

JONES VARGAS
100 West Liberty Street - Twelfth Floor
PO Box 281
Reno, Nevada 89504-0281
Tel: (775) 786-5000 Fax: (775) 786-1177

1 JANET L. CHUBB, ESQ.
California State Bar No. 41292
2 JONES VARGAS
100 West Liberty Street, 12th Floor
3 PO Box 281
Reno, Nevada 89504-0281
4 Telephone: 775-786-5000
Fax: 775-786-1177
5 Email: jlc@jonesvargas.com

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6 Attorneys for Western Asbestos
Settlement Trust and the Inchoate Trust
7

8 **UNITED STATES BANKRUPTCY COURT**
9 **NORTHERN DISTRICT OF CALIFORNIA**
10 **OAKLAND DIVISION**

11 In re:

12 WESTERN ASBESTOS COMPANY,
13 WESTERN MACARTHUR CO., and
14 MACARTHUR CO.,
15 Debtors.

Case No. 02-46284-T thru 02-46286-T
Jointly Administered under 02-46284-T

Chapter 11

**THIRD ANNUAL REPORT AND
ACCOUNTING OF WESTERN
ASBESTOS SETTLEMENT TRUST**

Date: June 4, 2007
Time: 2:00 p.m.
Place: 1300 Clay Street, Room 300
Oakland, CA 94604

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19 Western Asbestos Settlement Trust by and through its counsel, Janet L. Chubb, Esq., of
20 Jones Vargas, herewith files its Third Annual Report and Accounting.

21 DATED this 26th day of April, 2007.

22 JONES VARGAS

23
24 By: //s// Janet L. Chubb
25 JANET L. CHUBB (Calif. Bar No. 41292)
100 West Liberty Street, 12th Floor
P. O. Box 281
26 Reno, NV 89504-0281
Telephone: 775-786-5000
27 Fax: 775-786-1177
Email: jlc@jonesvargas.com

28 Attorneys for the Trustees of the
Western Asbestos Settlement Trust

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THIRD ANNUAL REPORT AND ACCOUNTING OF WESTERN ASBESTOS SETTLEMENT TRUST

The Trustees of the Western Asbestos Settlement Trust (“Trust”) hereby submit this Third Annual Report and Accounting (“Annual Report”) covering Trust activities occurring between January 1, 2006, to and including December 31, 2006 (“Accounting Period”) and also covers certain activities of the Trust, specified below, that took place outside the Accounting Period. This Annual Report is submitted to the U.S. Bankruptcy Court for the Northern District of California, Oakland Division, *In Re Western Asbestos Company*, Case no. 02-46284-T, in accordance with the Second Amended Joint Plan of Reorganization (“Plan”), the Court’s January 23, 2004, Order Confirming Second Amended Joint Plan of Reorganization and Granting Related Relief (“Order Confirming the Plan”), Western Asbestos Settlement Trust Agreement and the Fourth Amendment to and Complete Restatement of Western Asbestos Settlement Trust Agreement (“Trust Agreement”), Western Asbestos Settlement Trust Bylaws (“Trust Bylaws”), Case Valuation Matrix (“Matrix”), Trust Distribution Procedures (“TDP”), other controlling documents approved by this Court, and pursuant to the laws of the State of Nevada, where the Trust is organized and where it resides. The factual statements in this Annual Report are supported by the Declaration of Sara Beth Brown, Executive Director, in Support of Motion to Approve and Settle Western Asbestos Settlement Trust’s Third Annual Report, the Audited Financial Statements, and the Claim Report, as described in paragraphs 5 and 6 *infra*. Capitalized terms not defined herein are as defined in the Glossary of Terms for the Plan Documents, a copy of which is attached hereto as Exhibit “A”.

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1. Effective Date: In compliance with Sections 4.1 and 7.2 of the Plan, and the Glossary of Terms for the Plan Documents, the Effective Date of the Trust is April 22, 2004.
 2. Appointment of Trustees: In its February 2, 2004, Order Approving Futures

1 Representative's Motion for Approval of Appointment of Trustees for the Western Asbestos
2 Settlement Trust, this Court approved the appointment of SANDRA R. HERNANDEZ, M.D.,
3 JOHN LUIKART and STEPHEN M. SNYDER as Trustees of the Trust, who have acted in that
4 capacity since that time. Elected in 2004 by the other two Trustees, Stephen M. Snyder has
5 continued to serve as Managing Trustee throughout 2006.

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7 3. Tax Obligations: Section 2.2(b) of the Trust Agreement requires the Trustees to
8 file income tax and other returns and statements in a timely manner, and comply with all
9 withholding obligations as legally required, including fulfilling requirements to maintain its status
10 as a Qualified Settlement Fund. The Trust has complied with state and federal tax obligations on a
11 quarterly basis based upon the advice of the Trust's certified public accountants, Sitkoff/O'Neil
12 Accountancy Corporation. The 2006 federal tax return must be filed on or before September 15,
13 2007. The Trust resides in Nevada and Nevada has no state income tax. Although the Trust is not
14 subject to tax in California, the Trustees filed a 2004 and 2005 tax return in California, attached a
15 copy of the Trust's 2004 and 2005 federal tax return but showed no California taxable income or
16 state tax liability.

