



COMMONWEALTH OF PENNSYLVANIA
GOVERNOR'S OFFICE OF GENERAL COUNSEL

April 8, 2013

Michael F. Krimmel, Chief Clerk
Commonwealth Court of Pennsylvania
601 Commonwealth Avenue, Suite 2100
P.O. Box 69185
Harrisburg, PA 17120-9185

RECEIVED & FILED
COMMONWEALTH COURT
OF PENNSYLVANIA
2013 APR -8 A 10:06

Re: *In Re: First Sealord Surety, Inc. (In Liquidation)*
No. 1 FSS 2012

Dear Mr. Krimmel:

Attached please find an original and two copies of the Report of the Liquidator on the Status of the Liquidation of First Sealord Surety, Inc., as of December 31, 2012, with regard to the above-referenced liquidation.

As directed by the Court's Order, we are also enclosing copies of the documents on a computer disk.

Very truly yours,

Preston M. Buckman
Insurance Department Counsel

PMB:drh

Enclosures

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

IN RE: First Sealord Surety, Inc.,
In Liquidation

:
:

No. 1 FSS 2012

REPORT OF THE LIQUIDATOR
ON THE STATUS OF THE LIQUIDATION OF
FIRST SEALORD SURETY, INC. AS OF DECEMBER 31, 2012

RECEIVED & FILED
CLERK OF COMMONWEALTH COURT
OF PENNSYLVANIA
2013 APR - 9 AM 10:06

I. INTRODUCTION

Michael F. Consedine, Insurance Commissioner of the Commonwealth of Pennsylvania, in his official capacity as Statutory Liquidator (“Liquidator”) of First Sealord Surety, Inc. (“FSSI” or “Estate”), through his undersigned counsel, hereby submits this Report on the status of the liquidation of FSSI for the period from February 8, 2012 through December 31, 2012 (“Report”).

II. REPORT

A. Financial Statements.

FSSI has prepared Special Purpose Statements of: Assets (Exhibit A); Assets, Liabilities and Deficit (Exhibit B); Reconciliation of Assets and Deficit (Exhibit C); and Cash Flows and Changes in Cash (Exhibit D), for the period from February 8, 2012 through December 31, 2012 (“Statements”). The Statements include estimates as noted below and may not fully reflect the effects of the liquidation upon some assets and liabilities. Consequently, the ultimate distribution to creditors is unknown at this time. For this reason, third parties should not rely on

the financial information contained herein as providing any certainty as to the ultimate distribution that will be made from FSSI.

The Statements and Cash Flow Statement are addressed in more detail in sections 1 through 6 below.

1. **Special Purpose Statements of Assets; Assets, Liabilities and Deficit;**

Reconciliation of Assets and Deficit – EXHIBITS A – C.

As of December 31, 2012, the attached Special Purpose Statements of Assets shows estimated total assets were \$4,302,507.

a. **Cash and Cash Equivalents.**

FSSI had cash and cash equivalents of \$1,640,931 as of December 31, 2012. See Exhibit D — Statement of Cash Flows and Changes in Cash, for reconciliation between opening and ending cash and cash equivalent balances.

b. **Premium Receivable.**

As of December 31, 2012, approximately \$940,000 in premiums remains outstanding from agents on bonds issued by the company prior to liquidation. At the time of liquidation, this balance was approximately \$2,232,000 million. The Liquidator has collected \$348,000 directly from agents while almost \$793,000 in premium has been reversed due to the cancellation and replacement of bonds as of the date of liquidation. An additional \$151,000 was deducted from escrow account balances to recover premiums due FSSI. The Liquidator continues to pursue the collection of these funds through internal efforts as well as coordinating collection through other third parties. However, because collection is considered uncertain at this time the Liquidator has established an allowance for doubtful accounts that reduces the amount estimated as collectable to \$90,000.

c. **Inter-company Receivables.**

FSSI was a wholly owned subsidiary of Sealord Holdings, Inc. FSSI holds a note from Sealord Holdings, Inc. with a remaining balance of \$4.275 million. The status of Sealord Holdings is unknown to the Liquidator at this time. Therefore, the Liquidator has established a valuation loss reserve amounting to 100% of the asset value. Also, FSSI recorded in December 2010 an intercompany balance related to Federal Income Taxes Recoverable from an affiliate in the amount of \$81,736. This balance was not recovered as of the date of the liquidation and is part of another intercompany account balance totaling \$90,745 at the date of liquidation. A valuation loss reserve of 100% has also been established for this account. Accordingly, these inter-company receivable assets are not listed as of December 31, 2012.

