but for a particular company, a particular
14 machine shop in Tallahassee, no.

15 Q So is this a one-off situation?

16 A No. There is never -- if you were a
17 machine shop in Tallahassee and you buy windstorm
18 insurance, otherwise known as hurricane insurance,
19 you're buying it not based on with predilection of a
20 storm hitting you personally and your values and so
21 forth, you're basing it based on a predilection of
22 hurricane hitting north central Florida, or wherever
23 Tallahassee is

24 Q But it's difficult to make an accurate loss
25 projection for a particular company. Would you agree

1 with that?

2 A Yes. That's what I said.

3 Q And would it also be difficult to make an
4 accurate loss prediction for a particular company for
5 earthquake coverage?

6 A I would say that that would be the case.
7 Yes.

8 Q So are these two one-off situations?

9 A No. It's not a question of one-off, it's a
10 question of degree. That's where you're confusing
11 things. It's a question of degree. An earthquake
12 and a hurricane are going to cause significant
13 damage. The risks associated with each of them are
14 not calculated based on an individual company like
15 our machine shop in Tallahassee, they're calculated
16 based on the event, and the event being the hurricane
17 or the earthquake, and I did not say that it is
18 impossible or very unlikely to be able to calculate a
19 premium based on the event, because it is very likely
20 and possible to calculate a premium based on the
21 event.

22 Q Mr. Riggin, did you write this article,
23 Exhibit 141-P, it's an article that you authored?

24 A Yes.

25 Q And this article was published on March 14,

1 2016?

2 A That's what it says.

3 Q Well, look at it and tell me, please.

4 A I believe it does.

5 Q Do you know whether this -- this article is
6 not listed in your bibliography to your expert
7 report, is it?

8 A No. This goes into the same category as
9 self-published articles that I have not included in
10 the bibliography.

11 Q But this is an article that was written
12 within the last ten years.

13 A Oh, absolutely it was.

14 MR. ALBRIGHT: Your Honor, I move Exhibit
15 141-P into evidence.

16 MR. SCHEID: No objection, Your Honor.

17 THE COURT: 141-P is admitted.

18 (The document referred to, having been
19 previously marked for identification as
20 Exhibit 141-P, was received in evidence.)

21 BY MR. ALBRIGHT:

22 Q Mr. Riggin, have you ever heard of someone
23 who had insurance but decided not to file a claim
24 because they did not want the premiums to go up or
25 the insurance company to drop their coverage?

1 A I believe -- I don't have personal
2 experience with that but I think somewhere in the
3 literature that that is certainly possible. It's
4 certainly possible.

5 Q You don't know anyone who's done that?

6 A Not personally.

7 Q Not personally.

8 A That's what I said.

9 MR. SCHEID: Objection, Your Honor. I
10 don't understand the relevance of any of this.

11 MR. ALBRIGHT: We're going to get to it,
12 Your Honor.

13 THE COURT: You may continue.

14 BY MR. ALBRIGHT:

15 Q In your opinion, would there be anything
16 wrong for someone like that to make the election that
17 they're not going to file a claim under their
18 insurance policy?

19 A If it's a first party claim, meaning that
20 it's property or business interruption or a situation
21 where they have control over what is filed, there's
22 nothing inherently wrong with that. If it's a third
23 party claim, however, meaning that there's a third
24 party involved, such as an automobile liability or
25 general liability, there is a problem with that

1 because the third party has a lot to say about it.

2 Q So if the water heater at my house broke
3 and flooded my house, a portion of my house, and I
4 have insurance coverage on my house, would it be okay
5 for me not to file a claim?

6 A You are well within your rights not to file
7 a claim.

8 Q And is it possible that the reason that I
9 might not file a claim is because the premiums that I
10 pay might go up?

11 A That seems to be the way it works or the
12 way it appears to be in the insurance business that
13 depending on the line of coverage, depending on the
14 magnitude of your premiums, that yes, if you don't
15 file a claim, the insurance company has no idea what
16 your coverage is all about, so whether or not the
17 claim would be material to your premium, they would
18 not know that.

19 Q So it's well within my option as to whether
20 or not to file a claim or not.

21 A It is.

22 MR. SCHEID: Objection, Your Honor. Asked
23 and answered.

24 THE COURT: If you can move on to another
25 area.

1 BY MR. ALBRIGHT:

2 Q Mr. Riggin, at paragraph 36 of your report
3 there's a statement there that says: Of the eleven
4 coverages, all but two are first party, meaning that
5 it is up to Reserve's management to decide whether or
6 not to file a claim. This fact is material because
7 it allows Reserve to maintain as much premium as
8 possible in the captive and not exhaust it.

9 A I see that.

10 Q You said that.

11 A Yes, sir.

12 Q But you said this fact is material.

13 A Yes.

14 Q Why is it material?

15 A It's material because the majority of the
16 coverages in Reserve are elective in terms of whether
17 or not they want to file a claim. If they want to
18 maintain as much premium in the policy, to maintain
19 as much premium in Anguilla, then they the right and
20 they are perfectly able not to file a claim. There's
21 nothing that says that they must file a claim in a
22 first party arrangement.

23 Q So why is that material?

24 A Because in this situation, if they fall, I
25 should say, under 501(c)(15) which Peak does, Reserve

1 does, then the incentive is to keep as much premium
2 offshore and as much premium in this captive as
3 possible because they are not taxed on either the
4 premium portion of it or the investment income
5 portion.

6 Q Did anybody tell you that was what the
7 intention was here?

8 A No. That is an opinion, pure and simple.

9 Q But how is that different in my situation
10 where I've paid a premium for my homeowners policy
11 and I decide not to file a claim because I'll deal
12 with my losses in a different way, I don't want to
13 increase the cost to me ultimately of dealing with my
14 claims?

15 A Well, because in your case, the premium, as
16 you posited earlier, you said the premium would go
17 up, and in this case the premium may certainly go up
18 but for an entirely different reason.

19 Q But is that really a material fact as to
20 whether or not this is insurance in this case?

21 A I believe it's a material fact within the
22 context of the fact that all but two of these
23 coverages are first party coverages, meaning that the
24 insured has control over what is claimed and what is
25 not claimed.

1 Q But any insured can do this with their
2 insurance company, can't they?

3 A Yes, they can, except that there generally
4 isn't the incentive for you, except for the fact that
5 your premiums might go up, there's no incentive aside
6 from the tax incentive that is provided under
7 501(c)(15).

8 Q Mr. Riggin, if I could, I'd like to direct
9 your attention to the discussion of risk distribution
10 in your report. I believe it starts on page 12. And
11 you state at page 12 that you: "Will explain why
12 insurance risk distribution is entirely dependent on
13 per-line risk homogeneity and not on portfolio
14 diversity."

15 A Correct.

16 Q You made that statement.

17 A I did.

18 Q Do you know whether your position on
19 homogeneity is more strict than the IRS national
20 office position?

21 MR. SCHEID: Objection, Your Honor. I
22 don't know what the relevance of that question would
23 is.

24 THE COURT: Do you want to respond to the
25 objection?

1 MR. ALBRIGHT: Your Honor, I believe it's
2 relevant. He's testifying as an expert in this case
3 and Mr. Riggin has written on this topic.

4 THE COURT: I'll allow him to answer yes or
5 no.

6 THE WITNESS: Can you repeat the question,
7 please?

8 BY MR. ALBRIGHT:

9 Q You state at page 12 that you -- I'm sorry
10 -- Mr. Riggin, your position on homogeneity is more
11 strict than the IRS national office position, isn't
12 it?

13 A I do not know.

14 Q Now, Mr. Riggin, you've been critical of
15 the Internal Revenue Service for not requiring
16 homogeneity, haven't you?

17 A Yes, I have.

18 Q In other words, you don't agree with the
19 Internal Revenue Service about whether homogeneity is
20 required.

21 A I suppose in a limited sense you're right.

22 MR. ALBRIGHT: Your Honor, this Exhibit
23 108-P has been marked for identification previously.
24 May I provide a copy of Exhibit 108-P to Mr. Riggin?

25 THE COURT: Yes.

1 BY MR. ALBRIGHT:

2 Q Do you have a copy of Exhibit 108-P in
3 front of you?

4 A I do.

5 Q What is Exhibit 108-P?

6 A An article that I wrote on May 3, 2016
7 called "What Creates Insurance in a Captive?"

8 Q Now, Mr. Riggin, this article is also not
9 listed in your report as an article that you've
10 written in the last ten years.

11 A That is correct. This is part of the same
12 group of unpublished articles that I chose not to
13 include in that list.

14 Q But now, if you look right up there at the
15 top under the title "What Creates Insurance in a
16 Captive?" it says published on May 3, 2016, doesn't
17 it?

18 A Yes, it does. The term published in this
19 context is a LinkedIn term of art. LinkedIn would
20 like everyone to believe that everything they write
21 on their website is published. Well, this is a self-
22 published article.

23 Q But this is an article that you published.

24 A That I wrote.

25 Q And you published it too.

1 A Published it on LinkedIn.

2 MR. ALBRIGHT: Now, if you will look over -
3 - well, first of all, Your Honor, I'd move this
4 exhibit into evidence.

5 MR. SCHEID: We have no objection.

6 THE COURT: 108-P is admitted.

7 (The document referred to, having been
8 previously marked for identification as
9 Exhibit 108-P, was received in evidence.)

10 BY MR. ALBRIGHT:

11 Q Now, Mr. Riggin, if you'll turn to page 3.

12 A Yes.

13 Q I see your picture there agin.

14 A You do.

15 Q And it looks like you're responding to a
16 question from Hugh.

17 A I am.

18 Q And do you see the statement there that
19 says: I said that a portfolio theory is used as the
20 rationale for risk distribution, which it has been
21 done -- and in parentheses -- incorrectly sanctioned
22 by Revenue Ruling 2005-40. Insurance is not created
23 regardless of what you call the structure. Do you
24 see that statement?

25 A I do, yes.

1 Q Did you make that statement?

2 A I did indeed.

3 Q Do you agree with that statement?

4 A Yes.

5 Q And so aren't you saying there that Revenue
6 Ruling -- you disagree with the application of
7 Revenue Ruling 2005-40?

8 A I do. When you quoted the piece, you
9 omitted the word incorrectly which has a great
10 bearing on the meaning of what you read.

11 Q So you're saying that it was incorrectly
12 sanctioned by Revenue Ruling 2005-40?

13 A In my opinion.

14 Q Do you know whether the Internal Revenue
15 Service has adopted the concept of homogeneity in
16 defining what insurance is?

17 A The IRS includes the notion of the term
18 homogeneous in each of its applicable revenue rulings
19 -- 2005-40 is one of them -- and it has always been a
20 mystery to me as to why there has not been a greater
21 emphasis on homogeneity in these revenue rules.

22 Q Well, is there anything that you can point
23 to, anything that says that homogeneity is a
24 requirement for risk distribution to occur? Anything
25 other than yourself?

1 A Yes. Look at the revenue rule. It's in
2 the revenue rule but it is an aside and it has not
3 been enforced. What is enforced are the specific
4 instances. You know how revenue rulings work,
5 there's about four specific instances, three of which
6 are no good, one of which follows the logic of the
7 ruling. None of them specifically say homogeneous,
8 however, within the body of the revenue ruling it
9 does say: and we assume that -- or whatever the
10 language is -- homogeneity.