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18 4. Annual Report: Section 2.2 (c) (i) of the Trust Agreement provides in pertinent
19 part:

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21 The Trustees shall cause to be prepared and filed with the Bankruptcy Court, as
22 soon as available, and in any event within 120 days following the end of each fiscal
23 year, an annual report containing financial statements of the Trust (including,
24 without limitation, a statement of the net claimants' equity of the Trust as of the
25 end of such fiscal year and a statement of changes in net claimants' equity for such
26 fiscal year) audited by a firm of independent certified public accountants selected
by the Trustees and accompanied by an opinion of such firm as to the fairness of
the financial statements' presentation of the equity presently available to current
and future claimants and as to the conformity of the financial statements with
accounting principles generally accepted in the United States, except for the
special-purpose accounting methods set forth.

27 The special-purpose accounting methods were adopted by the Trustees with the approval of the
28 TAC and the Futures Representative in the Third Amendment to and Complete Restatement of the

1 Western Asbestos Settlement Trust Agreement, dated February 28, 2005. The Trust's financial
2 statements are prepared using special-purpose accounting methods that depart from Generally
3 Accepted Accounting Principles (GAAP) in certain instances in order to better disclose the
4 amount and changes in net claimants' equity.

5
6 The Trust is required by the Internal Revenue Code to account for and report on its
7 activities for tax purposes on a calendar-year basis. Therefore, except where otherwise stated, all
8 reports attached to this Annual Report cover the period between January 1, 2006, and fiscal year
9 end, December 31, 2006.

10 5. Financial Report: In accordance with the requirements of Section 2.2(c)(i) of the
11 Trust Agreement, the Trust has caused its accounts to be audited by independent certified public
12 accountants, Grant Thornton LLP. The Trust's audited financial statements ("Audited Financial
13 Statements") are attached hereto as Exhibit "B". These include a Statement of Net Claimants'
14 Equity, a Statement of Changes in Net Claimants' Equity, a Statement of Cash Flows and
15 explanatory Notes. The Statement of Net Claimants' Equity, which is the equivalent of a
16 corporate balance sheet, reflects total assets of the Trust at market value and on the other
17 comprehensive bases of accounting adopted by the Trust. These Audited Financial Statements
18 show, among other things, that as of December 31, 2006, total Trust assets were \$1,198,941,975,
19 total liabilities were \$48,064,881, and Net Claimants' Equity was \$1,150,877,094.

22 6. Claim Report: Section 2.2(c)(ii) of the Trust Agreement provides that along with
23 the Audited Financial Statements, the Trust shall file with the Court a report containing a
24 summary regarding the number and type of claims disposed of during the period covered by the
25 financial statements. The Western Asbestos Settlement Trust Claim Report As Of December 31,
26 2006 ("Claim Report"), is attached hereto as Exhibit "C". During the Accounting Period, the
27 Trust received 1,626 claims, paid and closed 1,408 claims, and made settlement offers on an
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1 additional 124 claims.

2 Section 5.4 of the TDP provides that the Trust shall pay Pre-Petition Default,
3 Settlement, and Matrix Claims (hereafter “Pre-Petition Liquidated Claims”)¹ “[as] soon as
4 practicable after the Effective Date”. The vast majority of these claims were paid in 2004, and by
5 December 2005, the Trust had paid 99% of all Pre-Petition Liquidated Claims. The Trust has not
6 yet received proper release documents for 39 remaining unpaid Pre-Petition Liquidated Claims.

7
8 7. Bi-annual Review: Section 5.7(b) of the TDP requires that the Trust shall conduct
9 a bi-annual (or more frequently at the request of the TAC or the Futures Representatives) review
10 of filed claims, paid claims, average payments and disallowed claims, sufficient to allow an
11 estimation of the adequacy of the Trust fund to compensate claimants as compared to the current
12 claims forecast. The Trust prepared a bi-annual report in compliance with this provision and
13 presented it for discussion with the Trustees, TAC and Futures Representative at the April 20,
14 2006, meeting.

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16 8. Trustees’ Meetings: Article II, Section 4 of the Trust Bylaws provides that the
17 Trustees shall meet in Nevada, or a state other than California, at least once per quarter as soon as
18 practicable after the Effective Date, and on or about the anniversary of the Effective Date. The
19 Trustees held four meetings during the Accounting Period (February 6, 2006, April 20, 2006,
20 September 21, 2006, and December 14, 2006). All meetings were held at the Trust headquarters
21 in Reno, Nevada.

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23 9. Public Inspection: In compliance with Section 2.2(c) of the Trust Agreement, the
24 Annual Report, including the Audited Financial Statements and Claim Report, has been sent to the
25 Approving Entities and the Office of the United States Trustee with responsibility for the Northern
26 District of California, and has been made available for inspection by the public in accordance with
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¹ See this Court’s February 3, 2004 Memorandum of Decision after Confirmation Hearing.

