

**ONTARIO COURT OF JUSTICE
(GENERAL DIVISION)
COMMERCIAL LIST**



**IN THE MATTER OF
CONFEDERATION LIFE INSURANCE COMPANY**

**AND IN THE MATTER OF THE
INSURANCE COMPANIES ACT, S.C. 1991, AS AMENDED**

**AND IN THE MATTER OF THE
WINDING-UP ACT, R.S.C. 1985, C.W-11, AS AMENDED**

B E T W E E N:

THE ATTORNEY GENERAL OF CANADA

Applicant

- and -

CONFEDERATION LIFE INSURANCE COMPANY

Respondent

**REPORT OF KPMG INC., THE LIQUIDATOR OF
CONFEDERATION LIFE INSURANCE COMPANY**

May 22, 1998

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May 22, 1998

I. NATURE OF THE MOTION

1. This Report is respectfully filed in support of a motion by KPMG Inc., the liquidator (the "Liquidator") of Confederation Life Insurance Company ("Confed"), for:

- (a) an order approving of and authorizing the Liquidator's
 - (i) entry into and participation in the plan of compromise or arrangement (the "Plan") under the *Companies' Creditors Arrangement Act* (the "CCAA") with respect to Confederation Treasury Services Limited

(“CTSL”) which was filed by Confederation Financial Services (Canada) Limited (“CFSC”), a wholly-owned indirect subsidiary of Confed and a creditor of CTSL, as it may be amended in accordance with its terms. A copy of the Plan is attached hereto as Schedule “A”; and

(ii) taking such other steps, including voting in favour of the Plan, and doing such other things as appear reasonable to the Liquidator to implement the Plan; and

(b) an order in the form contemplated by section 5.14(f) of the Plan.

2. The Liquidator respectfully recommends that this Court grant the relief sought herein. Implementation of the Plan will avoid significant, complex and expensive litigation either involving or having an impact on the estate of Confed as a whole. In the Liquidator’s considered view, the Plan will benefit the Canadian Estate (as defined below) and will be a positive step towards the completion of the liquidation. It will:

- (a) enhance the ability of the Liquidator to satisfy fully the claims of the Canadian Policyholders (as defined below) as expeditiously as possible;
- (b) facilitate the timely determination and resolution of significant obligations of the Liquidator under the U.S. Settlement Agreement (as defined below);
- (c) enhance the Liquidator’s ability to determine whether there will be, and the amount of, any recovery for Ordinary Creditors (as defined below); and
- (d) result in significant savings in professional fees and expenses which would otherwise be incurred as a result of the litigation in respect of CTSL.

On implementation, the Liquidator expects to increase the interim distribution percentage to Canadian Policyholders by 5%.

A. Usage of Certain Terms in this Report

3. In this Report:

- (a) “**Arm’s Length Creditors**” refers to parties outside the Confed group of companies who have asserted claims against CTSL;

- (b) “**Canadian Estate**” refers to the estate under the administration of the Liquidator which, for greater certainty, includes the administration of the claims of the Canadian Policyholders and of the Ordinary Creditors;
- (c) “**Canadian Policyholders**” refers to policyholders holding policies issued other than by Confed’s branches in the United States of America and the United Kingdom;
- (d) “**CLIC(U.S.)**” refers to the estate under the administration of the Rehabilitator, which was formerly Confed’s U.S. branch;
- (e) “**Confed Estate**” refers to the Canadian Estate and CLIC(U.S.);
- (f) “**Liquidator**” means:
 - (i) in respect of the period to and including September 10, 1997, collectively the Superintendent of Financial Institutions in his capacity as provisional liquidator of Confed and KPMG Inc. in its capacity as his agent; and
 - (ii) in respect of the period after September 10, 1997, KPMG Inc. as permanent liquidator of Confed;
- (g) “**Noteholders**” refers to the Arm’s Length Creditors holding notes issued by CTSL;
- (h) “**Noteholders’ Representative**” refers to the committees of the Noteholders consisting of UBS Limited and UBS Inc., appointed by the Noteholders by extraordinary resolutions passed in March 1995;
- (i) “**Ordinary Creditors**” refers to the creditors and claimants of Confed, wherever located, who are unsecured and whose claims rank subsequent to the claims of Policyholders;
- (j) “**Policyholders**” refers, collectively, to the Canadian Policyholders and the U.S. Policyholders;
- (k) “**Rehabilitator**” means the Commissioner of Insurance for the State of Michigan both in his capacity as Rehabilitator and in his capacity as liquidator of CLIC(U.S.);
- (l) “**U.S. Policyholders**” refers to policyholders who bought their policies from Confed’s U.S. branch; and
- (m) “**U.S. Settlement Agreement**” means the agreement made as of June 11, 1996 between the Liquidator and the Rehabilitator.

