

MIKE KREIDLER  
STATE INSURANCE COMMISSIONER

STATE OF WASHINGTON

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HEARINGS UNIT

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September 8, 2008

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Re: Proposed Acquisition of Safeco Insurance Companies by Liberty Mutual, et al.

Dear Messrs. Brown, Quinlan, Sorensen, Cantilo and Ms. Beusch:

This letter is written to Messrs. Brown, Cantilo and Ms. Beusch, representing the Insurance Commissioner's staff (Commissioner). This letter is also written to Messrs. Quinlan and Sorensen, who represent the Applicants.

On August 29, 2008 by Order Supplementing Notice of Hearing, the undersigned required a significant amount of additional information concerning this proposed transaction which was not included in the Form A filing made with the Insurance Commissioner earlier. Additionally, said Order also required clarification of a significant amount of information that was included in the Form A. The reason for this Order was,

as can be inferred, that the Form A filing was deficient in many areas, to such an extent that it would have been impossible for me to adjudicate this matter with an adequate degree of responsibility.

On September 3, 2008 the Applicants and Safeco filed their responses to the Order, furnishing additional information and clarification. These additional pieces of information/responses remain insufficient and raise additional concerns.

In a continued attempt to assist the Applicants in submitting the information that is required by law in this matter, please review the information below in order to best be prepared for hearing. Please be prepared to present duly qualified witnesses to address the issues below in addition to those contained in the Notice of Hearing, my August 28 Order Supplementing Notice of Hearing, and the Applicants' and Safeco's responses filed September 3.

**To the Commissioner's Staff:**

1. The company which will be the sole purchaser and the owner of the entire Safeco organization (Safeco), LIH US P&C Corporation (LIH US), states that its only material asset is its "investment in its subsidiaries." Further, Applicants state that there is no SEC filing required and that LIH US has not been, and will not be audited. How is the Commissioner satisfied that LIH US is able to bear all of the risks and expenses of Safeco? How the Commissioner is satisfied that LIH US is financially able to honor its obligations to the Safeco policyholders? Further, how is this transaction in compliance with RCW 48.31B.015(2)(c), which requires that the Form A *contain fully audited financial information as to the earnings and financial condition of each acquiring party for the preceding five fiscal years of each acquiring party...and similar unaudited information as of a date not earlier than ninety days before the filing of the statement [Form A].* In their response, Applicants advise that, while LIH US has not been audited, its subsidiaries have: this situation does not appear to satisfy the clear requirement that the *acquiring party* be audited. Please explain how this situation is acceptable to the Commissioner, given the requirements of RCW 48.31B.015(2) and the policy behind this statute? It is apparent that only LIH US, the sole owner of Safeco, will be legally responsible for proper coverage and treatment of the Safeco shareholders, and not LIH US's subsidiaries.

2. Applicants advise that they will raise the \$6.2 billion to purchase Safeco from cash on hand from sales of common stock of various companies, all in the end being gifted to LIH US P&C Corporation which will be the purchaser and remain the sole owner of Safeco. Specifically, in their responses filed September 3, 2008 (pgs. 8 and 9), Applicants advise:

- Liberty Mutual Fire Insurance Company will purchase approximately \$250 million worth of Liberty Insurance Holdings, Inc. (LIHI) common stock from “hybrid debt proceeds” received as a capital contribution from its parent Liberty Mutual Group Inc. (LMGI), approx. \$16 million received as a dividend from Ohio Casualty Corporation and the rest from the sale of investment securities and cash on hand. This provides LIHI with \$250 million.
- Employers Insurance Company of Wausau will purchase approx. \$350 million of LIHI common stock from approximate \$22 million received as a dividend from Ohio Casualty Corporation and the rest from sales of investment securities and cash on hand. This provides LIHI with \$350 million.
- Liberty Mutual Insurance Company will purchase approximate \$5.545 billion worth of LIHI common stock. These funds will come 1) from \$1.160 received as a capital contribution (gift) of “hybrid debt proceeds” from its parent Liberty Mutual Group Inc.; 2) from approx. \$500 million received from Peerless Insurance Company in exchange for readily marketable investment securities; 3) from \$219 million received from the Ohio Casualty Insurance Company in exchange for “readily marketable investment securities;” 4) from approx. \$518 million received as dividends from its affiliates; and 5) from \$3.748 billion from *sales of its investment securities* and cash on hand. This provides LIHI with \$5.545 billion.