1 procedures established by this Court.

2 10. Budget and Cash Flow Projections: Section 2.2(d) of the Trust Agreement requires
3 the Trustees to cause to be prepared a budget and cash flow projections prior to the
4 commencement of each fiscal year covering such fiscal year and the succeeding four fiscal years.
5 The Trustees approved the 2007 budget and the required four-year budget and cash flow
6 projections on December 14, 2006. Pursuant to the Trust Agreement, these were provided to the
7 Approving Entities and the Debtors. The budget for operating expenses in 2007 is \$4,152,591 (net
8 of claimant payments which are budgeted for \$71,890,000, and net of income tax payments which
9 are budgeted for \$9,500,000).

11 11. Maximum Annual Payment: Section 2.4 of the TDP provides:

12 The Trust shall estimate or model the amount of cash flow anticipated to be
13 necessary over its entire life to ensure that funds will be available to treat all
14 present and future claimants as similarly as possible. In each year, the Trust will
15 be empowered to pay out all of the interest earned during the year, together with a
16 portion of its principal, calculated so that the application of Trust funds over its
17 life shall correspond with the needs created by the anticipated flow of claims (the
18 “Maximum Annual Payment”).

19 In 2004, the Maximum Annual Payment (“MAP”) was set at \$90 million. In 2005, the remainder
20 of the 2004 MAP was carried over as the MAP for 2005. At the December 15, 2005, Trustees’
21 meeting, the Trustees set the 2006 MAP at \$90 Million. The Trustees re-evaluated the 2006 MAP
22 amount at their April 20, 2006, meeting. Due to the increase in the Payment Percentage in 2006,
23 from 31.5% to 34.2%, the 2006 MAP was increased from \$90 million to \$120 million. At the
24 December 14, 2006, Trustees’ meeting, the Trustees set the 2007 MAP at \$155 million.

25 12. Change in the Trust Claims Payment Ratio: In January 2006, it became apparent
26 that the Trust Claims Payment Ratio (TDP Section 2.5) then in effect soon would operate to
27 prevent the Trust from paying any further Category A (malignant) claims originating in Minnesota
28 or North Dakota. After investigation and discussion, the Trustees determined that in these

1 circumstances, application of the Claims Payment Ratio would work a manifest injustice. The
2 Trustees retained and consulted experts to advise whether these ratios could and should be
3 restructured and revised to prevent injustice. At its September 21, 2006, meeting, and after
4 reviewing all of the evidence and facts and consulting counsel, the Trust, with the consent of the
5 TAC and Futures, resolved to amend Section 2.5 of the TDP to i) combine the North Dakota and
6 Minnesota Claims Payment Ratios and ii) increase the percentage of the MAP available to pay
7 malignant claims and decrease the percentage of the MAP available to pay non-malignant claims
8 in that newly combined jurisdiction.²

10 13. Custodial Accounts: Wells Fargo Bank, N.A., continues to act as custodian for the
11 Trust.

12 14. Set Aside Fund: The Trust continues to maintain a separate account with Wells
13 Fargo entitled “Claims Defense Fund for Ordway and Milwaukee, Van Packer, and Mac Arthur
14 and Western Mac Arthur” as required by the Trust Documents. This account holds the legally
15 required amount in cash and securities for certain indemnification obligations.³ No claims were
16 made against any of these indemnity funds during the Accounting Period.

17 15. Indemnity Fund: Section 4.6 of the Trust Agreement provides that the Trust shall
18 indemnify the Trustees, the Trust’s officers and employees, the Futures Representative, the TAC
19 and each of their respective agents. The Trustees, the Futures Representative, the TAC and their
20 respective agents have a first priority lien upon the Trust’s assets to secure the payment of any
21 amounts payable to them pursuant to Section 4.6.

22 After significant research utilizing an expert in the insurance industry, the Trust
23 determined in 2004 that not only was insurance prohibitively costly (the annual cost of the policy
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27 ² The First Amendment to and Complete Restatement of Western Asbestos Company/Western Mac Arthur Co./Mac Arthur Co. Asbestos Personal
28 Injury Settlement Trust Distribution Procedures dated December 14, 2006 is attached to the Appendix.

³ The indemnification obligations are set forth in Section 2.5 of the Trust Agreement and pursuant to the Settlement Agreement with Hartford
Accident and Indemnity Company (“Hartford”) including section V.5.1.