4. All dollar references are to Canadian dollars unless otherwise noted.

II. GENERAL BACKGROUND

5. The financial affairs of the Canadian Estate and CLIC(U.S.) are intertwined because of the operation of the U.S. Settlement Agreement. The results of each have an impact on the other. To assess the interests of the Canadian Estate in respect of the Plan, it is necessary to have an understanding of the entire Confed Estate, including the relationship between the Canadian Estate and CLIC(U.S.), the various claimants of the Confed Estate and the issues surrounding CTSL. This section of the report will therefore address:

- A. The initial insolvency proceedings involving Confed in various jurisdictions;
- B. An overview of the business and liquidation of Confed;
- C. The major provisions of the U.S. Settlement Agreement relevant to the Plan; and
- D. CTSL, and the proceedings involving it.

A. Initial Insolvency Proceedings

(i) *Canada*

6. By Order of this Court dated August 15, 1994 (the “Winding-up Order”), Confed was ordered wound-up, effective August 12, 1994, pursuant to the *Winding-up Act* (as it was then named). By further Order of the same date, the Court appointed the Superintendent of Financial Institutions as provisional liquidator. The Superintendent of Financial Institutions appointed KPMG Inc. (then Peat Marwick Thorne Inc.) as agent to assist in the administration of the liquidation.

7. By Order of this Court dated September 10, 1997, the Superintendent of Financial Institutions was discharged as provisional liquidator of Confed and KPMG Inc. was appointed permanent liquidator.

8. On August 11, 1994, this Court made an Order pursuant to the CCAA with respect to CTSL and certain other Confed subsidiaries. The CCAA proceedings were subsequently abandoned for all of these companies except CTSL.

(ii) United States

9. By Order of Rehabilitation made August 12, 1994 by the Circuit Court for the County of Ingham, State of Michigan (the “Michigan Court”), which Order has been amended from time to time, it was ordered that all of Confed’s businesses in the U.S., including its U.S. branch, should in their respective existing forms cease operations as of August 12, 1994 and become known as CLIC(U.S.), an estate under the management, direction and control of the Rehabilitator. By Order dated October 23, 1996 and pursuant to a plan of rehabilitation approved by such Order, the Michigan Court ordered that CLIC(U.S.) be wound-up and appointed the Rehabilitator as liquidator of CLIC(U.S.).

(iii) United Kingdom

10. CTSL had a wholly-owned subsidiary in the United Kingdom, Confederation Treasury Services (U.K.) plc (“CTSUK”). As a result of the Winding-up Order and the proceedings under the CCAA with respect to CTSL, CTSUK was placed under administration and subsequently into liquidation in the United Kingdom. Peter Beirne and Anthony J. McMahon were appointed as joint liquidators.

B. Overview of the Business and the Liquidation of Confed

11. The Report filed with this Court dated July 15, 1996 in support of a motion for, among other things, approval of the U.S. Settlement Agreement, contains an overview of the business of Confed before the liquidation, its financial status as at the date of the Winding-up Order and some major events within the liquidation. That Report and certain relevant schedules thereto, including the U.S. Settlement Agreement, are attached as Schedule “B”.

12. Schedule “C” to this Report is a chart which sets out the corporate structure, ownership and organization of the various companies known as the “Confederation Life Group of Companies” (the “Confederation Group”), as at August 11, 1994. Confederation Financial Services Limited (“CFSL”) and CFSC were two of the Confed subsidiaries which came under the control of the Liquidator.

C. U.S. Settlement Agreement

13. The U.S. Settlement Agreement was reached in order to balance the goal of equitable distributions to all Policyholders and the need for certainty and expedition in the administration of the Canadian Estate.

14. On August 12, 1996, this Court approved the U.S. Settlement Agreement. On October 23, 1996, the Michigan Court approved the U.S. Settlement Agreement and a Plan of Rehabilitation proposed by the Rehabilitator. On November 27, 1996, the transactions contemplated by the U.S. Settlement Agreement were implemented.