11 Q And what revenue ruling are you talking
12 about?

13 MR. SCHEID: Objection, Your Honor, to this
14 whole line of questioning. He's not being offered as
15 an expert in tax law, he's opining on homogeneity
16 from an insurance industry perspective.

17 MR. ALBRIGHT: Your Honor, I'm just trying
18 to drill down and find out what Mr. Riggin's basis is
19 for saying that homogeneity is required from
20 insurance industry's perspective. That's all I'm
21 doing.

22 THE COURT: He's allowed to answer that
23 question and then move on.

24 THE WITNESS: That question, yes. It has
25 everything to do with my experience, everything to do

1 with what I've been doing for the last 35 years. The
2 way insurance premiums are developed is through
3 homogeneous class of business and homogeneous lines
4 of business. They have nothing to do with portfolio
5 diversity. In a captive it's very nice to have
6 portfolio diversity, it's a very good thing because
7 it reduces the amount of risk overall within the
8 captive, and we try to get it, and when we do get it,
9 what that also means is it allows us to reduce the
10 amount of capital that is assignable to each of the
11 lines.

12 If we have five or six different lines of
13 cover in a captive that do not correlate, meaning
14 that an event does not impact all of them, it impacts
15 one or two of them, then the amount of capital
16 involved in that -- it's a mathematical operation --
17 the amount of capital can be reduced. That's part of
18 the diversity argument, but it has nothing to do with
19 using historical losses to create expected losses, to
20 create rates and to create premiums.

21 BY MR. ALBRIGHT:

22 Q Would it come as a surprise to you that the
23 IRS has issued a written document that says that
24 they're not taking a position on whether homogeneity
25 is required or not?

1 MR. SCHEID: Objection again, Your Honor,
2 for the same reason set forth before: he's not
3 opining as a tax expert, as an IRS expert, he's
4 opining from an industry perspective.

5 THE COURT: I'm going to allow the question
6 to be answered.

7 THE WITNESS: No.

8 BY MR. ALBRIGHT:

9 Q It wouldn't surprise you?

10 A No. That's right, that's what you asked.
11 Whether or not it would surprise me? It might
12 surprise me. I have not heard of such a thing, but
13 it might surprise me.

14 Q Well, did you ever ask Respondent's counsel
15 what Respondent's position was on this issue?

16 MR. SCHEID: Objection, Your Honor. Again,
17 he's being offered as an industry expert.

18 THE COURT: I gave you a little leeway. If
19 you can move on.

20 BY MR. ALBRIGHT:

21 Q Mr. Riggin, you conceded in paragraph 26 of
22 your report that: "A heterogeneous risk pool has
23 some diversification value --"

24 A I do believe that, yes.

25 Q " -- which reduces the amount of risk in

1 the pool but is immaterial and irrelevant to the
2 creation of insurance risk distribution." End of
3 quote.

4 A I said it and I believe it.

5 Q But there is some diversification value
6 there that reduces the possibility or reduces the
7 risk in a sense.

8 A There is, there is. And the more of that
9 you can get, the better off you are. But it has
10 nothing to do with creating rates and forecasting
11 losses and creating premiums.

12 Q Mr. Riggin, your report does not quantify
13 how much of a reduction in the amount of risk in the
14 pool was required to achieve risk distribution, does
15 it?

16 A No, it does not.

17 Q At page 14 in paragraph 51, you state: The
18 goal of insurance risk distribution is to predict as
19 closely as possible what the risk is going to be.
20 Are you there?

21 A Paragraph what? I'm sorry.

22 Q Paragraph 51, page 14.

23 A Page 15? 51 is on page 14.

24 Q Yes. Page 14, paragraph 51.

25 A Okay. Could you read the passage again so

1 I can respond to it?

2 Q At page 14 in paragraph 51, you state: The
3 goal of insurance risk distribution is to predict as
4 closely as possible what the risk is going to be.

5 Don't you say that?

6 A I do.

7 Q But you don't say how much homogeneity is
8 required, do you?

9 A No.

10 Q Do you know how much homogeneity is
11 required?

12 A No.

13 Q You don't say either how much loss data is
14 required to project losses, do you?

15 A No, because it is entirely subjective.

16 Q It's entirely subjective?

17 A Yes, sir.

18 Q Is that a kind of a judgment that you would
19 make?

20 A No. It's a judgment that one of my
21 actuaries would make.

22 Q You don't say what -- I believe you did say
23 there's a confidence level that's required for an
24 actuarial analysis?

25 A No. Are you reading that here?>

1 Q I thought I heard you testify on direct
2 that you were testifying about what confidence level
3 that an actuary might have regarding a loss forecast.

4 A No.

5 MR. SCHEID: Objection, Your Honor. I
6 believe that mischaracterizes his prior testimony.
7 He can certainly restate.

8 THE COURT: I think it's fine to stay in
9 the record so that it's clear on the record that
10 that's not what he said. And if you can move on to
11 the next question.

12 BY MR. ALBRIGHT:

13 Q Well, would a 40 percent confidence level
14 work?

15 A Generally not, and it's not a question of
16 working, it's a question of acceptability. If a
17 client is comfortable with funding only to a 40
18 percent confidence level, as a consultant I would
19 strongly recommend against that. One of the things
20 that I do as a consultant is to make sure that the
21 funding is adequate to the risk, and a 40 percent
22 confidence level it might be in some circumstance, in
23 some situation, but I've never seen it to be, it's
24 too low.

25 Q Do you know how large a pool of homogeneous

1 loss exposures that an actuary would require to
2 project expected losses?

3 A No, because it's entirely subjective, it's
4 entirely subjective. It has to do with the amount of
5 premium involved and the amount of loss information
6 involved, and none of those things are the same in
7 any circumstance.

8 Q Mr. Riggin, at page 53 of your report --

9 MR. SCHEID: I believe you're referring to
10 paragraph 53.

11 MR. ALBRIGHT: Paragraph 53. Thank you.

12 THE WITNESS: Okay.

13 BY MR. ALBRIGHT:

14 Q There's a statement there: There are
15 isolated instances where the market and not actuarial
16 science is used to establish rates and premiums but
17 these are few and far between.

18 A I did write that, I see it.

19 Q And you go on to say that even in these
20 cases there's a rhyme and a reason to justify the
21 rates and premiums.

22 A Yes.

23 Q Your report really doesn't identify the
24 isolated instances where you can look to the market,
25 does it?

1 A No, specifically it does not, purposefully.

2 Q You don't identify in your report what are
3 isolated instances, do you?

4 A No, because they are, as the term suggests,
5 isolated instances. I think we've been over this,
6 satellites and terrorism are good examples of
7 isolated instances.

8 Q Now, if we turn to page 32 of your report,
9 you state that, quote -- let me give you a chance to
10 get to page 32.

11 A I'm there.

12 Q You state that: "There is no reason why
13 weather risk, as it relates to business interruption,
14 cannot be considered to be an insurable risk if
15 analytically based premiums can be established."

16 A I see it.

17 Q So you believe that weather risk as it
18 relates to business interruption is an insurable
19 risk.

20 A Oh, most definitely it is.

21 Q But analytically based premiums, that
22 sounds like a new concept that you didn't have in the
23 body of your report.

24 A Well, actually I think I did use the
25 expression, but what I mean is that a premium that is

1 based on historical data, and in this case historical
2 data would mean that a particular client would be
3 susceptible to -- let's say susceptible to
4 hurricanes. Again, if you're somewhere in Florida,
5 then weather risk, within a certain number of months
6 of the year, weather risk is a very big deal, so it
7 is quantifiable from that perspective. If you were
8 in Utah and you wanted to cover hurricanes or if you
9 wanted to cover whatever you wanted to cover from a
10 weather standpoint, then there is a question as to
11 whether or not there is a real risk.

12 Q What about do they have snowstorms in Utah?

13 A Of course they do.

14 Q Do they have floods in Utah?

15 A I would imagine they do.

16 Q Mr. Riggin, if you would turn to page 31 of
17 your report, and down at the bottom you say: There's
18 no reason why this captive cannot also offer such
19 coverage if analytically based premiums can be
20 established. Do you see that?

21 A I do.

22 Q When you wrote your report, did you know
23 that Peak Mechanical & Construction Company, Inc. was
24 conducting its business in a Superfund site?

25 A Yes, I did.

1 Q So you believe that excess pollution
2 liability, this insurance policy could cover an
3 insurable risk. You conceded that.

4 A Extraordinarily unlikely, but I will not
5 foreclose on the possibility that it could.

6 Q But just conceptually, conceptually you
7 agree that the excess pollution liability insurance
8 policy involved in this case for each year, that this
9 is an insurable risk, could be an insurable risk.

10 A If the premiums could be established
11 analytically the way they are in the standard
12 commercial insurance business.

13 Q And then if you could turn to page 30,
14 please.

15 A I'm there.

16 Q There's a reference to an expense
17 reimbursement-legal expenses. That's an insurance
18 policy, isn't it?

19 A It has been -- legal expenses have been
20 placed into insurance policies. Yes.

21 Q And so you're just questioning the manner
22 in which the premiums were determined. This could
23 still be an insurable risk, in your opinion.

24 A It is an insurable risk, in my opinion.

25 Q And then page 29 there's the excess cyber

1 risk policy.

2 A Okay.

3 Q But is cyber risk an insurable interest?

4 A An insurable interest?

5 Q Insurable risk. I'm sorry.

6 A Yes, yes, it is.

7 Q And then if you would turn to page 27,
8 there's a reference to special risk loss of major
9 customer.

10 A Indeed.

11 Q And excess intellectual property package
12 policy.

13 A Yes.

14 Q You agree that if these risks exist that
15 they could be an insurable risk for insurance
16 purposes.

17 A Not only do I believe it, I have placed
18 coverage with both of these risks into insurance
19 policies. Yes.

20 Q And if you'd turn back to page 26, there's
21 a reference there to special risk regulatory changes
22 insurance policy.

23 A Yes.

24 Q If you can determine a premium, you would
25 agree that that would constitute insurance. Correct?

1 A Yes, if there's a reasonable way to
2 determine a premium as opposed to just thinking of a
3 number, yes, I do agree with that.

4 Q And you would make the same statements with
5 regard to special risk punitive wrap liability
6 insurance policy. Correct? At the bottom of 26.

7 A Yes. That's not uncommon commercial
8 coverage.

9 Q And then special risk product recall on
10 page 25, that's also an insurable risk, it could be
11 if the premium was set properly.

12 A Oh, no. Product recall is available from
13 a good handful of commercial insurers, so that's very
14 much a legitimate risk.

15 Q Now, Mr. Riggin, in your rebuttal report,
16 if you would turn to page 5 of your rebuttal report.

17 A Yes.

18 Q And in paragraph 14 you state with
19 reference to Peak's risk exposures that, "None of the
20 risk exposures, save one, ever produced an insurance
21 claim. In the almost total absence of loss activity,
22 it is clear that these so-called risk exposures were
23 not only insignificant, they were unnecessary. In
24 fact, the lack of claims activity during the years
25 2008 to 2010 renders these risks wholly unqualified

1 to be called risks in the first place."

2 A Correct. That's what I said.

3 Q This concept of no losses is foundational
4 to your report and your testimony. Is that correct?

5 A It is correct.

6 Q You just looked to see whether there are
7 losses, and if there are not, there's no risk. Is
8 that correct?

9 A There's no risk to Peak Mechanical in this
10 situation.

11 Q And so if a company, an insured company is
12 good at managing its risk exposure, it might not have
13 a claim. Correct?