1 was \$468,000), but the policies available would not cover all matters the Trust was seeking to
2 insure. As a result of the findings, and upon the recommendation of the expert, an indemnity fund
3 in the amount of \$40 million⁴ was established. All interest earned by the fund is returned to the
4 Trust quarterly. During the accounting period, no claims were made against the fund and no
5 money was paid from the fund.
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7 16. Special Budget Fund: A Special Budget fund was approved by this Court in 2005
8 to pay anticipated operating and litigation expenses of the Trust, including, but not limited to,
9 expenses arising under the Trust Agreement and the Indemnity Agreement, in the event Congress
10 passes federal tort reform legislation that would seek to confiscate the Trust assets. The Special
11 Budget Fund was established to permit the Trust to continue to operate on a limited basis so that if
12 and when potential legislation is overturned, the Trust will be able to resume paying claims with
13 minimal interruption and expense. The Special Budget Fund was approved in this Court's May
14 18, 2005, Order to Approve and Settle Western Asbestos Settlement Trust's Annual Report and
15 Accounting, Audited Financial Statements, and Claim Reports; and to Approve Resolution
16 Regarding the FAIR Act ("May 18, 2005, Order"). In keeping with the May 18, 2005, Order, the
17 Managing Trustee is in charge of administering and reporting on the Special Budget Fund. In
18 accordance with the May 18, 2005, Order, the Managing Trustee has reported regarding the
19 disposition and status of these monies at each regular meeting in 2006 to determine whether to
20 increase or decrease the amount in this Special Budget Fund. No changes were recommended to
21 adjust the amount during the Accounting Period. As of December 31, 2006, the Special Budget
22 Fund contained \$33,272,920. (\$2.1 million is part of the Special Budget Fund and was returned to
23 the Trust from the Morgan law firm, but resides in the main custody account of the Trust. See
24 paragraph 21 c *infra*).
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⁴ The establishment of the Indemnity Fund was described in detail in the Trust's First Annual Report and Accounting.

1 17. Settlement Fund Control Account and Control Agreements: Section 4.7 of the
2 Trust Agreement grants to the Trustees, the Futures Representative and the TAC, a security
3 interest in all of the assets of the Trust to secure the indemnification obligations of the Trust to
4 such parties. The Trustees, the TAC, the Futures Representative and their agents have a security
5 interest in the assets of the Trust, including, but not limited to, the five Wells Fargo sub-accounts,
6 including the Set Aside Fund, Indemnity Fund, Operating Account, Special Budget Fund and
7 Settlement Fund Account (“Specific Funds”). The Trust has entered into five separate Control
8 Agreements with respect to the Specific Funds. The security interests of the indemnified parties
9 are perfected through Control Agreements. The Managing Secured Party for each of the Control
10 Agreements is Stephen M. Snyder, Managing Trustee of the Trust. There has been no change in
11 these Control Agreements during the Accounting Period.
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13 18. Resolution Regarding Payment Percentage: Section 4.2 of the TDP provides that,
14 commencing on the first day of January, after the Plan has been confirmed and no less frequently
15 that once every three years thereafter, the Trustees shall reconsider the Payment Percentage to
16 assure that it is based on accurate current information and may, after such reconsideration, change
17 the Payment Percentage if necessary with the consent of the TAC and the Futures Representative.
18 In its April 14, 2004, Order Under Fed.R.Bankr.P. 9019 Approving Compromises with Settling
19 Insurers, this Court approved a Payment Percentage to the Trust’s claimants of 31.5%. In
20 December 2005, the Trustees and the Approving Entities relied upon Dr. Thomas Vasquez of
21 Analysis Research Planning Corporation to review data to determine if the Payment Percentage
22 could or should be adjusted. After Dr. Vasquez’s report of January 18, 2006, was submitted, the
23 TAC proposed that the Payment Percentage be increased. At their February 6, 2006, meeting, the
24 Trustees increased the Payment Percentage to 34.2% effective January 1, 2006, based upon the
25 report and conclusions of Dr. Vasquez. The TAC and the Futures Representative consented to the
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1 adjustment.

2 19. Resolution Regarding Inflation Adjustment: The original Payment Percentage
3 approved by this Court was based upon projections of future claims payments adjusted annually
4 for inflation. In the interest of treating all claimants equitably in accordance with the Plan, the
5 Trustees recommended all claims payments made during a calendar year include a cost of living
6 adjustment for inflation based upon the Federal Bureau of Labor Statistics' *Consumer Price Index*
7 *for Urban Wage Earners and Clerical Workers* (CPI-W) announced in January each year. The
8 TAC and the Futures Representative consented to this adjustment. Consequently, as of January 1,
9 2006, all claims payments made during the calendar year were increased by 3.4% to account for
10 inflation. The resolution also stated that in each succeeding January, the Trust shall review the
11 CPI-W from the previous year and make a determination as to whether that adjustment shall be
12 included in claims payments made in that year.

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15 At the December 14, 2006, meeting, the CPI-W that was to be published in January
16 2007, was approved for use by the Trust in making the 2007 cost of living adjustment for claims
17 payments. Thus, all claims payments made during the 2007 calendar year include the inflation
18 adjustment of 3.4% paid in 2006 and then adjusted by an additional 2.6% to account for further
19 inflation.