15. The following is a summary of the major provisions of the U.S. Settlement Agreement relevant to the Plan:

- (a) an agreement that the Liquidator would make a request for the return of the U.S. assets pursuant to Section 164 of the *Winding-up Act*, that the U.S. assets would not be transferred in response thereto, and that the consequences of the non-transfer of the U.S. assets would be the deemed forfeiture by U.S. Policyholders of their claims in the Canadian Estate;
- (b) an equitable allocation between the Rehabilitator and the Liquidator of the assets of Confed, including:
 - (i) payment by the Liquidator to the Rehabilitator of \$225 million;
 - (ii) arrangements concerning recoveries from CTSL, including (a) an agreement by the Liquidator to pay the Rehabilitator the amount, if any, by which \$150 million exceeds the Rehabilitator's total recovery from CTSL (the "Liquidator's CTSL Guarantee"); and (b) an agreement by the Rehabilitator to pay the Liquidator the amount by which any payment the Liquidator is required to make in respect of the CTSL-Confed Claim-Over (as defined in paragraph 25(a)(ii) below) exceeds \$150 million, provided that the Rehabilitator will not be required to pay more than he recovers if his constructive trust claim against CTSL is successful (the "Rehabilitator's CTSL Indemnity");
 - (iii) an agreement by the Liquidator that if the claims of Canadian Policyholders are paid in full, any remaining residue will be paid to the Rehabilitator until U.S. Policyholder claims have been paid in full, and agreement by the Rehabilitator that if U.S. Policyholder claims are paid in full, any remaining residue will be transferred or paid to the Liquidator; and
 - (iv) an agreement that if the claims of U.S. Policyholders and Canadian Policyholders are paid in full, any remaining assets shall be placed under the control of the Liquidator and applied in accordance with the priority provisions of the *Winding-up Act*; and
- (c) a full and complete release from the Rehabilitator on his own behalf and on behalf of all U.S. Claimants (as defined in the U.S. Settlement Agreement) in favour of Confed, the Liquidator and the Canadian Estate.

16. In summary, the financial affairs of the Canadian Estate and CLIC(U.S.) are intertwined in that:

- If the Liquidator has funds remaining after paying Canadian Policyholders in full, it will remit them to the Rehabilitator for the payment of U.S. Policyholders;

- If the Rehabilitator has funds remaining after paying U.S. Policyholders in full, he will remit them to the Liquidator for the payment of Canadian Policyholders; and
- Any funds remaining after *all* Policyholders have been paid in full will come under the control of the Liquidator, to be paid to those entitled in accordance with their ranking under the *Winding-up Act*, including Ordinary Creditors. CTSL

(i) Nature of CTSL's Business

17. CTSL is a wholly-owned, indirect subsidiary of Confed. For several years before the commencement of the winding-up of Confed, CTSL performed treasury and corporate finance functions for the Confederation Group, among other activities. These functions included raising and managing capital market funds, providing and managing derivative products and managing cash flows within the Confederation Group.

(ii) CCAA and BIA Proceedings

18. As mentioned above, CTSL was one of the companies granted protection under the CCAA on August 11, 1994.

19. With leave of this Court, a petition for a receiving order against CTSL was issued and filed pursuant to the *Bankruptcy and Insolvency Act* on September 6, 1994.

20. Deloitte & Touche Inc. was appointed monitor of CTSL on September 14, 1994 and became its manager on January 24, 1995. After several extensions of the original stay of proceedings under the CCAA, a plan of compromise and arrangement was filed with this Court on July 26, 1995 on behalf of CTSL by Deloitte & Touche Inc.. A final, amended version was filed on August 3, 1995. At creditors' meetings held on October 26, 1995, the requisite majorities for approval of the plan were not obtained.

21. Pursuant to a receiving order made on December 15, 1995, CTSL was adjudged bankrupt and Richter & Partners Inc. was appointed as trustee in bankruptcy (the "Trustee"). The bankruptcy is deemed to have commenced on September 6, 1994, being the date of the petition.