14 A It might not.

15 Q But would you advise such a company not to
16 have an insurance policy?

17 A It depends on the exposure, the actual
18 real-life, real-world exposure to that particular
19 risk.

20 Q And so you've never visited Peak
21 Mechanical's facilities, have you?

22 A No.

23 Q Mr. Riggin, just to be clear, I'm not sure
24 I heard your answer to the last question. You've
25 never visited Peak Mechanical's facilities in Idaho,

1 have you?

2 A I have not.

3 Q So, Mr. Riggin, if you were advising me
4 about my insurance needs, you would ask about any
5 claims that I had. Correct?

6 A Incorrect.

7 Q And if I did not have claims, you would
8 recommend that I not purchase insurance. Is that
9 correct?

10 A No, that is not correct, because each of
11 these circumstances are different. There are no two
12 alike.

13 Q So you would agree with me that the absence
14 of claims or losses does not mean that I would not
15 need insurance. Is that correct?

16 A No. What I would agree with is that if you
17 were asking me if you needed tornado insurance and
18 you lived in South Florida, I would say no, don't buy
19 that.

20 Q No tornadoes in South Florida?

21 A Well, that may or may not be a good
22 example, but I think you understand where I'm coming
23 from.

24 Q No, I really don't.

25 A Rather than an example, I need to put this

1 in normal terms. If you don't have a risk, if there
2 truly is not a risk of loss, I would advise you to
3 save your money and not buy insurance for it.

4

5

6 Q So if I have never had my house burned
7 down, would you recommend that I not buy homeowners
8 insurance?

9 A Not at all, because there certainly is a
10 possibility that your house might burn down. That's
11 not what I said. I said if there is not a
12 possibility of a loss

13 Q Now, you state here on page 5 in paragraph
14 15, you state with respect to pollution liability,
15 and I quote, "Like all of Reserve's coverages, a
16 claim for pollution liability is unlikely in
17 *extremis*."

18 A I said that, yes.

19 Q And you put *extremis* in italics.

20 A Yes.

21 Q Was that for emphasis or is that just
22 because it's Latin?

23 A No. I like Latin, but no, that was for
24 emphasis.

25 Q And so you're aware that Peak Mechanical's

1 facilities were in a Superfund site.

2 A I totally am aware of that.

3 Q And you're aware that Peak Mechanical's
4 facilities were also in a flood plain.

5 A Indeed.

6 Q And I believe you heard the testimony about
7 cleaning the equipment when they bring it out of the
8 mines into this retaining pit.

9 A I did hear that, yes.

10 Q But now, again, you state like all of
11 Reserve's coverages, a claim for pollution liability
12 is unlikely in extremis, with emphasis.

13 A That's what I said.

14 Q Have you ever inspected the products that
15 Peak manufactures themselves?

16 A Not physically, no.

17 Q In your view, the risks associated with
18 these products are innocuous. Correct?

19 A The risks for pollution liability is
20 innocuous.

21 Q But you also say in paragraph 14: "In
22 fact, the lack of claims activity during the years
23 2008 to 2010 renders these risks wholly unqualified
24 to be called risks in the first place."

25 A Risks as they pertain to Reserve and Peak.

1 These risks exists in the world, but as they apply to
2 Reserve and Peak, that is what I believe.

3 Q So in your view, the risks associated with
4 Peak's products are innocuous. Correct?

5 A No, because product liability is not part
6 of Reserve's coverages.

7 Q Does Peak manufacture products?

8 A It does indeed.

9 Q Would you agree that the products that Peak
10 manufactures and sells are used in a dangerous
11 environment?

12 A So I have heard.

13 Q But you don't believe that that's a
14 dangerous environment, thousands of feet down in a
15 mine?

16 A You must define the word dangerous, and
17 dangerous to whom, dangerous to a Superfund site,
18 dangerous to an individual, dangerous to the company,
19 dangerous to Reserve?

20 Q So dangerous is relative to where you are,
21 is that what you're saying?

22 A Entirely relative to where you are.

23 Q But thousands of feet down in a mine, how
24 does that enter into the mix?

25 A That's what they do for a living, that is

1 what they do for a living, they go thousands of feet
2 into a mine of their own free will, understanding the
3 risks.

4 Q Understanding the risks?

5 A I would hope they understand the risks.

6 Q And so there are some risks.

7 A I never said there weren't risks,
8 Counselor.

9 Q You just said they were innocuous.

10 A They are innocuous. Now you are moving
11 away from the specific pollution liability that we
12 started talking about.

13 Q Now, Mr. Riggin, in your rebuttal report
14 you offered opinions concerning Ms. Mead's report.

15 A Indeed.

16 Q And Mr. Solomon's report.

17 A I did.

18 Q But you're not an actuary.

19 A That has been established, I'm not an
20 actuary.

21 Q And you've ever practiced as an actuary.

22 A If I'm not an actuary, I would never have
23 practiced as an actuary.

24 Q You've never practiced as a CPA.

25 A No.

1 Q And you're not a CPA.

2 A Correct.

3 Q And so if actuaries have techniques to
4 address differences in the data that they are
5 considering, you've not performed those types of
6 actuarial techniques, have you?

7 A Are you reading from something?

8 Q No, no. I'm asking you a question.

9 A Just asking.

10 Q So if actuaries have techniques to address
11 differences in the data that they are considering,
12 you've not performed those types of actuarial
13 techniques, have you?

14 A I would say that I have not, no.

15 Q You don't even know what those techniques
16 are, do you?

17 A Those techniques are specific to the
18 profession of actuarial science. I don't deal with
19 the know-how, I deal with the outcome, the output.
20 An actuary is part of my team. A trusted actuary
21 will provide me with output that I trust.

22 MR. ALBRIGHT: One moment, Your Honor,
23 please? Pass the witness, Your Honor.

24 THE COURT: The Court is going to ask
25 questions now.

1 Mr. Riggin, on page 18 you mentioned --

2 THE WITNESS: Of what, Your Honor? I'm
3 sorry.

4 THE COURT: Page 18 of your report.

5 THE WITNESS: Of my report.

6 THE COURT: Of you report which is 136-R.
7 Captive feasibility and implementation of two captive
8 programs. I just want to clarify. From your
9 responses, I'm not sure what you mean by
10 implementation, and so I want to know when you
11 implement the plan or your captive feasibility -- and
12 I'm also unclear who's part of your team when you
13 repeatedly refer to yourself as the quarterback. Do
14 you have -- and I know that you said that you're not
15 a captive manager, and a captive manager does not do
16 a feasibility study.

17 THE WITNESS: Correct.

18 THE COURT: Is someone on your team a
19 captive manager, or do you ever make recommendations
20 for a captive manager?

21 THE WITNESS: Yes. The answer to that
22 question is a definitive yes. I hire the team and
23 the team consists of a captive manager, an attorney,
24 an auditor and an actuary.

25 THE COURT: So do you hire the captive

1 manager before or after you have finished your
2 captive feasibility study?

3 THE WITNESS: After, always after, because
4 we have no reason -- before the study is complete, we
5 have no reason to believe that we need a captive
6 manager.

7 THE COURT: So do you use the same captive
8 managers?

9 THE WITNESS: I use a handful of managers
10 that I've come to trust. Yes.

11 THE COURT: And they're not involved until
12 you finish your analysis.

13 THE WITNESS: Correct.

14 THE COURT: And once the team is put
15 together, when do you step aside, because now you
16 have -- if you said you just kind of do the
17 feasibility analysis and then when you have the
18 captive manager in place, isn't that more
19 implementation and starting to put the program, so
20 when do you move aside?

21 THE WITNESS: I move aside once the
22 decision has been made by the client that it makes
23 sense to do this and it makes sense for the client to
24 spend the money to do this, not on me.

25 THE COURT: But you have a role in putting

1 together the team, who the manager is, who the
2 actuary is.

3 THE WITNESS: Correct. And we do that
4 almost immediately after feasibility is determined.

5 THE COURT: And I know you've been in the
6 courtroom for, I believe, all of this. 16J, a
7 stipulated document, is the feasibility study. Is
8 your feasibility analysis similar to what was done in
9 that feasibility study?

10 THE WITNESS: You know, Your Honor, that's
11 a very subjective question. Feasibility studies are
12 very, very subjective. I suppose in a very broad
13 sense, my feasibility analysis would come close to
14 what is presented here, but in some cases it's much
15 more complicated, in other cases it's much less so
16 depending on the focus.

17 THE COURT: Earlier there was some back and
18 forth, it was a while ago now, that I just did not
19 understand when you were talking about someone -- the
20 insurance contract and the premium and you were
21 talking about if someone had arrears and stopped
22 paying the premium.

23 THE WITNESS: Right.

24 THE COURT: I was confused by this concept
25 because if someone stops paying the premiums, I

1 understood, but weren't premiums involved before the
2 start, it's the insured person decided to stop paying
3 the premiums.

4 THE WITNESS: Right.

5 THE COURT: When they entered the contract,
6 wasn't there a part of that contract that they would
7 pay premiums?

8 THE WITNESS: The insurance contract is
9 made up of four specific components: one is the
10 declarations, the other is the conditions, the other
11 is definitions, and the other is exclusions. The
12 contract can be separated, so the declarations part
13 has the premium and it states you will pay X amount
14 of premium and so forth for this coverage. Inside
15 that is where the coverage exists in the coverage
16 grant. That's the part of the contract that is
17 inviolable until it is canceled.

18 THE COURT: But I think I was confused
19 because I was thinking of the creation of the
20 contract and wouldn't the premiums be part of the
21 creation and then it wouldn't matter -- because I
22 feel like you were mixing apples and oranges when you
23 were talking about someone stopping to pay and then
24 going into arrears. Because I think when you enter a
25 contract, it's always a risk you take if the person

1 is going to stop paying.

2 THE WITNESS: It is, it is. The difference
3 in insurance is that the insurance company has the
4 option -- and maybe this is something that will help
5 clear this up -- the insurance company always has the
6 option to cancel the policy based on nonpayment of
7 premium. In the situation that I used earlier, the
8 policy stands alone if the insurance company doesn't
9 cancel it. If for some reason they don't cancel it
10 and the insured keeps saying I'm going to pay you,
11 I'm going to pay you, I'm going to pay you, and they
12 do not issue specific notice of cancellation and they
13 have a loss, that insurance policy continues to be
14 effective, regardless of how much premium they have
15 or have not paid.

16 THE COURT: On page 5 of your report --
17 again, I'm talking about 136-R -- it's paragraph 12.

18 THE WITNESS: Okay.

19 THE COURT: You talk about companies form
20 captives for a wide variety of reasons.

21 THE WITNESS: They do.

22 THE COURT: And you said the majority of
23 which are quite legitimate, but you don't go on to
24 expand kind of what these are. And I was also
25 confused by the use of your word legitimate, because

1 earlier in your beginning testimony when you were
2 being qualified, you used the term legitimate when
3 you were talking about captives and you used the term
4 legitimate for larger captives, so I'm unclear if you
5 think that if something is less than a million it's
6 not legitimate, or are you looking at what -- I was
7 confused by what you mean by legitimate there.

8 THE WITNESS: What I mean by that is is
9 there enough historical loss information combined
10 with enough historical premium information to be able
11 to forecast losses. This is the case 90 percent of
12 the time, this is where we live.