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21 20. Amendments to the Trust Documents: In addition to amendments referred to
22 above, the Trustees approved the following additional amendments to the Trust Documents during
23 the Accounting Period, with the consent of the TAC and the Futures Representative:

24 a. On April 20, 2006, Section VIII of the Matrix was amended to allow, in special
25 circumstances, for an Individual Review claim to be awarded an amount above the cap upon the
26 recommendation of the Executive Director, with the unanimous agreement of a special panel
27 consisting of a Trustee, the Futures Representative and TAC member. The revised language of
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1 Section VIII of the Matrix is attached to the Appendix.

2 b. On April 20, 2006, a correction was made to the naming of subparagraphs in
3 Section VII of the Matrix. The corrected Section VII of the Matrix is attached to the Appendix.

4 c. On September 21, 2006, revisions were made to the Indemnity Agreement,
5 including clerical revisions and clarification as to the parties and matters covered. The First
6 Amendment to Indemnity Agreement is attached to the Appendix.

7 d. On December 14, 2006, Section VII c of the Matrix was amended to allow
8 claimants to blend differing exposure ratings of multiple job sites. Under the amended Section
9 VII c, the Trust will calculate a blended exposure giving proportional weight to each site based
10 upon the length of exposure and the site rating. The revised language of Section VII c of the
11 Matrix is attached to the Appendix.

12 e. On February 22, 2007, the Trust Agreement was amended to include the
13 following significant changes: Its title was changed to “Fifth Amendment to and Complete
14 Restatement of Western Asbestos Settlement Trust Agreement”; Paragraphs 2.2(c) (i) 6 and 7 of
15 the Trust Agreement were amended to restate financial reporting of interest and dividend income
16 on available-for-sale securities on a net realized and unrealized gains and losses basis; Paragraph
17 2.2(d) was amended to remove the requirement that the budgets be sent to the Debtors; Paragraph
18 4.5(a), 4.6(b) and (d) and 5.5(a) were amended to reflect the current compensation of the Trustees,
19 TAC and Futures Representative. (See paragraph 24, *Infra*).

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23 21. Claims and Legal Disputes: The Trust has been involved in four legal disputes
24 during the Accounting Period:

25 a. *Stephen Snyder, Sandra Hernandez and John Luikart in Their Capacity as*
26 *Trustees of the Western Asbestos Settlement Trust v. The Bank of New York Company, et al.*,
27 Alameda Sup. Ct., November 9, 2004, Case No. BG04184438, and removed by Defendant Bank
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1 of New York on Dec. 9, 2004 to U.S. Dist. Ct., N.D.Cal. (Oakland Division), Case No. 04-04372,
2 under jointly administered Case No. 02-46284T. The Trustees brought this action to recover
3 escrow fees alleged to be excessive that were incurred before the Trust came into being. Counsel
4 to the Trust, Pinnacle Law Group, undertook this representation on a contingency fee basis.

5
6 In November of 2004, the Trust demanded immediate return of all fees
7 because Bank of New York (“BONY”) had bypassed the billing mechanism provided for in the
8 controlling escrow agreement, and collected fees for its services directly from the escrow custody
9 accounts. BONY repaid the entire \$4,114,051 it had charged as fees and included interest of
10 \$21,208. The Trust paid the attorney’s fees due to Pinnacle Law in the amount of \$1,234,216. The
11 parties submitted the remaining dispute, concerning what fee was reasonable to compensate
12 BONY as escrow agent, to mediation and BONY agreed to accept \$650,000 as its fee for holding
13 the Escrow Accounts. This Court approved this settlement, as revised, in its Amended Order of
14 May 1, 2006. The Trust paid \$650,000 to BONY and received a refund of attorney’s fees in the
15 amount of \$194,999 from Pinnacle Law Group in May 2006.

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17 b. *Western Asbestos Settlement Trust, et al. v. Zurich-American Insurance Co., et*
18 *al.*, San Francisco Sup.Ct., Case No. CGC04-436181, November 9, 2004: This is an insurance
19 coverage action against various insurers for recovery under numerous primary and excess policies
20 issued to the Debtors starting in 1946. The Trustees retained Morgan Lewis & Bockius LLP
21 (“Morgan”) to represent the Trust in the *Zurich* litigation pursuant to an hourly fee arrangement,
22 capped monthly, in addition to a contingency payment based on the amount of the final award.
23 The Trust reports on the amounts paid and accrued to Morgan at each Trustee’s meeting.