d. **Reinsurance Recoverable.**

The company maintains excess reinsurance under several treaties with reinsurers. The treaties typically are effective for a twelve month period and are effective on July 1st. The most recent treaty expired on July 1, 2012. The company's retention under the most recent treaty is \$750,000. The first layer of coverage reinsures FSSI to a limit of \$750,000. The 2nd layer of reinsurance protection adds another layer of \$2.5 million and a 3rd layer provides additional coverage of \$5 million from the reinsurers. At the time of liquidation and through the expiration date of the treaty, the company owed reinsurers approximately \$988,000 in premium that may act as an offset against potential recoveries during prior and current treaty years. Coverage is provided to the company under the treaties on the date the claims are discovered, or noticed, to the reinsurers.

There remain several claims with activity during prior treaty years that may result in future reinsurance recoverables. However, until the Liquidator performs additional analysis to

establish a likelihood of recovery, any values for related reinsurance recoverables have been excluded from receivables.

e. **State Deposits.**

There is \$1,451,170 in state deposits.

f. **Salvage and Subrogation Recoveries.**

FSSI has entered into an agreement with Kazlow and Fields, LLC, a collections firm, to collect the available Salvage and Subrogation, on a contingent fee basis. In addition, FSSI has engaged a former employee of the company as a consultant and he is also collecting subrogation and salvage for the estate. The total gross amount collected as of December 31, 2012, was \$706,144. The projected amount net of fees to be collected going forward, is approximately \$729,694.

2. **Liabilities – EXHIBITS B & C.**

Total estimated liabilities at December 31, 2012, were \$76,804,692. FSSI liquidation expenses are class (a) first priority payments under the Insurance Department Act of 1921, 40 P.S. §221.1 et seq. (“Act”), as are certain guaranty association (“GA”) expenses, to the extent permitted by the Act. Both Liquidator and GA expenses will be paid before distributions to other lower class creditors. As of December 31, 2012, there was \$280,322 in reserves for unpaid Liquidator administrative expenses and \$48,128 in reserves for unpaid GA administrative expenses.

However, the most significant liability is the \$76,267,673 assigned to priority class (e) claims. This category includes direct surety benefits reported by the GAs as paid \$247,271 and reserves of \$1,777,290. As of December 31, 2012, FSSI’s liability for non-guaranty fund NODs accepted was \$13,872,695. In addition, the Liquidator estimated other reserves of \$60,370,417 million to include the value of POCs in excess of the GAs limits or uncovered by the GAs and

for claims not yet fully developed. (Note: These POCs are treated at full value unless NODs are issued for lesser amounts.)

a. Priority Class A.

The Operating Statement Analysis, attached as Exhibit E, lists \$2,050,302 of Liquidator administrative operating expenses incurred by FSSI for February 8, 2012 through December 31, 2012. The GAs report their administrative expenses to FSSI via financial reports generally received quarterly from most GAs. Attached as Exhibit J is the Guaranty Fund Claim Overview Report showing by state the total \$48,128 in administrative expenses reported to FSSI as paid by GAs as of December 31, 2012.

b. Priority Classes below Class E.

Also included in total liabilities are estimated liabilities for proofs of claim (“POC”) assigned to priority classifications below class (e), which total \$208,569.

3. Special Purpose Statement of Operations – EXHIBIT E.

Attached is the Special Purpose Statement of Operations for the period from February 8 2012 through December 31, 2012, which reports FSSI experienced a net operating loss of \$77,688,644, due to the inclusion of GA and Liquidator claims processed, paid, or evaluated after the date of liquidation, as well as the cancellation of bonds on or prior to the liquidation date that were included in premiums receivable.