22. On May 19, 1998, this Court made orders which, among other things, permitted the filing of the Plan.

(iii) Current Financial Position of CTSL

23. According to the Trustee, as at June 30, 1998, CTSL is projected to have liquid assets of approximately \$660 million. It is also asserting claims totalling approximately \$36 million, which are being disputed, including claims against the Canadian Estate of approximately \$34 million, described below. In addition, there are numerous inter-company accounts which are in dispute. CTSL has no other material realizable assets. Therefore, the only possibility for future financial growth in CTSL is the receipt of interest income, and, potentially, any proceeds actually realized if claims are successful. However, significant professional fees are being expended on litigation in various jurisdictions, which may result in a net reduction of CTSL's assets in the future.

24. The following have asserted claims against CTSL:

- (a) The Liquidator, on behalf of both Confed and CFSC (collectively, the "Liquidator's Claim"), including:
 - (i) a claim under a \$75 million promissory note issued by CTSL to CFSC. The Trustee has asserted that this claim should not be paid on the basis of equitable subordination (i.e., that as a subsidiary of Confed, CFSC should have its claims against CTSL subordinated to those of other creditors of CTSL);

- (ii) a claim by Confed in respect of inter-company advances which the Trustee has also asserted should be subordinated to the claims of other creditors; and
- (iii) a claim that the proceeds of repayment of certain loans made to Newcourt Credit Group Inc., which proceeds are currently under the control of the Trustee, are in fact property of Confed;
- (b) The Rehabilitator for, among other things, a constructive trust over all of the assets of CTSL and a sum in excess of \$840 million in debt and damages (collectively, the “Rehabilitator’s Claim”);
- (c) The Arm’s Length Creditors, who are owed approximately \$524 million by CTSL pursuant to derivative contracts, public market obligations, financial guarantees and other obligations, including trade creditors of approximately \$1 million; and
- (d) Parties who have been sued by others and, as a consequence, have made claims-over against CTSL. (Parties asserting claims-over are referred to in the Plan as the “Third Party Creditors”). At the date hereof, the claims-over, which are discussed below, are all unliquidated and contingent.

(iv) Status of the Proceedings Involving CTSL

Ontario Proceedings

25. The following is a summary of the status of the major relevant proceedings in Ontario:

- (a) With respect to the Rehabilitator’s Claim:
 - (i) By Orders of this Court dated April 8, 1996 and December 6, 1996, a trial was directed in respect of the issues arising out of the Rehabilitator’s Claim and certain directions were given in respect thereto;
 - (ii) By Order of this Court dated August 12, 1996, issued in the Confed winding-up proceedings, the Trustee was granted leave to commence a third party proceeding against Confed (the “CTSL-Confed Claim-Over”). The CTSL-Confed Claim-Over arises out of the claims asserted by the Rehabilitator in the trial of issues directed pursuant to the April 8, 1996 Order. The CTSL-Confed Claim-Over is a claim-over against the Liquidator or the Canadian Estate for the same right of trust, constructive trust or other equitable remedy in priority to all other claims asserted

against the assets held by the Liquidator, including claims of Policyholders;

- (iii) By another Order of this Court dated December 6, 1996, the Trustee's claims against Confed were ordered to proceed as a third party claim, and the third party trial of issues was directed to be tried together with the trial of the issues with respect to the Rehabilitator's Claim; and
- (iv) On August 12, 1997, this Court granted in part a motion for production of certain documents by the Trustee against the Rehabilitator and the Liquidator. The Trustee and the Rehabilitator are appealing therefrom. The appeal and certain related issues are scheduled to be heard by the Ontario Court of Appeal on June 10, 1998.

Copies of the Rehabilitator's Statement of Claim, the Trustee's Statement of Defence, the CTSL-Confed Claim-Over and the Liquidator's Defence are attached to this Report as Schedules "D" to "G" respectively.

A trial of issues with respect to the Rehabilitator's Claim and the CTSL-Confed Claim-Over has been scheduled for April 6, 1999. To date, one day of examination for discovery has been held and it is anticipated that at least six more weeks will be necessary. The trial is expected to take three months;

- (b) Claims by the Trustee against Confed or its subsidiaries:
 - (i) The Trustee has commenced an action against CFSL, a subsidiary of Confed not subject to insolvency proceedings, for the sum of \$14 million; and
 - (ii) The Trustee has asserted a claim for \$20 million against the Confederation Real Estate Fund (the "CREF"), a segregated fund administered by Confed. No action has been commenced, however, by consent Order of this Court dated September 12, 1997, the Liquidator was directed to hold the amount of \$22.5 million in separately named interest-bearing instruments on terms to be agreed between the Trustee and the Liquidator and not to finally dissolve, wind-up or terminate the CREF so long as there remains a dispute as between the Liquidator and the Trustee concerning the claim by the Trustee against the CREF.