24
25 c. Tort Reform Representation and claims against Gibson Dunn & Crutcher LLP:
26 At the February 28, 2005, Trustees’ meeting, the Trustees decided it would be in the best interests
27 of the Trust’s beneficiaries to join with multiple asbestos settlement trusts, (“Common Interest
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1 Group”) to protect the Trust’s interests in the face of certain confiscatory provisions in proposed
2 federal tort reform legislation. The Common Interest Group retained Gibson Dunn & Crutcher
3 (“GDC”) to help develop and implement a strategy to protect the interests of the Trust’s
4 beneficiaries from those features of the proposed legislation which, if passed, would confiscate all
5 Trust assets for inclusion in a national claim resolution fund likely resulting in smaller payments
6 or no payments to some trust beneficiaries. The Trust initially paid GDC \$2.2 million for legal
7 fees, costs and expert witness costs. At the same time, the Trust continued to use Morgan to assist
8 and to act as back-up counsel in the event conflicts of interest arose within the Common Interest
9 Group. Under the parallel fee arrangement with Morgan, the Trust advanced fees and expenses in
10 the amount of \$4.2 million. The arrangement provided that the Trust would recover all remaining
11 funds in the event the proposed legislation did not pass.
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14 In July of 2005, GDC withdrew from its representation of the Common
15 Interest Group (“CIG”) and as a result of that withdrawal, the CIG retained new counsel, Cooper
16 & Kirk PLLC of Washington D.C. (“C&K”), to represent its interests with respect to these same
17 issues. The CIG also retained ethics counsel, Zuckerman Spaeder LLP of Washington, D.C., to
18 represent its members with respect to their claims for recovery of prepaid fixed fees held by GDC,
19 disgorgement of other fees and costs, including costs of retaining ethics counsel and substitute
20 counsel, occasioned by GDC’s decision to withdraw. The Trust claimed that it was owed
21 \$2,633,838k, of which \$2,113,102 (representing most of the prepaid fixed fee paid by the Trust)
22 was returned by GDC in 2005. The CIG entered into a settlement agreement with GDC and of the
23 remaining \$520,736 claimed by the Trust, \$300,091 was returned by GDC during the Accounting
24 Period.
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27 In February 2006, the CIG entered into a Joint Representation Agreement
28 and fixed fee arrangement with C&K. The Trust paid C&K \$1.4 million for legal fees and costs,

1 except costs related to experts and consultants. The fixed fee arrangement included an agreement
2 with CIG Trust Expert Services (“CTES”) in connection with C&K’s retention of experts and
3 consultants. Therefore, the Trust paid CTES \$400,000.

4
5 Congress did not pass the threatened confiscatory legislation in 2006. In
6 October 2006, Morgan returned \$2.1 million of the advanced fees to the Trust. In December
7 2006, the CIG terminated its fixed fee arrangement with C&K and CTES and the Trust received
8 its share of the unused fixed fees in the amounts of \$1,315,042 and \$351,308.

9 d. Minnesota Interest Issue: In the fall of 2004, Minnesota claimants who had
10 *Miller-Shugart* settlement agreements with the Debtors requested the Trust pay \$1,521,323 in
11 post-judgment interest on claims under Minn. Statute § 549.09 and *Miller v. Shugart*, 316 N.W.2d
12 (Mn. 1982). The Trust retained Minnesota counsel and in December 2005, the parties mediated
13 and reached resolution of the controversy. The Trust approved a settlement in the amount of
14 \$212,000 at the February 6, 2006, meeting.

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16 22. Claim Processing Notifications: In 2004, the Trust began placing informational
17 claim processing notifications on its website. The following notifications have been placed on the
18 Trust’s website since that time:

- 19 a. Updates to the site and ships lists. (6/2/2006; 7/5/2006; 10/4/2006)
- 20 b. Notice of amendment to Section VII c of the Matrix. (6/13/2006)
- 21 c. Policy that the filing fee will be refunded for a claim submitted based upon a
22 site and/or ship which is subsequently removed from the official list. (5/11/2006)
- 23 d. Notice of the 2006 Payment Percentage increase and 2006 inflation adjustment.
24 (4/14/2006)
- 25 e. Additions to the Traditional Occupation List. (7/29/2005)
- 26 f. Policy that the first ten claims submitted by a law firm may be eligible for a
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1 refund of the filing fee, should those claims be denied or withdrawn within 60 days. (1/6/2005)

2 g. Notice that the appropriate statute of limitations is applied to all claims, but for
3 all claims not barred by the applicable statute of limitations or repose on November 22, 2002
4 (which was the date the Chapter 11 Bankruptcy was commenced), the statute of limitations is
5 deemed tolled as of November 22, 2002, to and including April 22, 2005. (12/29/2004)

6 h. Notice that claims that do not meet the Matrix requirements may be submitted
7 for Individual Review under Section VIII of the Matrix. (11/23/2004)

8 i. Notice that claims properly submitted on or before December 30, 2004, and
9 withdrawn on or before February 28, 2005, may receive a refund of the filing fee. (11/23/2004)

10 j. Notice that the attorney for the claimant may sign the verification for answers
11 to interrogatories supplied as supporting documents to a claim. (11/23/2004)

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14 23. Claim Processing Issues:

15 a. Pursuant to Section 5.9 of the TDP, the Trust is required to adopt arbitration
16 procedures and forms to resolve disputes concerning the Trust's outright rejection or denial of a
17 claim or concerning a claimant's medical condition or exposure history for purposes of
18 categorizing a claim. The arbitration procedures were approved by the Trustees with the consent
19 of the TAC and the Futures Representative on April 20, 2006. The arbitration procedures and
20 forms are attached to the Appendix.