LIHI will then *contribute, pursuant to a capital contribution* approx. \$6.145 billion to LIH US P&C Corporation. [Further, LIH US will have received approx. \$55 million in dividends from its subsidiaries, which together with its receipt of approx. \$6.145 billion capital contribution from LIHI will equal approx. \$6.2 billion.] In response to my Question 7.d. in the Order Supplementing Notice, Applicants advise that the \$6.2 billion these various corporations are giving to LIH US to buy Safeco is being paid as a *capital contribution*, i.e. various Liberty corporations are giving \$6.2 billion to LIH US P&C Corporation in order for LIH US P&C Corporation to purchase Safeco. This is, according to Applicants, money that is not loaned, that LIH US P&C Corporation has given no collateral for and for which there are no written documents evidencing the transfer of \$6.2 billion from these separate corporations to LIH US P&C Corporation. What does the Commissioner believe is the impact of this arrangement? Also, what is the amount of stock being purchased? –Applicants’ September 3 response, states LMIC will purchase \$5.545 billion of LIHI stock, while page 9, 3<sup>rd</sup> paragraph of “Specifics” states that LMIC is purchasing \$6.145 billion of LIHI stock. How does this enter into the Commissioner’s view of these proposed transactions?

3. In the organization charts filed with the Form A, Peerless Insurance Company is wholly owned by Employers Insurance Company of Wausau [Org. Chart 1]. However, in Org. Chart 2, Ex. C, Peerless Insurance Company is wholly owned by LIH US P&C Corporation. Peerless, as above, is the ultimate donee of \$500 million from Peerless Insurance Company. What is your understanding of the legal and financial structure regarding Peerless?

4. We are advised that you have received communications from interested parties, whether they are objecting to the proposed transaction or not, to date have not forwarded this information to the Hearings Unit. Please advise the Hearings Unit promptly, before hearing, as to the identity and nature of all individuals and entities who have indicated an interest in participating in this proposed transaction/proceeding in some manner and whether each wishes to participate in the hearing.

**To Applicants:**

1. In the organization charts filed with the Form A, Peerless Insurance Company is depicted as being wholly owned by Employers Insurance Company of Wausau [Org. Chart 1]. However, in Org. Chart 2, Ex. C, Peerless Insurance Company is depicted as being wholly owned by LIH US. Peerless, as above, is the ultimate donee of \$500 million from Peerless Insurance Company. What is the correct relationship among these entities?

2. Please confirm whether the capital contributions from the other named corporations to LIH US P&C Corporation are simply gifts, with no responsibility to repay, no collateral and no written agreements.

3. Please provide a detailed diagram of the financing of this proposed transaction as described in writing on pages 8 and 9 of your response filed September 3, 2008, in a form to be exhibited at hearing.

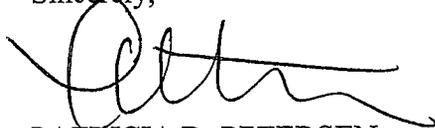
4. Michael Fallon is listed in Lehman Brothers' March 3 letter filed as Ex. 6.a as Vice President and Director, Corporate Finance for Liberty Mutual Group Inc. In a Declaration filed with the undersigned on September 5, Mr. Fallon states that he is a Senior Vice President of Liberty Mutual Insurance Company. Yet, in Ex. 4.d's list of officers and directors, Mr. Fallon is not listed, although he is listed in this exhibit as the President for Big Apple Merger Corporation. Please explain these apparent discrepancies.

5. Information contained in the material filed by Applicants alludes to the possibility of the Safeco organization being sold again at some time after closing of the instant transaction. Please provide information as to this possibility.

6. Please be prepared to present a qualified representative to testify at hearing as to these issues, among all other issues included in the Notice of Hearing and Supplemental Notice of Hearing. In addition, please submit a written declaration or brief as to these issues either before, during or following the hearing.

Your time and cooperation is appreciated, in the interest of reaching a fair, equitable and expeditious decision in this matter.

Sincerely,



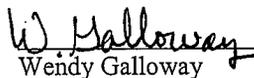
PATRICIA D. PETERSEN  
Chief Hearing Officer

CC: Mike Kreidler, Insurance Commissioner  
Vernon Stoner, Chief Deputy Insurance Commissioner  
James T. Odiome, Deputy Commissioner, Company Supervision Div.  
Ronald Pastuch, Holding Manager, Company Supervision Div.  
Carol Sureau, Deputy Commissioner, Legal Affairs Division  
Linda Dalton, Sr. Assistant Attorney General  
DeAnn F. Work, Safeco Plaza  
James Williams, Perkins Coie

DECLARATION OF MAILING

I declare under penalty of perjury under the laws of the State of Washington that on the date listed below, I mailed or caused delivery of a true copy of this document to the parties listed above.

Dated this 8<sup>th</sup> day of September, 2008.

  
Wendy Galloway