(These two claims will be referred to in this Report collectively as the "Trustee's CFSL-CREF Claims".)

Michigan Proceedings

26. The Rehabilitator commenced an action in the Michigan Court (the “Michigan Action”) on June 28, 1995 which, as amended, is now against certain former officers and directors of Confed and CTSL (the “Former Officers and Directors”), Ernst & Young, Ernst & Young LLP, Ernst & Young International, Ltd. and Harris Trust and Savings Bank (“Harris Trust”). The Rehabilitator claims damages for, among other things, breach of trust, breach of fiduciary duty and negligence.

27. The Former Officers and Directors, Harris Trust, Ernst & Young and Ernst & Young LLP have commenced third party proceedings against CTSL in the Michigan Action claiming over against CTSL in respect of the Rehabilitator’s claims against them. The following is a summary of the relevant proceedings with respect thereto:

- (a) Pursuant to the April 8, 1996 Order, a contingent claim filed in the bankruptcy of CTSL by Ernst & Young arising out of the Michigan Action was disallowed. Further, applications for leave to add CTSL as a third party in the Michigan Action by Ernst & Young and the Former Officers and Directors (as defendants in the Michigan Action) were dismissed;
- (b) On January 14, 1997, the Ontario Court of Appeal allowed an appeal by Ernst & Young and the Former Officers and Directors, and they were given leave to bring third party proceedings against CTSL in the Michigan Action;
- (c) On May 26, 1997, the Supreme Court of Canada dismissed an application by the Trustee for leave to appeal from the decision of the Ontario Court of Appeal;
- (d) The Former Officers and Directors, Harris Trust, Ernst & Young and Ernst & Young LLP commenced third party proceedings against CTSL in the Michigan Action; and
- (e) In March 1998, CTSL issued counterclaims against the Former Officers and Directors and Ernst & Young in the Michigan Action.

The Trustee has put the Liquidator on notice that it intends to seek leave to bring fourth party proceedings against Confed.

III. CTSL SETTLEMENT

A. Liquidator's Considerations

28. Following the creditors' rejection of the original CTSL plan of arrangement and compromise in October, 1995, the Ontario proceedings discussed above were initiated. With the implementation of the U.S. Settlement Agreement and the evolution of the Canadian Estate and CLIC(U.S.) since then, the Liquidator considered entering into negotiations with respect to CTSL. The Liquidator took into account a number of factors, including:

1. The CTSL litigation;
2. The position of Canadian Policyholders;
3. The position of U.S. Policyholders; and
4. The position of Ordinary Creditors.

(i) CTSL Litigation in Michigan and Ontario

29. Of particular concern to the Liquidator respecting the litigation are the following factors:

- (a) The level of professional activity, and therefore the expenditure of professional fees by the Liquidator is likely to increase dramatically as the trial date in the Ontario proceedings approaches. Further, the Trustee has not yet vigorously pursued the Trustee's CFSL-CREF Claims. The prosecution of such claims will inevitably accelerate, also resulting in increased expenditures of resources and fees by the Liquidator. In addition, if the Trustee seeks leave to add Confed as a fourth party in the Michigan Action, there will be a significant expenditure of fees both with respect to the initial motion and the appeals which will likely ensue whatever the result of that motion;

- (b) The expenditure of professional fees by the Rehabilitator is also likely to increase dramatically as the trial date in the Ontario proceedings approaches. Because of the relationship between the Canadian Estate and CLIC(U.S.) arising out of the U.S. Settlement Agreement, the professional fees being expended by the Rehabilitator could have an impact on the Canadian Estate;
- (c) While the professional fees relating to the CTSL estate and litigation are escalating and will escalate further, the estate of CTSL is not correspondingly growing;
- (d) The litigation surrounding CTSL is extremely complex, involving many complicated issues. The ultimate resolution of any individual issue is uncertain. The uncertainty is compounded by the number of issues, and their interrelationship; and
- (e) Taking into account the complexity and the likelihood of appeals throughout, the major issues in the litigation are not likely to be resolved within the next five years.