4. Operating Expense Analysis.

The operating expenses of FSSI relate to efforts by the Liquidator to marshal and maximize the assets of the Estate for the benefit of all FSSI surety bond claimants and creditors, as well as to review and determine the ultimate liabilities of the Estate, to fulfill the public policies and purposes of the Act and the liquidation process, and to investigate and hold accountable those third parties alleged to have contributed to the insolvency of FSSI. Additional

significant time was allocated to the disposition of managed escrow funds and collateral held as additional security in the form of cash and Irrevocable Letters of Credit as of the date of liquidation.

The attached Special Purpose Statement of Operations indicates the total dollar amount for each major expense category for the period from February 8, 2012 to December 31, 2012, as detailed in the Statement of Operations and supporting schedules, the administrative expenses of FSSI for the period totaled \$2,050,302. GA incurred operating expenses are reported cumulatively on Exhibit J.

a. Legal Fees.

Attached as Exhibit F is a schedule containing the legal expense detail by entity.

b. Professional Services Expenses.

Attached as Exhibit G is a schedule containing the professional service expense detail by vendor name for the period covered by the report. The individual entities listed in the schedule provided services including collateral review, reinsurance analysis and collection, salvage and subrogation collection and escrow disbursing account administration and disposition of assets.

c. Real Estate Expenses.

Until March 30, 2012, FSSI did business at its location in Villanova, Pennsylvania. Thereafter, operations were moved to the Pennsylvania Insurance Department.

d. Guaranty Association Claims and Expense Information.

GA coverage for surety claims is limited to six states: Arkansas, Kansas, Kentucky, Maryland, Michigan and New York. Claim and Expense information as reported by the GAs is reflected in Exhibit H.

5. **Claims Process.**

The deadline for filing POCs was October 5, 2012. As of December 31, 2012, FSSI had received a total of 947 POCs. Of those, 31 were received after the claim filing deadline.

a. **Proofs of Claim Statistics (Inception-to-Date).**

As of December 31, 2012, FSSI had issued Notices of Determination (“NODs”) for 563 of the 947 POCs received for a total allowed amount of \$14,081,264.

Issued NODs accounted for 59% of the POCs filed with the Estate.

b. **Notice of Claim Evaluation Objection Statistics.**

As of December 31, 2012, the Liquidator had received a total of 32 objections to the 563 NODs issued. Of those 32 objections, the Liquidator has resolved 16 without the need to seek the appointment of a referee and continues to work toward resolution of the remaining objections.

c. **Claims Bar Date.**

There has been no claims bar date set for the Estate.

6. **FSSI Operations Moved to PA Insurance Department.**

Effective April 2, 2012, FSSI operations were transferred “in house” to the Pennsylvania Insurance Department’s Office of Liquidations, Rehabilitations and Special Funds. FSSI staff trained Liquidator staff prior to the transfer and three former FSSI employees became consultants to assist with the Estate administration. As of December 31, 2012, one former FSSI employee remains on a part time consulting basis.

7. **Disposition of Escrowed Funds.**

At the time of liquidation, FSSI was under agreement to administer construction funds as a pass through entity receiving funds from the obligees identified on certain bonds and subsequently making payments to the principal. The primary purpose of funds control was to

control job funds and to help minimize payment bond risk. These funds were maintained individually for each construction project within the construction escrowed funds program and were disbursed upon review of the project status. The Liquidator was involved in the eventual disposition of the escrowed funds. At the time of the liquidation there were approximately \$7 million in funds under administration, or about 250 individual escrow accounts. As of December 31, 2012 amounts remaining to distribute total approximately \$330,000, representing 35 accounts. These funds have never been treated as assets of the estate.

8. Collateral.

Under certain construction projects, FSSI required that principals provide collateral in the form of cash or an Irrevocable Letter of Credit (ILOC) to secure FSSI's interests in the bond in the event the principal failed to perform as required and to help offset the bond exposure to the company. Under the collateral arrangement, cash funds were set aside in separate bank accounts identified by principal while the ILOCs were secured in a local bank safe deposit box for safekeeping. The Liquidator has released some of the cash collateral to the principals, where there were funds remaining in the accounts as of the date of liquidation, as well as the ILOCs for principals with no claims, or where all claims have been settled. Before the date of liquidation, some of the cash collateral was comingled with operating funds and dissipated at the direction of certain former directors and/or officers of FSSI, and is not available for use or return to the impacted principals or depositors.