13 THE COURT: And when you talked about --
14 and not using the word legitimate here, when you used
15 it earlier when you referred to those one million or
16 higher and legitimate and the larger ones, sometimes
17 wouldn't a small business need to be growing and
18 would you recommend that sometimes a small business
19 shouldn't be getting captive insurance even though
20 it's going to be growing and would need it later?

21 THE WITNESS: Oh, by all means, but there
22 isn't a specific threshold where a small business
23 would grow and then I would say: Voila, you are now
24 qualified to have a captive. There are so many
25 little specific details that go into that decision or

1 qualified to be considered a good candidate for a
2 feasibility study.

3 THE COURT: When you're talking on pages 6
4 and 7 -- I think it's just page 6 of your report, you
5 talk a little bit about risks and about risks being
6 insurable and material and that you shouldn't get
7 insurance until you know you can measure the loss,
8 but I don't know how are you able to sometimes
9 determine if there ever is going to be a loss.

10 THE WITNESS: It doesn't have to do with
11 the future, it has to do with the past, and the
12 determinations that we make, given whether or not
13 there are past losses, it's a huge deal in insurance
14 and it's a huge deal basically because this is what
15 gives us the basis to project losses and to project
16 premiums -- or create premiums, I should say.

17 THE COURT: And as I mentioned back on page
18 5 in paragraph 12, you left out of your report why
19 captives are formed for a wide variety of reasons.
20 Aren't captives sometimes formed because they're not
21 able to get insurance?

22 THE WITNESS: Absolutely. It's a very
23 prevalent reason for forming a captive.

24 THE COURT: And I think you were here when
25 Mr. Zumbaum testified and he talked about an accident

1 of Mining Equipment, Incorporated, and I'm not
2 familiar on mining tools, I believe the winch wasn't
3 operating correctly and the winch, the way it was set
4 up, I believe, in the hole it went down in, the
5 construction company did the changes to it. So how
6 could something like that be foreseen because
7 sometimes you don't know if something you sold is
8 going to change your product.

9 THE WITNESS: Well, it isn't a question of
10 foreseeing, it's a question of is there a risk that
11 that could happen, and the answer to the question is
12 yes, there certainly would be a risk that that could
13 happen. That is a specific set of circumstances that
14 we can apply to whether or not insurance should be
15 purchased, and in that case insurance certainly
16 should be purchased, third party insurance.

17 THE COURT: And I was confused several
18 times during your responses because on page 7 of your
19 report listing out the policies here in paragraph 17
20 on page 7, I think sometimes I thought you were
21 saying they were normal coverage and sometimes they
22 weren't normal coverage, because sometimes I thought
23 you were saying they could have been able to get
24 these and then other times they wouldn't be able to
25 get these. So I wasn't clear on what your view of

1 these was.

2 THE WITNESS: My view of these are that in
3 the commercial markets many of them, if not all of
4 them, are available, so it's not a question of coming
5 up with a brand new set of coverages and being able
6 to price them or determine premiums based on the fact
7 that they're brand new, they're not brand new. The
8 question is and the doubt is that they have any
9 specific relevance to Reserve and Peak, and I don't
10 believe they do.

11 THE COURT: And when you mentioned
12 possibility of loss and claim at the end -- this
13 isn't anywhere in your report, I think it was towards
14 the end of the questioning you mentioned the
15 possibility of loss, and sometimes your try to
16 determine the possibility of loss. Isn't it
17 sometimes hard to predict? I think you mentioned
18 South Florida, a tornado, but I mean, you can't ever
19 predict where a tornado is going to come.

20 THE WITNESS: Positively not. That's a
21 typical one-off event. If you were talking about the
22 mid coast of Florida and you were talking about
23 hurricanes, well, there's a whole lot of data that
24 suggests that if and when a hurricane exists, there
25 will be X amount of damage.

1 THE COURT: Right. But I think now with
2 climate change and other aspects, you can't -- how
3 can you predict the possibility, because I think
4 where you think normal weather patterns and normal
5 things would be happening maybe will not happen now.

6 THE WITNESS: I totally agree with that,
7 absolutely agree with that, but it doesn't really
8 come down to normal or abnormal weather patterns, it
9 comes down to -- in a weather situation it comes down
10 to does the risk fit the circumstances, and in this
11 case Peak and Reserve.

12 THE COURT: Right. But I'm thinking of a
13 hypothetical, you're from Massachusetts, years ago no
14 one would have bought tornado insurance in
15 Massachusetts.

16 THE WITNESS: That's right.

17 THE COURT: Now what would you do in
18 Massachusetts about tornado insurance? So I feel
19 like it's hard to predict exactly what someone might
20 need and they might be thinking ahead that things are
21 going to change and something that might not have
22 been an issue for them might now be one.

23 THE WITNESS: Absolutely. Tornado may not
24 be the very, very example because it's part of
25 windstorm coverage and that's part of every property

1 insurance policy that is sold, so it isn't a question
2 of whether or not you have to figure out is a tornado
3 going to hit us or not.

4 THE COURT: And I'll move on, but I think
5 it also goes into how much wind coverage, if you know
6 how much your policy would be.

7 THE WITNESS: Yes, it does.

8 THE COURT: And I think if you were in a
9 tornado-prone environment, you would have broader
10 coverage.

11 THE WITNESS: The coverage would be almost
12 identical to how it would be anywhere else in the
13 country because windstorm is windstorm, it doesn't
14 matter if it's a tornado, it's just big wind. The
15 premium, however, if you are in Tornado Alley, if you
16 are in Oklahoma, the premium is astronomical for this
17 stuff.

18 THE COURT: That concludes my questions.

19 MR. SCHEID: May I have just a moment, Your
20 Honor? If I may have just a few moments to redirect
21 the witness, Your Honor?

22 THE COURT: Yes.

23 REDIRECT EXAMINATION

24 BY MR. SCHEID:

25 Q Good afternoon now, I guess, Mr. Riggin.

1 There was quite a bit of discussion about these one-
2 off events on cross-examination. How do these one-
3 off events that were previously described, how do
4 they compare with the coverages that were offered by
5 Reserve to Peak in this case?

6 A Many of them could be construed to be a
7 one-off event. The difference here is how liberally
8 do you use specific actuarial techniques to
9 circumvent the fact that there is no loss information
10 from which to calculate a premium. I readily accept
11 the fact that good actuaries have ways of
12 approximating premiums that have no basis in any
13 historical losses. Those situations, as Professor
14 Doherty mentioned yesterday or the day before, are
15 one-offs, they are satellites and terrorism. It is
16 not common to have a raft of coverages where each and
17 every coverage is not based on historical losses but
18 is based on basically a one-off approach.

19 Q Now, you have sat through this entire trial
20 thus far?

21 A I have.

22 Q And during the trial have you heard any
23 information, loss information or loss data presented
24 as it would relate to the Capstone program?

25 A No, there have been none.

1 Q You were asked with respect to a paragraph
2 in your opening report, the definition of purported
3 needs. You went through that at some length.

4 A Yes.

5 Q In your view, why did Peak not need the
6 coverages that were provided by Reserve?

7 A If Peak needed these coverages, there would
8 be some inkling of historical loss information, there
9 would be some reason from a historical perspective
10 why Peak would say to itself: You know, we've had a
11 loss in this area, it would be difficult for us to
12 get insurance in the commercial markets or it would
13 be very expensive to get insurance in the commercial
14 markets, so that it might not be a bad idea to
15 explore a captive. There is no loss information that
16 would inform Peak to be able to make that
17 determination, so that what we have are three years
18 of captive premiums not based on any amount of loss
19 information, based on no loss information.
20 There was one claim, the loss of customer which is an
21 outlier because you can't use that to determine
22 anything. But there's no loss information and that's
23 the absolute bedrock foundation for creating expected
24 losses, and as an actuary knows, you create expected
25 losses with historical losses and through expected

1 losses you create rates and premiums.

2 Q I want to shift gears a little bit. You
3 were questioned quite extensively on your opinion
4 regarding homogeneity. How do you determine the
5 appropriate level of risk homogeneity for insurance
6 risk distribution?

7 A That's a great question, and unfortunately,
8 the answer is so subjective. The first thing you do
9 is you look at the relationship between losses and
10 premiums, and so in a larger captive arrangement, if
11 the premium is, say, a million dollars or a million
12 and a half, you can be pretty sure -- unless the
13 circumstances are so crazy, you can be pretty sure
14 that there's enough loss history associated with that
15 risk such that perhaps it can be used in an actuarial
16 model to come up with a forecast of losses. And
17 that's the whole idea is to be able to forecast
18 losses, to be able to create rates and premiums.

19 Q I think you said during your cross-
20 examination that a claim by Peak for pollution
21 liability would be unlikely. Is that correct?

22 A Extremely unlikely.

23 Q Why is that?

24 A Because they're on a Superfund site.
25 Actually, I think someone testified yesterday or the

1 day before that filing an insurance claim, it would
2 be almost impossible to find insurance in the
3 commercial markets if you work on a Superfund site.
4 Putting this risk into a captive is kind of
5 ridiculous because there would be no way to separate
6 what Peak would have done in any real meaningful
7 sense than what the whole place was all about being a
8 Superfund site, meaning it's nothing but pollution.

9 Q In paragraph 5 of your rebuttal, you were
10 asked -- or on page 5 of your rebuttal report, we got
11 into this point, the remaining risks if we look
12 beyond just the pollution liability, are these
13 remaining risks qualified to be viewed as real risks?

14 A I believe mos of them are qualified to be
15 real risks but you've got to look at it in the
16 context. Real risks, if they had loss experience
17 associated with them, then, yes; real risks as
18 associated with Reserve and Peak, I believe not.

19 MR. SCHEID: Thank you.

20 No further questions, Your Honor.

21 MR. ALBRIGHT: Your Honor, I'd like to ask
22 just a few questions based on the Court's questions
23 to follow up with Mr. Riggin.

24 THE COURT: Yes.

25 MR. ALBRIGHT: May I have this document

1 marked for identification as Petitioner's exhibit
2 next in order?

3 THE COURT: Yes.

4 MR. ALBRIGHT: And I'm handing a copy of
5 this to Respondent's counsel.

6 May I approach, Your Honor?

7 THE COURT: Yes.

8 THE CLERK: Document titled "Captive
9 Feasibility Studies Necessary?" is marked for
10 identification as Exhibit 142-P.

11 (The document referred to was marked for
12 identification as Exhibit 142-P.)

13 MR. ALBRIGHT: Your Honor, may I approach
14 and may I provide Mr. Riggin with a copy of this?

15 THE COURT: Yes.

16 RE CROSS-EXAMINATION

17 By MR. ALBRIGHT:

18 Q Mr. Riggin, do you have a copy of Exhibit
19 142-P in front of you?

20 A I do.

21 Q And what is Exhibit 142-P?

22 A It's an article I wrote for the
23 International Risk Management Institute under their
24 expert commentary series called "Captive Feasibility
25 Studies Necessary?"

1 MR. ALBRIGHT: And then if you turn to page

2 2.

3 Your Honor, I'd offer this document into

4 evidence, 142-P.

5 MR. SCHEID: No objection, Your Honor.

6 THE COURT: The exhibit is admitted.

7 (The document referred to, having been

8 previously marked for identification as

9 Exhibit 142-P, was received in evidence.)

10 BY MR. ALBRIGHT:

11 Q Now, Mr. Riggin, if you would turn to page

12 2 of 142-P.