30. The Liquidator does not propose to comment on its view of the merits of the various CTSL claims by or against the Canadian Estate because, if the Plan is not implemented, the litigation may still proceed. However, it is clear that, regardless of the outcome of any claim, there can be no reasonable certainty as to the ultimate impact of the litigation, taken as a whole, on the Confed Estate.

(ii) Canadian Policyholders

31. Attached as Schedules “H”, “I” and “J”, respectively, are unaudited, non-consolidated financial statements for the Canadian Estate prepared by the Liquidator to September 30, 1997, December 31, 1997 and March 31, 1998. The Court has passed and approved the accounts of the Liquidator to September 30, 1997 as reflected in the September 30, 1997 financial statements. The Liquidator has not yet sought the Court’s approval of the accounts for the subsequent quarters. **The financial statements must be read in their entirety, including their attached notes.**

32. The financial statements project the ultimate realization for the Canadian Estate. They show an increase in surplus after payment of Canadian Policyholders. The improving results in each quarter reflect favourable transactions which have been completed or may otherwise be taken into account in that quarter, and continuing favourable interest rates and economic activity. However, the Canadian Estate remains subject to considerable risk and uncertainty, which may have a material impact on the ultimate results. Further, the financial statements do not reflect significant contingencies in respect of the CTSL litigation, including the Liquidator's CTSL Guarantee of \$150 million, or in respect of the CTSL-Confed Claim-Over, after taking into account the Rehabilitator's CTSL Indemnity, of \$150 million.

33. In light of these contingencies and other uncertainties surrounding the Canadian Estate, the Liquidator must set an interim distribution percentage at a level which ensures there will be sufficient assets in the future to pay all Canadian Policyholders the same distribution percentage. The present interim distribution percentage for Canadian Policyholders is 90%.

34. Although, as indicated, there remain other uncertainties, given the success and progress being made by the Liquidator in other areas of the liquidation, the need to reserve for the contingencies in respect of the CTSL litigation has become a major impediment to the Liquidator's ability to increase the distribution level to Canadian Policyholders on a timely basis.

35. As evidenced by the financial statements, the Liquidator is increasingly confident that the Canadian Policyholders will ultimately receive full recovery. The settlement of the CTSL issues will both accelerate the timing thereof and increase its certainty.

(iii) U.S. Policyholders

36. As noted above, the Liquidator has an obligation to pay any amounts remaining, after the Canadian Policyholders are paid in full, to the Rehabilitator until U.S. Policyholders are paid in full. Ordinary Creditors are not entitled to receive a distribution until all Policyholders are paid. The Liquidator, therefore, considered the position of the U.S. Policyholders, based on information received from the Rehabilitator.

37. The Rehabilitator informed the Liquidator that whether or not U.S. Policyholders will be paid in full depends on a number of factors, including:

- (a) the outcome of the Rehabilitator's claims against CTSL;
- (b) the outcome of the Michigan Action;
- (c) the cost of transferring the immediate annuities to another insurer through an assumption reinsurance transaction. The immediate annuities have a value of approximately U.S. \$2 billion;
- (d) the timing of payments to U.S. Policyholders holding guaranteed investment certificates on which interest continues to accrue, resulting in a net loss to the estate;
- (e) whether there are any funds after Canadian Policyholders are paid in full available for payment by the Liquidator to the Rehabilitator and, if so, how much; and
- (f) the resolution of significant contingent liabilities.

38. The Rehabilitator has advised the Liquidator that there is now a favourable market for the transfer of the immediate annuities. However, the Rehabilitator requires additional liquid assets to take advantage of the current market. He also requires additional liquid assets to fund payment on the guaranteed investment certificates to prevent further loss to the estate.

39. The Liquidator has indicated its own increasing confidence that Canadian Policyholders will be paid in full. The settlement of the CTSL issues will have a positive impact on CLIC(U.S.) both directly and indirectly through its benefit to the Canadian Estate. Accordingly, a settlement of the CTSL issues increases the possibility that U.S. Policyholders will be paid in full and, therefore, the possibility that there may be a distribution to Ordinary Creditors.