9. Federal Income Taxes.

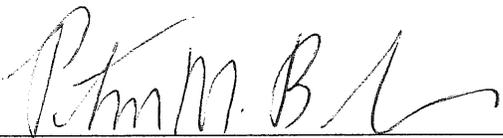
FSSI federal income taxes were filed as part of consolidated group of affiliated companies with its parent company Sealord LLC. The Liquidator is not aware of any potential liabilities on Federal income taxes or of any tax benefit that will accrue from the tax losses

created by FSSI. The company does have a tax sharing agreement with its parent entity whereby each company shares in proportion to amounts calculated as if they filed individual returns.

10. Cash.

Amounts classified as cash do not include certain bank account balances considered as inactive from pre-liquidation relationships with other entities. These inactive bank account balances amount to approximately \$537,269. The eventual disposition of these funds continues to remain uncertain at this time. The funds will either be retained by FSSI or returned to their rightful owner(s).

Respectfully submitted:

By: 

PRESTON M. BUCKMAN (I.D. #57570)
Insurance Department Counsel
Governor's Office of General Counsel
Pennsylvania Insurance Department
Capitol Associates Building
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(717) 787-6009

Attorney for Michael F. Consedine, Insurance
Commissioner of the Commonwealth of
Pennsylvania, in his official capacity as Statutory
Liquidator of FSSI

Dated: 4/8/13

EXHIBIT A

First Sealord Surety, Inc. (In Liquidation)

SPECIAL PURPOSE STATEMENT OF ASSETS
AS OF FEBRUARY 8, 2012

<u>Assets</u>	
Cash and Cash Equivalents	\$ 296,535
Accounts Receivable, net of allowances	2,232,536
Other Assets	195,253
Note Receivable from affiliate	3,551,251
Other Receivables due from affiliates	4,357,631
Escrow Fees Receivable	425,656
State Deposits	3,263,041
Fixed Assets, net of accumulated depreciation	271,083
Total Assets	\$ 14,592,984

See accompanying report.

EXHIBIT B

First Sealord Surety, Inc. (In Liquidation)

SPECIAL PURPOSE STATEMENT OF ASSETS, LIABILITIES AND DEFICIT

As of December 31, 2012

<u>Assets</u>	
Cash and Cash Equivalents	\$ 1,640,931
Accounts Receivable, net of allowances	\$ 90,000
Other Assets, principally Salvage and Subrogation	\$ 930,591
Amounts due from escrow fund	\$ 189,816
State Deposits	\$ 1,451,170
Total Assets	\$ 4,302,507
<u>Liabilities</u>	
Class A Administrative Expenses Unpaid	\$ (280,322)
Class A GA Paid Administrative Expenses	\$ (48,128)
Class E GA LAE Paid and LAE Reserves	\$ (251,860)
Class E GA Paid claims	\$ (227,012)
Class E GA Claim Reserves	\$ (1,545,689)
Class E Liquidator Claims	\$ (13,872,695)
Class E Liquidator Claims Reserve	\$ (60,370,417)
Class F Liquidator Claims	\$ (208,569)
Total Liabilities	\$ (76,804,692)
<u>Deficit</u>	
Beginning assets minus asset adjustments	\$ (5,186,459)
Loss from Operations	\$ 77,688,644
Total Deficit	\$ 72,502,185
Total Liabilities and Deficit	\$ (4,302,507)

See accompanying report.

Exhibit B

EXHIBIT C

First Sealord Surety, Inc. (In Liquidation)

SPECIAL PURPOSE STATEMENT RECONCILIATION OF ASSETS AND DEFICIT
FOR THE PERIOD FEBRUARY 8, 2012 to DECEMBER 31, 2012 - Unaudited

Beginning Assets - February 8, 2012	\$ 14,592,984
Asset Reserves	9,055,062
Asset write-offs, net of proceeds	351,464
Loss from Operations	77,688,644
Ending Deficit - December 31, 2012	\$ 72,502,185

See accompanying report.