13 A I'm there.

14 Q Do you see the heading entitled The

15 Comprehensive Study?

16 A I do.

17 Q And so it says: The comprehensive study

18 variety is usually the most expensive and the

19 consultant will gather a lot of historical data?

20 A I do.

21 Q Crunch a lot of numbers?

22 A Yes.

23 Q Research appropriate domiciles?

24 A Yes.

25 Q Discuss ownership options?

1 A Yes.

2 Q Provide the pros and cons of sale captives
3 versus equity captives?

4 A Correct.

5 Q Determine whether or not the captive might
6 qualify to use insurance accounting?

7 A Correct.

8 Q Et cetera.

9 A Yes.

10 Q This type of feasibility study is the Real
11 McCoy.

12 A Indeed.

13 MR. ALBRIGHT: Your Honor, may I provide a
14 copy of Exhibit 16-J to Mr. Riggin?

15 THE COURT: Yes.

16 MR. ALBRIGHT: And may I go up and assist?

17 THE COURT: Yes.

18 BY MR. ALBRIGHT:

19 Q Do you have Exhibit 16-J in front of you?

20 A I do.

21 Q Are you familiar with it?

22 A Only in the fact that it exists.

23 Q Did you review it before you prepared your
24 report?

25 A I reviewed it.

1 Q And so in your article 142-P you talk about
2 the comprehensive study.

3 A Yes, I do. Yes, sir.

4 Q And what is it about Exhibit 16-J that
5 doesn't fit the description that you have in this
6 article 142-P?

7 A I have no opinion on that, I do not know.

8 Q You do not know.

9 A Correct.

10 Q So, Mr. Riggin, how can you tell if Peak
11 had the risks that are discussed in Exhibit 16-J?

12 A I keep going back to the fact that there
13 was no historical loss information. If they had
14 historical loss information, that would indicate to
15 me that the risk was real to Peak.

16 Q What is the National Association of
17 Insurance Commissioners?

18 A What about it?

19 Q What is the National Association of
20 Insurance Commissioners?

21 A NAIC? It's the National Association of
22 Insurance Commissioners where the insurance
23 commissioners -- I can't describe I past what you
24 just said, it's the National Association of Insurance
25 Commissioners. Each state has an insurance

1 commissioner and they belong to that association.

2 Q Well, would you consider the National
3 Association of Insurance Commissioners to be an
4 authoritative body?

5 A I would say they are.

6 Q Very well respected?

7 A They are indeed.

8 Q Would you turn to page 43 of Exhibit 16-J?
9 Do you see footnote 2?

10 A I do.

11 Q It say: The 2006 National Association of
12 Insurance Commissioners annual statement instructions
13 include an exemption to the required actuarial
14 opinion for small insurers with less than \$1 million
15 total direct written premiums plus assumed written
16 premiums during a calendar year and less than \$1
17 million total direct plus assumed loss and loss
18 adjustment expense reserves at year-end. Do you see
19 that statement?

20 A I do.

21 Q Do you disagree with that statement?

22 A It's not up to me to disagree with it, this
23 is what the NAIC has said.

24 Q And so if the NAIC issues a statement,
25 would that have an impact on the insurance industry?

1 A Oh, I would imagine it does.

2 Q And would it have an impact on what people
3 in the insurance industry do in terms of performing
4 actuarial studies for smaller insurance companies?

5 A It doesn't say that we can proceed with no
6 loss information and come up with a premium. That's
7 what it doesn't say. It says that the exemption to
8 the required actuarial opinion. Now, required
9 actuarial opinion gets to the issue of doing the
10 requiring. NAIC requires an actuarial opinion for
11 insurance companies that making filings to the NAIC.
12 This has absolutely no bearing on the fact that
13 reserves coverage have no basis, no basis in anything
14 without loss information. I am not saying that this
15 is wrong, I'm saying that the reason for being, the
16 reason for the Reserve captive being doesn't exist,
17 whether or not -- whether or not an actuarial report
18 was completed.

19 Q So if you don't have any personal loss data
20 that's personal to you, personal to your company, I
21 guess, specific to your company, why do you ever do a
22 feasibility study?

23 A Well, a feasibility study is a lot
24 different from an actuarial study.

25 Q But you're saying if you don't fall into

1 one of these categories, you're not going to be able
2 to determine a premium.

3 A One of what categories?

4 Q Well, the categories -- you've got loss
5 data or you have coverages that are covered by the
6 CLM or you have a wealth of data that you can refer
7 to to set prices, or if you're in one of these one-
8 off situations that you've testified about, if you're
9 not in those categories, then you couldn't write an
10 insurance policy for a captive insurance company.

11 A That may very well be the case. If you're
12 in one or more of those categories, I, as an
13 insurance professional and a captives consultant,
14 will probably turn you away.

15 Q You testified about pollution liability,
16 there were some questions that Respondent's counsel
17 asked you about that. And you said that you had a
18 difficult time determining what would be the cause of
19 the loss: would it be because you're in the
20 Superfund site or would it be because you had a loss
21 that should be covered. I believe that's what you
22 said.

23 A No. It's because they're in a Superfund
24 site, that is what I said.

25 Q What do you mean by that?

1 A You know what a Superfund site is. Right?

2 Q Well, I think I do.

3 A Okay. That's what I mean. A Superfund
4 site is an environment where the EPA watches over
5 every single thing that happens. As someone said
6 yesterday, you can't put a shovel in the ground
7 without permission from the EPA. Now, how are you
8 going to create -- or how are you going to file a
9 pollution liability claim in that environment?
10 Virtually no commercial insurers will cover pollution
11 in a Superfund site because of that very reason.

12 Q But wouldn't that be an exact situation or
13 the kind of situation that you might use a captive
14 insurance company if you couldn't obtain coverage
15 elsewhere?

16 A Absolutely not, absolutely not, because you
17 have no history of losses here. If there was a
18 history of losses, then my answer would be entirely
19 different, but you have no history of losses. So
20 what is the rationale for putting out your money into
21 an offshore facility to buy coverage that you know
22 and that is widely believed to be the case where
23 there is not going to be a claim. You're not going
24 to file a pollution claim in a Superfund site.

25 Q Why would you not file a claim if you're in

1 a Superfund site? I don't understand that, Mr.

2 Riggan.

3 A I just believe that that's the case.

4 Q So what if there were a flood and you had
5 some contaminants outside on your premises, the flood
6 comes along and those contaminants get spread all
7 over the place, is it possible that you could have
8 liability related to pollution issues?

9 A You could have liability but under the
10 Superfund rules you do not have liability, it is a
11 Superfund site, everything that occurs on the
12 Superfund site is part and parcel of that
13 environment.

14 Q So you're immune from liability if you're
15 in a Superfund site?

16 A I believe that's the case, but I actually
17 cannot opine on that.

18 Q So you don't know whether you're immune
19 from risk when you're in a Superfund site?

20 A Look, if we get down to this particular
21 situation, this particular case, if you're working in
22 a Superfund site, there is no reason to have
23 pollution liability in a captive. If you can get it
24 -- which you cannot get it in the commercial markets
25 because there's no reason to get it in the commercial

1 markets -- that's one thing, but there's no reason
2 here to have this coverage in this captive because,
3 as I keep going back to time after time after time,
4 there's no loss information against which to gauge
5 the risk.

6 Q So why does the EPA, why are they out there
7 regulating in a Superfund site?

8 MR. SCHEID: Objection, Your Honor. Again,
9 he's being offered as an industry expert, he's not
10 being offered as an expert in EPA rules and
11 regulations.

12 THE COURT: I'm going to allow the answer,
13 to answer the question if this supports his opinion,
14 but he can answer he doesn't know and then we'll move
15 on.

16 THE WITNESS: I do not know.

17 BY MR. ALBRIGHT:

18 Q You don't know.

19 A No.

20 Q So you're really not qualified to assess --

21 THE COURT: You can move on.

22 MR. ALBRIGHT: Okay. Your Honor, at this
23 point -- one second, please. Your Honor, we'd move
24 to strike Mr. Riggin's testimony and his expert
25 report and rebuttal report, basically on the same

1 grounds as we put in the motion in limine, Mr. Riggin
2 is not qualified on a lot of the matters that he's
3 testified to, his testimony is confusing, and it just
4 doesn't make any sense. It's really not reliable
5 evidence.

6 THE COURT: Mr. Scheid.

7 MR. SCHEID: Your Honor, the Court has
8 already qualified Mr. Riggin as an expert in
9 insurance industry matters, and he's proven his
10 qualifications. We believe that his report and his
11 testimony will be helpful to the Court in that
12 regard.

13 THE COURT: Under the Tax Court Rules
14 143(g), under Expert Witness Reports, it's D, the
15 witness's qualifications, including a list of all
16 publications authored, the Court is unclear if
17 Respondent asked him for all his publications and
18 this distinction between self-publications, because
19 it seems apparent to the Court that these self-
20 publication documents are readily available and
21 they're not just distributed.

22 MR. SCHEID: Yes, Your Honor. We inquired
23 of the witness, of Mr. Riggin as to whether all of
24 his publications had been identified, however, we
25 were not aware of these LinkedIn documents at an

1 point previous to his testimony today.

2 THE COURT: Okay. The motion to strike is
3 denied, but the purpose of expert testimony in Tax
4 Court is for it to be helpful to the Court, and the
5 Court will determine if it's been helpful at all or
6 not.

7 MR. SCHEID: Thank you, Your Honor.

8 THE COURT: You have no further?

9 MR. SCHEID: No.

10 THE COURT: You may step down.

11 (Whereupon, the witness was excused.)

12 THE COURT: Do you have one more witness,
13 Respondent?

14 MR. SCHEID: We do, Your Honor. Could we
15 have just a moment?

16 THE COURT: Not yet. The Court is thinking
17 of taking a break now, and during this break the
18 Court would like the parties also to be able to --
19 the eleven documents that were incomplete or had
20 something missing, blocked off at the end of the
21 page, if that could be sorted out now because that's
22 something the parties still have to be done.

23 MR. HARRIMAN: Yes, Your Honor.

24 THE COURT: And then Petitioner had, I
25 think, was it three with the policies, it was three

1 documents that you thought were part of the policies,
2 or was it more?

3 MR. ALBRIGHT: Your Honor, I believe it's
4 the common policy conditions. They're referenced in
5 the policies.

6 THE COURT: Is it three documents?

7 MR. ALBRIGHT: I'm sorry.

8 THE COURT: Because there's three years, so
9 I didn't know, was it three?

10 MR. ALBRIGHT: It's three documents, Your
11 Honor.

12 THE COURT: So also, if the parties could
13 see if that has actually been exchanged with each
14 other and if it was something Respondent has
15 received. I know it was not part of the stipulation,
16 and Mr. Albright can offer that at the end.

17 So how much time do you think you will need
18 to resolve some of this?

19 MR. HARRIMAN: We can probably get it
20 resolved -- if the Court is going to take a lunch
21 break, Your Honor, we can probably get it resolved
22 over the lunch break.

23 THE COURT: Okay. We'll take an hour then.
24 That should give time to have resolve, because the
25 missing, you have to switch out and give us the full

1 stipulations that were missing, have those prepared
2 to give to us too.

3 The Court is in recess until 2:30.

4 (Whereupon, the trial was recessed, to
5 reconvene this same day, Tuesday, May 2,
6 2017, at 2:30 p.m.)

7 THE COURT: Respondent, did you want to
8 proceed with the rest of your case and then do the
9 documents? Because I told you this morning we'd do
10 that if that was your preference.