21
22 b. At the February 6, 2006, Trustees' meeting, the Executive Director reported
23 that the Trust was incurring excessive costs as a result of repetitive claim resubmissions by
24 claimants whose claims the Trust had returned as deficient. After discussion, the Trustees, TAC
25 and Futures Representative arrived at and agreed on the following policy concerning multiple
26 submissions of a claim: The Trust will deem a claim to be withdrawn after it is submitted three
27 times (the original submission and two subsequent submissions). The claim may be resubmitted at
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1 any time after it has been withdrawn by the Trust upon payment of an additional filing fee. It was
2 agreed that the Trust would give fair warning to any firm who was in serious violation of the
3 policy to give them an opportunity to correct the problem prior to enforcement.

4 c. A revised form of the approved release was implemented on April 20, 2006.
5 The revised form clarifies that the Trust will accept as adequate and authentic the signature of any
6 heir or their successor in interest, a personal representative of the estate, or one holding a valid
7 power of attorney for any of the aforementioned persons. The Trust will only accept signatures of
8 individuals on behalf of the injured party if the Trust is provided with appropriate documentation
9 establishing the authority of the signatory. In the event the person holding a valid power of
10 attorney is a representative of the law firm which submitted the claim, appropriate documentation
11 must be provided to verify that the law firm's client understands, accepts, and has authorized
12 settlement of the claim. The approved release was also revised to replace the specific payment
13 amount with a reference that the payment amount will be that of the current Payment Percentage
14 value plus any applicable inflation adjustment then in effect. The revised release is attached to the
15 Appendix.
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17 d. To date the Trust has utilized land and ship site exposure lists provided to it at
18 the commencement of the Trust by the Approving Entities. The Trust continues to conduct
19 research on the lists as claims are received and from time to time receives information concerning
20 various sites on the lists which indicate that the site should be removed as one where Western
21 Asbestos or Mac Arthur performed work. The Trust also receives information periodically
22 concerning sites that should be added to these lists. At least one claimant contended that fairness
23 required that a site once listed should not be dropped from the list. The Trustees, after consulting
24 with the Approving Entities, concluded that the Trust should continue with its current practice to
25 avoid compensating invalid claims in violation of Trust Agreement and the TDP.
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1 e. Pursuant to Section 5.7 of the TDP, the Trustees, with the agreement of the
2 TAC and Futures Representative, contracted with Mr. David Maxam to conduct a Claims
3 Processing and Internal Controls Audit. Mr. Maxam reported his findings at the September 21,
4 2006, meeting. Among other things he found that of 48 claims randomly selected, each claim had
5 been processed and paid correctly according to Trust documents and policies. His Executive
6 Summary and resume is attached to the Appendix. Mr. Maxam also made several suggestions for
7 more efficient processing and administration of the Trust (creating a standard practice manual,
8 creating a worksheet in Excel which would calculate the total liquidated values of claims to
9 double check the claims processing system's calculations, open separate bank accounts for filing
10 fees and claims payments, fire-proof storage for written releases, and the addition of a third
11 summary review of claims with liquidated values over \$100,000). The Trust implemented all but
12 one of these recommendations. The Trustees determined that a third review of claims over
13 \$100,000 would add unnecessary expense and was not warranted since every claim is reviewed
14 twice, with spot reviews by the lead processor and the Executive Director before any offer is
15 authorized.
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18 f. At the September 21, 2006, meeting, the Trustees, with the consent of the TAC
19 and the Futures Representative, approved certain administrative revisions to the Claim Form. The
20 list of the approved revisions and a complete copy of the revised Claim Form are attached to the
21 Appendix.
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23 24. Trustees' Compensation: Section 4.5(c) of the Trust Agreement requires the Trust
24 to report the amounts paid to the Trustees for per annum compensation and expenses. Pursuant to
25 section 4.5(a) of the Trust Agreement "per annum compensation payable to the Trustees...shall be
26 reviewed every three years and ... adjusted with the consent of the Approving Entities." At the
27 September 21, 2006, meeting, the Managing Trustee was instructed to conduct a survey prior to
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1 the December meeting concerning the payments made by other similarly-situated trusts. The
2 survey was conducted by ARPC and the results were reported at the December 14, 2006, meeting.
3 The Trustees, TAC, and Futures Representative resolved that as of January 1, 2007, the Trustees'
4 annual payment will be increased from \$50,000 to \$65,000, and the non-managing Trustees' and
5 TAC members' hourly rate for purposes of calculating per diem compensation will be increased
6 from \$250 to \$450.

8 25. Filing Fee: Pursuant to Section 6.4 of the TDP, the Trustees, TAC, and Futures
9 Representative reviewed the current amount of the filing fee during the September 21, 2006,
10 meeting and determined that no change is warranted.