EXHIBIT D

First Sealord Surety, Inc. (In Liquidation)

SPECIAL PURPOSE STATEMENT OF CASH FLOWS AND CHANGES IN CASH
FOR THE PERIOD FEBRUARY 8, 2012 to DECEMBER 31, 2012 - Unaudited

Beginning Cash and Cash Equivalent Balance 2/8/12	\$	296,535
Sources of Cash:		
Premium payments	\$	348,193
Reinsurance recoveries		48,541
State Deposits		1,811,871
Salvage & Subrogation Collections		706,144
State Premium Taxes Recovered		32,462
Commission Rights		81,524
Other		86,524
Total Sources	\$	3,115,258
Uses of Cash:		
Payroll, Taxes and Benefits	\$	575,127
Professional and Consulting Fees		476,826
Legal Expenses		400,501
Asset Collection Fees		45,190
Real Estate related		93,132
Furniture and Equipment		3,381
Postage, Telephone and Supplies		22,014
Data Processing and Software		50,299
Other Operating		104,392
Total Uses	\$	1,770,862
Net Increase in Funds	\$	1,344,396
Ending Cash and Cash Equivalent Balance 12/31/12	\$	1,640,931

See accompanying report.

Exhibit D

EXHIBIT E

First Sealord Surety, Inc. (In Liquidation)

SPECIAL PURPOSE STATEMENT OF OPERATIONS

For the Period February 8, 2012 to December 31, 2012 - Unaudited

Income		
Premiums cancellations	\$	(801,681)
Salvage and Subrogation		1,538,337
Commission Rights earned		105,346
Other Income		44,026
Total Income	\$	886,028
Claims		
Class A GA Paid Administrative Expenses	\$	48,128
Class E GA Paid LAE & LAE Reserves		251,860
Class E GA Paid Claims		227,012
Class E GA Claim Reserves		1,545,689
Class E NOD's Accepted		13,872,695
Class E Liquidator Reserves		60,370,417
Class F NOD's Accepted		208,569
Total Claims	\$	76,524,370
Expenses		
Payroll, Taxes and Benefits	\$	669,151
Professional and Consulting Fees		505,996
Legal Fees		427,536
Asset Collection Fees		160,614
Real Estate related		93,226
Furniture and Equipment		4,351
Postage, Telephone and Supplies		24,587
Data Processing and Software		53,523
Other Operating Expenses		111,317
Total Expenses	\$	2,050,302
Net Loss	\$	(77,688,644)

See accompanying report.

Exhibit E

EXHIBIT F

FIRST SEALORD SURETY, INC. (IN LIQUIDATION)

LEGAL FEE EXPENSES
FOR THE PERIOD FEBRUARY 8, 2012 TO DECEMBER 31, 2012 - Unaudited

VENDOR NAME

Dreifuss Bonacci & Parker	\$ 4,815
Eckert Seamans Cherin & Mellott, LLC	3,250
Kazlow & Fields, LLC	8,232
Statutory Liquidator	111
Stradley Ronon Stevens & Young LLP	411,128
TOTAL	<u>\$ 427,536</u>

See accompanying report.

EXHIBIT G

FIRST SEALORD SURETY, INC. (IN LIQUIDATION)

PROFESSIONAL SERVICE EXPENSES
FOR THE PERIOD FEBRUARY 8, 2012 TO DECEMBER 31, 2012 - Unaudited

VENDOR NAME

Crowne Plaza - Harrisburg	\$	12,591
DeVito Consulting, Inc.		37,625
INS Regulatory Ins Services		8,090
Invotex Group		183,171
James L Chokas		31,461
Michael McNulty		20,738
Morrone Technologies		9,000
Nancy M. Mucchetti		46,655
Salil P. Patel		149,450
Barry S. Slosberg		429
Statutory Liquidator		2,786
Wm. F. Comly & Son, Inc		4,000
TOTAL	\$	<u>505,996</u>

See accompanying report.

CERTIFICATE OF SERVICE

I hereby certify that I am this day serving the foregoing document upon all parties of record in this proceeding in accordance with the requirements of 1 Pa. Code Chapter 33 in the following manner:

Service by first-class mail, addressed as follows:

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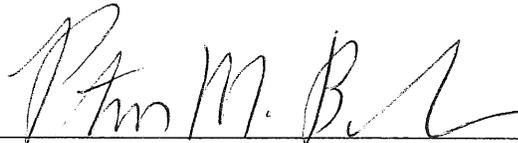
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DATED: _____

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Counsel for the Statutory Liquidator of First
Sealord Surety, Inc. (In Liquidation)