11 MR. HARRIMAN: Your Honor, right now we can
12 address the changes we made to the documents.

13 THE COURT: Okay. We'll do that on the
14 record.

15 MR. HARRIMAN: All right. First, Your
16 Honor, regarding the stipulation of facts, there was
17 a change that was made that's been agreed to by the
18 parties in paragraph 24. The date reference of
19 December 3, 2015 has been replaced to read March 30,
20 2016.

21 THE COURT: And you've gotten some of the
22 changes to the stipulation. Correct?

23 MR. HARRIMAN: Yes, Your Honor.

24 THE COURT: Okay.

25 MR. HARRIMAN: Then regarding the

1 stipulated exhibits, we made the following additions
2 to the Court's copy and to our respective copies to
3 address the missing pages or incomplete pages. In
4 Exhibit 3-J a page was added to supplement RSV000641.
5 On 20-J -- strike that. That was the stipulation
6 paragraph we just discussed.

7 I'm sorry, Your Honor?

8 THE COURT: So I just want to be clear,
9 there was no change to Exhibit 20-J, it was just the
10 change on the stip.

11 MR. HARRIMAN: Yes, Your Honor.

12 On Exhibit 36-J, page 2 of the document,
13 Bates Number RES666, a page was added to supplement
14 it.

15 On 64-J, page 2, Bates Number RES647, a
16 page was added.

17 On 65-J, pages 6 and 13, labeled as Bates
18 Number RES686 and RES693, respectively, were added to
19 supplement that exhibit.

20 In 66-J, page 3, Bates Number RES701, a
21 page was added to supplement the exhibit.

22 In Exhibit 67-J, page 6, Bates labeled
23 RES713, a page was added to supplement the exhibit.

24 In Exhibit 69-J, page 2, Bates Number
25 RES726, a page was added to supplement the exhibit,

1 as well as a schedule that does not have a Bates
2 Number.

3 For Exhibit 70-J, page 3, RES734, a page
4 was added to supplement the exhibit. Further, we
5 determined that there were additional Bates Numbers
6 unrelated to Exhibit 70-J; that was RES735 through
7 RES743. Those were removed from the exhibit.

8 For Exhibit 71-J, page 6, Bates Number
9 RSV4291, a page was added to supplement the exhibit.

10 For 73-J, page 9, which was labeled with
11 Bates Number RES743 and Bates Number RSV3110, a page
12 was added to supplement the exhibit.

13 Finally, with Exhibit 86-J --

14 THE COURT: Could you repeat on 73-J again?

15 MR. HARRIMAN: Yes, Your Honor. On 73-J
16 the Bates page that was impacted with the change was
17 RES743 and then this page number had an additional
18 Bates labeling on it of RSV3110.

19 THE COURT: Thank you.

20 MR. HARRIMAN: And the last exhibit, Your
21 Honor, was on Exhibit 86-J, this was regarding Bates
22 Number RES879, and the second Bates Number on it was
23 RSV4430, a page was added to supplement the exhibit.

24 I believe Petitioner has some additional
25 exhibits that she'll now give us.

1 (Page 1012 and subsequent pages enclosed
2 under separate cover.)

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1 CERTIFICATE OF TRANSCRIBER AND PROOFREADER

2 CASE NAME: Reserve Mechanical Corp, f.k.a. as

3 Reserve Casualty Corp. v. Commissioner

4 DOCKET NO.: 14545-16

5 We, the undersigned, do hereby certify that the
6 foregoing pages, numbers 920 through 1011, inclusive,
7 are the true, accurate and complete transcript
8 prepared from the recording made by electronic
9 recording by Leslie Berridge, on May 2, 2017, before
10 the United States Tax Court at its session in
11 Houston, Texas, in accordance with the applicable
12 provisions of the current verbatim reporting contract
13 of the Court, and have verified the accuracy of the
14 transcript by comparing the typewritten transcript
15 against the verbal recording.

16

17 _____

18 Nancy H. King 05/23/2017

19 (Transcriber) (Date)

20

21 _____

22 Laurel H. Stoddard 05/24/2017

23 (Proofreader) (Date)

24

25

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IN THE UNITED STATES TAX COURT

In the Matter of:)
)
RESERVE MECHANICAL CORP., f.k.a.)
RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
v.)
)
COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

Volume: 13
Pages: 1012 through 1043
Place: Houston, Texas
Date: May 2, 2017

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IN THE UNITED STATES TAX COURT

 In the Matter of:)
)
 RESERVE MECHANICAL CORP., f.k.a.)
 RESERVE CASUALTY CORP.,)
)
 Petitioner,) Docket No. 14545-16
)
 v.)
)
 COMMISSIONER OF INTERNAL REVENUE,)
)
 Respondent.)

Room 7006
Casey U.S. Courthouse
515 Rusk Avenue
Houston, Texas

May 2, 2017

The above-entitled matter resumed for
trial, pursuant to recess, at 9:00 a.m.

BEFORE: HONORABLE KATHLEEN KERRIGAN
Judge

APPEARANCES:

For the Petitioner:

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C O N T E N T S

WITNESSES:	DIRECT	CROSS	REDIRECT	RECROSS	DIRE	VOIR
For Petitioner:						
Michael Solomon	1021	1030				
For Respondent						
None						

1	E X H I B I T S		
2	EXHIBITS:	IDENTIFIED	RECEIVED
3	143-J thru 146-J	1018	1018
4	147-P	1021	1022
5	148-R	1032	not offered

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1 P R O C E E D I N G S

2 THE COURT: I have just one question on
3 65J.

4 MR. HARRIMAN: Yes, Your Honor.

5 THE COURT: Could you just repeat 65-J
6 again?

7 MR. HARRIMAN: Yes. The impacted pages
8 were labeled in their native format pages 6 and 13
9 but they were Bates numbered with page 6 being RES686
10 and page 13 being Bates labeled RES693.

11 THE COURT: Maybe if the clerk could show
12 this to you. I feel like I have two 6 of 13 in 65.

13 MR. HARRIMAN: Yes, Your Honor. There will
14 be some duplications in there.

15 THE COURT: Because you just added things
16 and not took out?

17 MR. HARRIMAN: We had to add for two
18 reasons: one, it's double-sided, and two, if we were
19 to remove one of the double-sided pages, it would
20 remove a page as well.

21 THE COURT: Okay. I caught that, you went
22 kind of fast but I noticed there were two 6 of 13.

23 And both parties are in agreement with all
24 these changes that were made to the stipulation.
25 Correct?

1 MS. KU: Yes, Your Honor.

2 MR. HARRIMAN: Yes, Your Honor.

3 THE COURT: Thank you.

4 MS. KU: Your Honor, Petitioner has four
5 exhibits that we have discussed with Respondent's
6 counsel, and Respondent's counsel, it is our
7 understanding, does not have any objection to them
8 being added as separate exhibits to the stipulation,
9 but being orally stipulated on the record.

10 THE COURT: Okay. Do you want to have them
11 marked? We can have them marked individually bu they
12 can be all marked at one time. You may approach.

13 MS. KU: Yes, Your Honor.

14 THE COURT: And should these be marked as P
15 exhibits?

16 MR. HARRIMAN: They will be Js, Your Honor.

17 THE COURT: J exhibits.

18 THE COURT: Okay.

19 THE CLERK: The document titled "Common
20 Policy Conditions" is marked as Exhibit 143-J.

21 MR. HARRIMAN: For clarity, which common
22 policy conditions? If you look in the lower left, it
23 has an ending number of either 06 or 09.

24 THE CLERK: It ends in 06 is marked as 143-
25 J.

1 MR. HARRIMAN: Thank you.

2 THE CLERK: Then the Common Policy
3 Conditions ending in 09 is marked for identification
4 as Exhibit 144-J.

5 And then a document titled "General Change
6 Endorsements" with an endorsement effective date of
7 1/1/09 is marked for identification as 145-J.

8 THE COURT: And the date on this is 1/1/09.

9 THE CLERK: And then the General Change
10 Endorsement dated 1/01/2010 is marked for
11 identification as Exhibit 146-J.

12 THE COURT: 143 to 146-J are admitted.

13 (The document referred to were marked for
14 identification as Exhibits 143-J through
15 146-J and were received in evidence.)

16 MS. KU: Your Honor, if I may, Respondent's
17 counsel and Petitioner's counsel discussed it and we
18 wanted to state on the record that these specific
19 exhibits that have been entered into the record
20 actually correspond with specific policies. If I may
21 state that effect on the record?

22 THE COURT: Yes.

23 MS. KU: With respect to the Exhibit that's
24 been marked Exhibit 143-J, and this one is
25 differentiated from the one marked as 144-J by on the

1 lower left-hand corner it says CAP-CPC-06 for Exhibit
2 143-J, Exhibit 144-J says CAP-CPC-09.

3 Exhibit 143-J corresponds with the exhibits
4 that are referenced as Exhibits 36-J through Exhibit
5 48-J, commonly referred to within the stipulations as
6 the 2008 contracts or insurance policies. Exhibit
7 143-J should be construed together with those
8 policies, each and every single one of those
9 exhibits.

10 The same as to Exhibit 144-J, this exhibit
11 specifically corresponds with the exhibits that are
12 referenced as Exhibit 60-J to 70-J, and exhibit 75-J
13 through 85-J, commonly referred to as --

14 THE COURT: 75 through did you say 80 or
15 85?

16 MS. KU: Eighty-five.

17 THE COURT: Eighty-five. Thank you.

18 MS. KU: Those would be the 2009 and 2010
19 contracts or insurance policies.

20 With respect to exhibit marked as 145-J,
21 referred to as the General Change Endorsement,
22 effective date January 1, 2009, that exhibit
23 corresponds with the exhibits that are referenced as
24 Exhibit 60-J, 65-J, 67-J, 69-J and 70-J.

25 With respect to the exhibit marked as 146-

1 J, that exhibit corresponds with the exhibit that is
2 referenced as Exhibit 75-J.

3 THE COURT: Thank you.

4 MS. KU: Thank you.

5 MS. KHAN: Your Honor, Respondent will not
6 be calling its agent to testify and will not be
7 calling any further witnesses.

8 THE COURT: I'm sorry, I didn't hear you.

9 MS. KHAN: Respondent will not be calling
10 any further witnesses, Your Honor.

11 THE COURT: Okay. All right. Thank you.

12 MR. ALBRIGHT: We have one final witness,
13 Your Honor, it's a rebuttal witness.

14 THE COURT: Yes.

15 MR. ALBRIGHT: Michael Solomon, Petitioner
16 would call Michael Solomon.

17 THE COURT: You may be seated because
18 you're still under oath.

19 MR. ALBRIGHT: Good afternoon, Mr. Solomon.

20 Your Honor, if I could, I would like to
21 have Mr. Solomon's rebuttal report marked for
22 identification as Petitioner's exhibit next in order.

23 THE COURT: Yes. You may approach.

24 MR. ALBRIGHT: And please let the record
25 reflect that I'm handing a copy to Respondent's

1 counsel.

2 May I approach?

3 THE COURT: Yes.

4 THE CLERK: A rebuttal report of Donald J.
5 Riggin is marked for identification as Exhibit 147-P.

6 (The document referred to was marked for
7 identification as Exhibit 147-P.)