(iv) Ordinary Creditors

40. The Liquidator has not yet done a call for claims. However, based on the information currently available to it, including the books and records of Confed and the Liquidator's experience in the liquidation to date, the general categories and magnitude of claims of Ordinary Creditors are:

- (a) Commercial Paper, approximately \$200 million;
- (b) Other, approximately \$150 million;
- (c) Potential CTSL-related, including on account of Confed Guarantees of the Arm's Length Creditors' claims of approximately \$480 million, intercorporate debt of approximately \$750 million, which is the subject of litigation, and sums allegedly owing to CTSUK of approximately \$55 million (which has now been acquired by CTSL). The Liquidator has not recorded all potential CTSL-related debt in the financial statements; and
- (d) Subordinated debt of approximately \$260 million.

41. A number of significant and complex issues must be resolved before it can be determined whether the claims of Policyholders will be satisfied so that there will be funds available for Ordinary Creditors. However, even if funds become available, assuming the subordinated debt is subordinated to the claims of Ordinary Creditors in accordance with its

terms, the Liquidator is of the view that there is no realistic possibility of recovery by holders of subordinated debt.

(iv) *Summary*

42. Considering that:

- (a) Both the Canadian Estate and CLIC(U.S.) are progressing well. The economies in both countries are favourable at this time, but there is no certainty as to how long such conditions will continue; and
- (b) The litigation surrounding CTSL is complex and there can be no certainty as to its ultimate impact on the Confed Estate. It will take at least five years to resolve;

the Liquidator concluded that both the Canadian Estate and CLIC (U.S.) would benefit from an early settlement of the CTSL issues, which could provide both certainty and an enhanced ability to take advantage of the present economic conditions.

43. Based on all the foregoing, the Liquidator decided to attempt to settle the outstanding issues by engaging in negotiations with the Rehabilitator, the Noteholders' Representative and the Trustee.

B. Original Terms of Settlement

44. On November 24, 1997, the Rehabilitator, the Liquidator and the Noteholders' Representative agreed on the terms of settlement attached hereto as Schedule "K" (the "Original Terms of Settlement").

45. As contemplated by the Original Terms of Settlement, the parties commenced negotiation of a plan to be filed under the CCAA respecting CTSL. The Liquidator filed a

report dated December 9, 1997 with this Court in connection with a motion returnable December 12, 1997 for approval of the Original Terms of Settlement.

46. On December 10, 1997, the Noteholders' Representative advised the Liquidator and the Rehabilitator that there would be difficulty in obtaining the necessary support from the Arm's Length Creditors for the plan as it was then contemplated. In particular, the Noteholders' Representative stated that the Arm's Length Creditors considered the proposed payment to the Rehabilitator as compensation for a damages claim on account of the expected shortfall to U.S. Policyholders. Therefore, from CTSL's perspective, if there were any residue after Policyholders were paid in full, CTSL would have made an overpayment and the Ordinary Creditors would receive a windfall. The Noteholders' Representative advised that an adjustment mechanism to allow for repayment out of Confed residue to CTSL would be required if a plan were to succeed.

47. The Liquidator, therefore, withdrew its motion for approval. However, all parties confirmed their commitment to continue discussions with the goal of reaching a satisfactory settlement which had a reasonable prospect of being implemented.

IV. CTSL PLAN

48. The Liquidator, the Rehabilitator, the Noteholders' Representative and the Trustee engaged in further extensive negotiations resulting in the Plan. Attached as Schedules "L", "M" and "N" are copies of letters from the Rehabilitator, the Noteholders' Representative and the Trustee, respectively, indicating their support for the Plan. (The schedule to each letter has not been included). A majority in number of the claimants of CTSUK, who hold notes issued by CTSUK and guaranteed by CTSL (the "CTSUK Claimants"), representing over 80%

in value of their claims, have also agreed to support the Plan. The Inspectors of CTSL unanimously approved the filing of a plan of arrangement in substantially the form of the Plan on May 7, 1998.