11 26. J.T. Thorpe Settlement Trust Administration: The Trust was approached in the
12 spring of 2006 about sharing its resources to administer and process the newly formed J.T. Thorpe
13 Settlement Trust ("J.T. Thorpe Trust"). One of the Trustees, Stephen M. Snyder, also serves as
14 sole trustee of the J.T. Thorpe Trust. The Executive Director was asked by the two non-conflicted
15 Trustees of the Trust, Sandra R. Hernandez, M.D. and John F. Luikart, to analyze the benefits and
16 burdens of sharing resources with the J.T. Thorpe Trust. In accordance with the analysis, the non-
17 conflicted Trustees concluded that sharing resources as proposed would result in a more efficient
18 and economical operation for the benefit of both the current and future claimants of each of the
19 Trusts, and would enable the Trust to retain full use of its existing resources at less cost and
20 maintain its critical mass notwithstanding the ebb and flow of claims entering the system, without
21 imposing additional burdens that might slow the processing of Trust claims. The Trustees
22 concluded that entering into a resources sharing agreement with the J.T. Thorpe Trust would be in
23 the best interests of the Trust's beneficiaries and that doing so was not prohibited by the Trust
24 Documents and was permitted by Nevada law. The Trust Facilities and Services Sharing
25 Agreement negotiated and approved on June 29, 2006, by the non-conflicted Trustees with the
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1 consent of the Approving Entities provides:

2 i) for the J.T. Thorpe Trust to pay all of its own start up costs and a monthly
3 amount, subject to the annual adjustment described in iii), of \$21,000 to the Trust for processing
4 and its share of fixed costs as well as the hiring of the Trust Executive Director as its Executive
5 Director.

6 ii) for the sharing of the Trust employees other than the Executive Director.

7 iii) for an annual accounting in July of each year to identify and adjust actual costs
8 as shared to insure that each trust is paying its proportionate share of the expenses.

9 A copy of the Agreement is attached to the Appendix.

10 27. Significant Vendors: Although the Trust has many vendors, those who were paid
11 more than \$100,000 during the Accounting Period are listed below:

12 a. Analysis Research Planning Corporation (“ARPC”): Consulting firm hired to
13 help the Trust develop a claims manual, claims processing procedures, create a system to process
14 claims, provide program updates and improvements to the claims processing system and provide
15 monthly maintenance. Dr. Vasquez of ARPC also acts as the expert professional with whom the
16 Trustees consult.

17 b. BlackRock Financial Management: One of five investment managers for the
18 Trust.

19 c. Cooper & Kirk PLLC: Law firm that took over from GDC in representing the
20 Trust and the CIG.

21 d. Dwight Asset Management Company: One of five investment managers for the
22 Trust.

23 e. Eagle Capital Management, LLC: One of five investment managers for the
24 Trust.

- 1 f. Fergus, a Law Firm: Counsel to The Honorable Charles Renfrew, Futures
2 Representative.
- 3 g. Jones Vargas: Law firm that acts as Nevada counsel responsible for the legal
4 administration of the Trust and bankruptcy matters.
- 5 h. Legal Analysis Systems: Expert hired by the TAC.
- 6 i. Morgan Lewis & Bockius LLP: Counsel to Debtors, counsel to the Trust in the
7 Zurich litigation described in paragraph 20 *supra* and counsel assisting in the constitutional
8 analysis of the proposed federal tort reform legislation.
- 9 j. Sheppard, Mullin, Richter & Hampton LLP: Legal counsel to the TAC.
- 10 k. Standish Mellon Asset Management Company: One of five investment
11 managers for the Trust.
- 12 l. State Street Global Advisors: One of five investment managers for the Trust.
- 13 m. Sitkoff/O'Neil Accountancy Corporation: CPA and Tax Firm for the Trust
- 14 28. Trust Investment Management: Article 3 of the Trust Agreement authorizes the
15 Trust to administer the investment of funds in the manner in which individuals of ordinary
16 prudence, discretion and judgment would act in the management of their own affairs, subject to
17 certain limitations. Callan & Associates continued to assist the Trust during the Accounting
18 Period as its manager of investment managers. BlackRock Financial Management, Inc., Dwight
19 Asset Management Company, Eagle Capital Management, LLC, Standish Mellon Asset
20 Management Company, LLC, and State Street Global Advisors have continued to act as
21 investment managers to the Trust.

22 ***

23 The Trustees submit that the Annual Report and attached exhibits demonstrate the Trust
24 acted prudently and expeditiously in executing its legal obligations during the Accounting Period.

JONES VARGAS
100 West Liberty Street - Twelfth Floor
PO Box 281
Reno, Nevada 89504-0281
Tel: (775) 786-5000 Fax: (775) 786-1177

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The Trust conscientiously worked to execute equitable claims procedures and process Trust Claims with due diligence during the Accounting Period. Moreover, the Trust worked with its accountants and financial advisors to preserve and grow Trust assets in order to fulfill the purpose of the Trust--paying valid asbestos claims. In so doing, the Trust carefully complied with all Plan documents and the mandates of this Court.