8 MR. ALBRIGHT: Your Honor, may I provide
9 Mr. Solomon with a copy of Exhibit 147-P?

10 THE COURT: Yes.

11 Whereupon,

12 MICHAEL SOLOMON

13 having been previously duly sworn, was
14 recalled as a witness herein and was examined and
15 testified further as follows:

16 DIRECT EXAMINATION

17 BY MR. ALBRIGHT:

18 Q Mr. Solomon, do you have a copy of Exhibit
19 147-P in front of you?

20 A I do.

21 Q And can you tell me what Exhibit 147-P is?

22 A It's my rebuttal to the expert report of
23 Mr. Riggin.

24 MR. ALBRIGHT: And Your Honor, I believe
25 that Mr. Solomon has already been qualified as an

1 expert in the case, and I would offer Exhibit 147-P
2 into evidence.

3 MR. SCHEID: No objection, Your Honor.

4 THE COURT: 147-P is admitted.

5 (The document referred to, having been
6 previously marked for identification as
7 Exhibit 147-P, was received in evidence.)

8 MR. ALBRIGHT: Your Honor, may I provide
9 Mr. Solomon with a copy of Exhibit 139-P?

10 THE COURT: Yes.

11 MR. ALBRIGHT: And Your Honor, to save
12 time, if I could just give him a copy of Exhibit 138P
13 as well, 138-P and 139-P.

14 THE COURT: Yes.

15 BY MR. ALBRIGHT:

16 Q Mr. Solomon, would you look a Exhibit 139P?

17 A Yes.

18 Q And if you would turn to page 4 and there's
19 a discussion at the bottom of that page in our case,
20 the risk transfer percentage is 25 percent, so on and
21 so forth.

22 A Yes.

23 Q Do you understand what the discussion is
24 here on page 4 in that last paragraph?

25 A I believe I understand what the author is

1 trying to say.

2 Q And is there anything wrong with what's
3 said there?

4 A Yes. If I can back up just for a minute.
5 So there's two issues. We talked this morning, it
6 was spoken about this morning, FAS 113 time was spent
7 on FAS 113 on whether or not it is applicable to
8 insurance companies rather than just reinsurance
9 companies, and Mr. Riggin expressed his opinion and
10 I've expressed my opinion in my rebuttal. That's one
11 thing.

12 The second is even if it was applicable to
13 insurance companies, this question of whether these
14 policies would pass that test. Mr. Riggin, in his
15 report, said that my policies did not pass that test,
16 as far as I remember, or at least some of the
17 policies but I note in this paper that he offered
18 that he's misunderstanding the tests that are
19 generally applied under the FAS 113 rule.

20 Now, I hadn't seen this paper before this
21 morning, it took me a few minutes to work out what he
22 was trying to do and it might take me that long ago
23 to explain what I understand what he's trying to do
24 and where he's wrong. So he states: In our case the
25 risk transfer percent is just 25 percent (\$5 million

1 divided by \$20 million). Over the years, many
2 practitioners applied what is called the 10-10 rule.
3 This meant a 10 percent chance of a 10 percent loss
4 was thought to satisfy the reasonable chance of a
5 significant loss mandate.

6 Then he says: Since the dust-up over
7 certain reinsurance arrangements, few people use this
8 rule anymore because there's not enough chance of
9 significant loss. Our example can be said to satisfy
10 a 25-25 percent rule, if such a thing existed. If we
11 hewed to the old 10-10 rule, a reinsurance layer
12 would be only \$2 million instead of \$5 million.

13 It's my opinion, based on this paragraph,
14 that Mr. Riggin is misunderstanding what it means to
15 have a 10 percent loss. A 10 percent loss is applied
16 under FAS 113 as a 10 percent loss on the contract to
17 the reinsurer. So for instance, let's say I'm a
18 reinsurer -- I'm talking reinsurance because that's
19 what I've seen FAS 113 applied to -- let's say I'm a
20 reinsurer and I agree to cover some exposures for \$1
21 million. A 10 percent loss to me is \$100,000, 10
22 percent of the \$1 million that I received. So if the
23 claims under the policy that I need to pay out are
24 \$1.1 million or \$100,000 more than I received, I've
25 then lost \$100,000 which is a 10 percent loss on the

1 policy.

2 Similarly, because 25 percent is mentioned,
3 a 25 percent loss would be 25 percent of the cost of
4 the policy, the reinsurance policy was \$1 million, so
5 if we had a loss of \$250,000 which means if I had to
6 pay claims of \$1.25 million, I would have paid
7 \$250,000 more than I received in premiums so I would
8 have a loss of \$250,000. That's what FAS 113 -- when
9 the 10-10 rule was used under FAS 113, that is how it
10 was used. When people talk about the loss, the 10
11 percent loss, they mean it in the way I've described,
12 10 percent of the amount that was paid to the
13 reinsurer.

14 Mr. Riggin is not using it that way. Mr.
15 Riggin is dividing by that percentage, so for
16 instance, he's saying that I paid \$2 million for a
17 \$20 million policy, so if I could lose \$20 million on
18 a policy that cost \$2 million, that's the 10-10 rule.
19 That would be a loss of -- if I paid \$2 million and I
20 lost \$20 million, I lost \$18 million, that's a 900
21 percent loss, not a 10 percent loss.

22 Similarly, he says with the \$5 million
23 follows what he calls a 25-25 rule, because you're
24 paying \$5 million for the maximum limits of \$20
25 million, but if you pay \$20 million on a \$5 million

1 policy, you're not losing 25 percent of what you got
2 which was the \$5 million, you're losing \$15 million
3 on the policy which is 300 percent.

4 So it seems to me that he's misapplying the
5 10-10 rule that was commonly used.

6 Q Mr. Solomon, will you look there on the
7 witness stand, is there a copy of Exhibit 137-R
8 laying there?

9 A I do not believe so.

10 MR. ALBRIGHT: Your Honor, may I?

11 THE COURT: Yes.

12 MR. HARRIMAN: Your Honor, is Petitioner
13 attempting to locate the expert report of Don Riggins?
14 If so, we have an extra copy available. Is that the
15 rebuttal? We have a copy of the rebuttal report as
16 well.

17 BY MR. ALBRIGHT:

18 Q Mr. Solomon, do you have a copy of Exhibit
19 137-R in front of you there?

20 A I do.

21 Q And if you would, please turn to page 9 of
22 Exhibit 137-R. Are you there?

23 A Yes.

24 Q And do you see paragraph 35 there that
25 states: Any methodology, including the TAA rating

1 manual, that does not use actual loss data cannot
2 replace the usage of actual loss data?

3 A I do.

4 Q Do you agree with that statement?

5 A I do not believe that actual loss data is
6 needed to come up with actuarially sound premiums. I
7 was not attempting to, as Mr. Riggin puts it, replace
8 actual loss data, but because in my general actuarial
9 work I often am asked to price policies, come up with
10 premiums and so on in the absence of loss data. That
11 is not specific to what have been called captive
12 insurance companies, that is in many other contexts
13 also.

14 Q Now, Mr. Solomon, do you still have Exhibit
15 138-P in front of you there?

16 A 138-P. Yes, I do.

17 Q And if you turn to the second page of
18 Exhibit 138-P and if you would read the first two
19 paragraphs on the second and third page of 138-P.

20 A Beginning with okay?

21 Q Yes.

22 MR. HARRIMAN: Objection, Your Honor. The
23 document speaks for itself.

24 THE COURT: You may read it to yourself.

25 THE WITNESS: I've read the first two

1 paragraphs.

2 BY MR. ALBRIGHT:

3 Q Do you agree with those statements there,
4 those two paragraphs that you just read on 138-P?

5 A Well, there's a lot in here, et me go line
6 by line. He says the actuary's job is to establish
7 what is known as expected losses. I might change
8 that to say the actuary's job is to come up with
9 premiums. Premiums do contain provisions and the
10 majority is for expected losses, it's not solely for
11 expected losses, it also is meant to include some
12 actual costs that may be associated with the running
13 of the captive or adjudication of claims, and so on.

14 I do agree with what I understand to be
15 written here that actuaries determine loss funding
16 where little or no historical data exists about an
17 individual company. I do that regularly.

18 Q Which sentence is that, Mr. Solomon?

19 A It says: Clearly there is no way to
20 project expected losses. That's how he states it,
21 although I assume he means to say that since there's
22 no actual loss history in the context of how he's
23 saying it. He says: There's another way in which
24 actuaries determine loss funding future potential. I
25 think he means by that -- and again, I only saw this

1 for the first time this morning -- my understanding
2 from that is that actuaries are able to project
3 potential losses in the absence of a loss history.
4 That's my understanding of what he's saying here, and
5 if that is what he's saying here, then I agree with
6 that.

7 Q So now, does that statement contradict what
8 Mr. Riggin says about you in his rebuttal report,
9 Exhibit 137-R, specifically page 9, paragraph 35?

10 A Can you repeat the question, please?

11 Q Does the statement in Mr. Riggin's article,
12 138-P, in the second paragraph of the second page of
13 138-P, that statement that you agreed with in that
14 article, does that contradict, does Mr. Riggin's
15 statement from the article, is it consistent with
16 what he says about you in paragraph 35?

17 A My understanding of the intent of his 35 is
18 that an actuary cannot price without loss data. If
19 that's what it means, and I think that's what he's
20 trying to say here, then, yes, it does appear to be a
21 contradiction to me.

22 MR. ALBRIGHT: No further questions, Your
23 Honor.

24 CROSS-EXAMINATION

25 BY MR. HARRIMAN:

1 Q Good afternoon, Mr. Solomon. I just have a
2 couple of questions to clean up and then we'll let
3 you get out of here.

4 So regarding Exhibit 139-P, the article
5 that Petitioner's counsel asked you about.

6 A Yes.

7 Q In particular the 10-10 rule, where in Mr.
8 Riggin's report does he use the 10-10 rule?

9 A He states that many of the policies I was
10 opining about do not pass the FAS 113 test.

11 Q So he said specifically in his report: I
12 am applying the 10-10 rule?

13 A He said he was applying the FAS 113 test,
14 he does not state how he applied that test.

15 Q So you don't know if he applied it with the
16 10-10 rule as he does in this article that you
17 critiqued earlier.

18 A Well, my point about what he states about
19 the 10-10 rule and the 25-25 rule is that he doesn't
20 understand how you test under FAS 113.

21 Q But as far as you know, he's not applying
22 these particular tests in his report.

23 A Correct. I don't know what test he applies
24 in his report. He doesn't state that or document
25 that.

1 Q Now, I wanted to discuss your rebuttal
2 report. You referenced a document that was referred
3 to as a statement of principles regarding property
4 and casualty insurance rate-making. Correct?

5 A I recall doing that, and I'm trying to find
6 exactly where.

7 Q I believe it's on the bottom of the first
8 page of your report.

9 A Okay. I see it.

10 Q So you're familiar with these principles?

11 A I'm familiar with the principles regarding
12 property and casualty insurance rate-making. I can't
13 say I recall every word offhand.

14 MR. HARRIMAN: Your Honor, I have a
15 document I would like marked for identification next
16 in line. May I approach?

17 THE COURT: Yes.

18 MR. HARRIMAN: Let the record reflect I'm
19 giving a copy of the document to Petitioner's
20 counsel.

21 THE CLERK: A documented titled "Statement
22 of Principles Regarding Property and Casualty
23 Insurance Rate-Making" is marked for identification
24 as Exhibit 148-R.

25 (The document referred to was marked for

1 identification as Exhibit 148-R.)

2 MR. HARRIMAN: Your Honor, if I may, I'd
3 like to hand a copy of what's been identified as 148-
4 R to the witness.

5 THE COURT: Yes.

6 BY MR. HARRIMAN:

7 Q Mr. Solomon, I've just handed you what's
8 been identified as 148-R. Do you recognize it?

9 A Yes.

10 Q What is it?

11 A It's the Statement of Principles Regarding
12 Property and Casualty Insurance Rate-Making.

13 Q And how does the Statement of Principles
14 Regarding Property and Casualty Insurance Rate-Making
15 impact your day-to-day work as an actuary?

16 A When I am rate-making, I seek to apply
17 these principles.

18 Q Now, I want to turn your attention to page
19 2. It's line 40, it's the principles of the
20 Statement of Principles, so it seems pretty
21 important. In particular line 43, what's the first
22 principle of rate-making?

23 A A rate is an estimate of the expected value
24 of future costs.

25 Q And what do you take that to mean?

1 A I think this is a repetition of what I just
2 stated, that a rate -- I said a premium -- a rate
3 doesn't just cover expected losses, it will include
4 other costs as well.

5 Q So you're looking into the future when
6 you're setting a rate, a premium.

7 A Generally so. Correct.

8 Q And in fact, can you read the line 41 and
9 42?

10 A Rate-making is prospective because the
11 property and casualty insurance rates must be
12 developed prior to the transfer or risk.

13 Q So an insurance rate or a premium has to be
14 developed prior to the transfer of risk. Is that
15 your understanding?

16 A It's my understanding if I was rate-making
17 now for a premium about to be written, I do not think
18 it's necessary if you're judging the reasonability of
19 premiums on a past policy, I think in you can apply
20 the same methods.

21 Q No. I'm asking if you're setting a policy,
22 you're setting a premium, you have to do the
23 actuarial work beforehand.

24 A Correct.

25 Q Otherwise, you wouldn't know if you have an

1 actuarially sound premium. Let me rephrase.

2 A Sorry. I'm confused.

3 Q Sometimes my words get ahead of me. When
4 you're setting a premium you have to do the actuarial
5 work, you have to look at the numbers, you have to
6 analyze the future costs in order to arrive at a
7 sound rate. Would that be correct?

8 A Correct.

9 Q And that has to happen before a transfer of
10 risk.

11 A Let me restate this. If somebody comes to
12 me now and says please set the rate for this policy,
13 that is generally only asked for when the policy is
14 about to be written. People generally do not ask me
15 to price premiums for a policy that was written, say,
16 in 2015. In the case of my testimony -- I think this
17 goes back to what you asked me about previously -- I
18 used rating manuals that were developed --

19 Q By Capstone -- or for Capstone by your
20 company.

21 A Correct, correct, yes, yes. That were
22 produced in 2016 or '17, I think we stated last time,
23 I think that's right. And then I was asked to opine
24 on the reasonableness of premiums that had been
25 written before that time.

1 Q Certainly, yes, and that as your testimony
2 regarding retroactively looking back and applying the
3 premiums.

4 A So the goal of my testimony is to opine on
5 whether those premiums that were set in 2008, 2009
6 and 2010 were reasonable.

7 Q Using the manuals that were developed in
8 2015 and on.

9 A Well, that's how I did it.

10 MR. HARRIMAN: Thank you. No further
11 questions, Your Honor.

12 THE COURT: I have a quick question. Mr.
13 Solomon, 147-P, which is your rebuttal report, and
14 you might have explained this on Friday but I just
15 want to make sure I understand it clear, in the
16 paragraph where you say in your experience as an
17 actuary, and then ends how you've priced the cost of
18 new products, so when you're pricing the cost of new
19 products and you don't have historic data to look at,
20 what's your baseline, what's your starting point?

21 THE WITNESS: My starting point is to get
22 as much data as I can from other sources. I can give
23 examples based on these policies if that helps.

24 THE COURT: If you could give an example
25 for one of them, that would be helpful.

1 THE WITNESS: I'll give an example for one
2 of them. Porsche's prepaid maintenance program, one
3 of the deciding factors on how much that should cost
4 is how much Porsche drivers use the program that they
5 prepay for. So if they use everything they pay for,
6 that will mean we have to charge more than if on
7 average the average user will only use half of what
8 they pay for. So we didn't have any historical data
9 around that, so in that case I actually asked our
10 sales and my at the time chief marketing officer. I
11 asked him because he had worked for Porsche before.
12 I'm just using this as an example, but where we don't
13 have historical data for an individual company, we
14 will use industry data and we will use whatever other
15 data we can find we believe is reliable that is
16 relevant to how to price a program.

17 Other examples I can give is we can use a
18 trend. So for instance, when I'm coming up with a
19 premium for let's say workers' compensation.
20 Workers' compensation wasn't one for the lines I
21 wrote about, but let's say I discovered the ultimate
22 loss costs for prior years was a certain amount. I
23 may decide that if it was \$10,000 in the year 2000,
24 it might be more or less than that in 2015. Most of
25 my clients, in fact, all of my clients would have

1 enough data to say how to get from the year 2000 to
2 2015, and in that kind of situation, I would look to
3 industry data in many cases.

4 THE COURT: I just want to follow up and go
5 back to the prepaid maintenance program example. When
6 you say industry data, I want to know more about than
7 just the industry data. Like in this example, what's
8 your starting point, would you be looking at other
9 cars manufacturers that offered prepaid plans and
10 then within them are you trying to find -- because
11 Porsche has a unique place in the marketplace, so
12 would you be trying to find a car closer to it than
13 say something that is more commonly owned?

14 THE WITNESS: So that's absolutely correct.
15 So I can go into more depth on the Porsche prepaid
16 maintenance program. We already have in our company
17 a Hyundai prepaid maintenance program, so one of the
18 things I looked up was what I'll call the usage rate
19 or how often Hyundai users were actually using the
20 service they prepaid for. I then adjusted for
21 Porsche for a variety of reasons. One is, for
22 instance, on certain models of cars, for certain
23 models of Porsches they don't get driven as much as a
24 Hyundai, a lot of Porsche owners, especially at the
25 higher level cars, more expensive cars, those weekend

1 cars they'll drive less miles, that can also affect
2 pricing. But Your Honor said is correct, you can
3 start off with a similar car and then adjust as is
4 needed.

5 THE COURT: And then I believe this will be
6 my last question. A couple of lines further down you
7 talk about the conference -- and I'm just using this
8 for a hypothetical, the autonomous vehicles
9 liability. So what do you do when there really is no
10 -- I'm not a car expert but thinking that there would
11 be no industry comparison in the autonomous car, yet
12 where in the example we just discussed there was
13 other car makers that had done something similar. So
14 what do you do when there's really nothing similar?

15 THE WITNESS: Correct. So in this
16 situation of autonomous vehicles liability, I haven't
17 been asked to price it so I'm saying what I
18 understand the process would be. I would look at the
19 car history for non-autonomous vehicles. I would
20 then look at frequency and severity probably
21 separately. By frequency I mean how many accidents,
22 the loss of actually how much those accidents cost
23 when they occur, and I would try to decide based on I
24 may look at articles online, industry articles, as
25 much information as I can gather as to whether

1 autonomous vehicles have more accidents or less
2 accidents, by how much, et cetera, whether those
3 accidents are likely to cost more or less on average,
4 and so forth.

5 THE COURT: That's all I have.

6 MR. ALBRIGHT: No further questions from
7 here, Your Honor.

8 MR. HARRIMAN: No further questions, Your
9 Honor.

10 THE COURT: You may step down. Thank you.

11 (Whereupon, the witness was excused.)

12 MR. ALBRIGHT: We have no further
13 witnesses, Your Honor, in rebuttal.

14 MS. KHAN: Your Honor, we also have no
15 rebuttal witnesses as well.

16 THE COURT: Okay. I mentioned the other
17 day that I wasn't going to have closing arguments
18 since we're going to have post-trial briefs, and I
19 didn't know if you wanted to go with a traditional
20 briefing schedule or if you had discussed something
21 among yourselves.

22 MS. KHAN: Your Honor, we had discussed
23 with Mr. Albright, we were proposing to submit
24 simultaneous briefs, the opening briefs being
25 submitted 90 days from now, and then the reply briefs

1 being submitted 60 days thereafter. We had proposed
2 to submit an opening brief with a page limit of 100
3 pages and then a reply brief with a page limit of 60
4 pages, and we wanted to inquire from you whether that
5 page limit would include a table of contents and the
6 findings of facts, or just argument.

7 THE COURT: Okay. Since you are reasonable
8 with your page limits, I won't include a table of
9 contents but I want to follow the standard that the
10 Tax Court requires for the standard font and spacing.

11 MS. KHAN: Yes.

12 THE COURT: And there's a few things the
13 Court would like the parties to focus on and to
14 address in their briefs. One of the concerns the
15 Court has in this case, there were numerous insurance
16 policies added on in the captive insurance that the
17 Petitioner didn't have prior to forming Reserve, and
18 also that Peak continued to remain its insurance
19 policies once the policies were in the captive and if
20 all those policies were necessary. And then another
21 concern the Court has is that just because it's hard
22 to look at historical losses, is there really no way
23 you can make the assumption that there's not a way to
24 get to the premiums.

25 So I'll have the trial clerk tell us when

1 90 days is.

2 THE CLERK: Ninety days is July 3, 2017.

3 THE COURT: So opening briefs are due on or
4 before July 3, and they're 100 pages and that does
5 not include the table of contents, and as I mentioned
6 before, following the Tax Court rules on font size.

7 If the trial clerk could tell us when 60
8 days is.

9 THE CLERK: Sixty days is September 29,
10 2017.

11 THE COURT: And the simultaneous briefs are
12 due on or before September 29, 2017, and they have a
13 page limit of 60 pages, and again, the table of
14 contents won't count against the page limit.

15 Are there any other administrative matters?

16 MS. KHAN: None from Respondent, Your
17 Honor.

18 MR. ALBRIGHT: None from Petitioner, Your
19 Honor.

20 THE COURT: And I'll just quickly, 108-P
21 which was identified previously but was not offered
22 was offered today and admitted. 136-R was admitted,
23 137-R admitted, 138-P admitted, 139-P through 142-P
24 admitted, and 143-J through 146-J, and 147-P was
25 admitted.

1 This case is submitted, and I thank both
2 parties for their cooperation and especially their
3 cooperation today to get through the changes in the
4 stipulation. So thank you. And the Court is in
5 recess.

6 (Whereupon, at 4:00 p.m., the above-
7 entitled matter was concluded.)

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1 CERTIFICATE OF TRANSCRIBER AND PROOFREADER

2 CASE NAME: Reserve Mechanical Corp, f.k.a. as

3 Reserve Casualty Corp. v. Commissioner

4 DOCKET NO.: 14545-16

5 We, the undersigned, do hereby certify that the
6 foregoing pages, numbers 1012 through 1043,
7 inclusive, are the true, accurate and complete
8 transcript prepared from the recording made by
9 electronic recording by Leslie Berridge, on May 2,
10 2017, before the United States Tax Court at its
11 session in Houston, Texas, in accordance with the
12 applicable provisions of the current verbatim
13 reporting contract of the Court, and have verified
14 the accuracy of the transcript by comparing the
15 typewritten transcript against the verbal recording.

16

17 _____

18 Nancy H. King 05/23/2017

19 (Transcriber) (Date)

20

21 _____

22 Laurel H. Stoddard 05/24/2017

23 (Proofreader) (Date)

24

25

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