A. Summary of Terms of the Plan

49. The following is a summary of the key terms of the Plan:

- (a) The Trustee will act as Administrator for purposes of the Plan;
- (b) On implementation of the Plan, the Arm's Length Creditors will receive distributions from CTSL assets and the assignment of proceeds from the Liquidator's Claim and from the Contribution Amount (as defined below), being, in the aggregate, at least what is referred to in the Plan as the "ALC Minimum", which is the greater of
 - (i) \$371.5 million; and
 - (ii) the sum of \$2.5 million plus 70¢ on the dollar of the total allowed claims of the Arm's Length Creditors;
- (c) The Rehabilitator will be deemed to have a claim equal to the total allowed claims of all Arm's Length Creditors. On implementation of the Plan, the Rehabilitator will receive at least what is referred to in the Plan as the "Rehabilitator's Minimum", being \$305 million;
- (d) The Liquidator is deemed to have a single claim for \$75 million in respect of the Liquidator's Claim and will file no other claims. The Liquidator's Claim will rank and share equally with the claims of the Rehabilitator and the Arm's Length Creditors;
- (e) The Liquidator will assign a portion of the proceeds of the Liquidator's Claim to the Noteholders in recognition of claims they have asserted arising out of or in connection with subordination provisions contained in guarantees of CTSL indebtedness given by Confed to the Noteholders, resulting in a differential in recovery between the Noteholders and the other Arm's Length Creditors of 3.75% of the Noteholders' proven claims;
- (f) The Liquidator will assign the balance of the proceeds of the Liquidator's Claim to the Arm's Length Creditors and will also pay to the Administrator the sum of \$25 million (the "Contribution Amount") which will be distributed as follows:

- (i) firstly, to the Arm's Length Creditors and/or the Rehabilitator to meet the ALC Minimum and the Rehabilitator's Minimum respectively;
 - (ii) secondly, out of any remaining amounts, the next \$1 million to the Arm's Length Creditors; and
 - (iii) thirdly, any amounts remaining thereafter to be divided between the Arm's Length Creditors and the Rehabilitator by paying 53% thereof to the Arm's Length Creditors and 47% thereof to the Rehabilitator;
- (g) The Plan will implement settlements reached between the Trustee, the CTSUK Claimants and the liquidators of CTSUK, resulting in the CTSUK Claimants claiming in the CTSL estate for 19% of their CTSUK notes, as set out in the Plan;
- (h) After implementation of the Plan, if Policyholders are paid in full and there are available funds in the estate of Confed (the "Confed Residue"), CTSL will be entitled to share in distributions therefrom in the following manner:
 - (i) none of the first \$20 million will be payable to CTSL;
 - (ii) of the next \$155 million, 75% will be payable to CTSL; and
 - (iii) of any amounts in excess of \$175 million, 50% of such excess will be payable to CTSL;
- (i) CTSL will issue "Residue Certificates" on Plan Implementation to the Arm's Length Creditors, being instruments evidencing an entitlement to share in the amounts payable to CTSL from the Confed Residue and any other remaining realization in the CTSL estate in the same proportion as the allocation of the ALC Distribution to the proven claims of the Arm's Length Creditors, the maximum payable thereunder being the excess of the aggregate proven claims of the Arm's Length Creditors plus, among other things, interest thereon calculated in accordance with the *Bankruptcy and Insolvency Act* over their distribution under the Plan;
- (j) UBS Inc. has acted as the Noteholders' Representative. It will be appointed representative of the holders of the Residue Certificates (the "Residue Certificate Holders' Representative") with the primary mandate to produce information for the holders of Residue Certificates concerning the financial condition of the Confed Estate. It will be remunerated from a \$2.5 million fund to be established from the ALC Distribution. In addition, the Residue Certificate Holders' Representative is entitled to a success fee calculated in accordance with the Plan;
- (k) The Trustee and the Arm's Length Creditors will assign any and all claims and proceeds of claims against the Third Party Creditors and certain other claims to the Rehabilitator and the Liquidator jointly or to a vehicle to be established by them;

- (l) As discussed further in paragraphs 52 to 56 below, orders of the appropriate courts will be sought to, among other things, provide that judgements in favour of the Third Party Creditors against CTSL (a "Claim-over Judgment") will be satisfied by a credit which will decrease any judgment against the Third Party Creditors by the Rehabilitator or the Liquidator;
- (m) The Trustee will maintain reserves in respect of certain costs and priority claims referred to as "Trustee Costs". Any amounts that are not required will be distributed to the Rehabilitator and to CTSL for distribution to the Residue Certificate Holders;
- (n) The Plan is subject to certain conditions, including that it be implemented by no later than July 31, 1998; and
- (o) Besides the approvals required by the provisions of the CCAA, the Plan is subject to the approval of this Court and of the Michigan Court.

50. Releases will be exchanged by various parties. In addition, CTSL will be barred from seeking any recovery or pursuing any right, action or claim against Confed. The Plan will include provisions barring the policyholders and creditors of Confed and CTSL from seeking any recovery from the estate of CTSL or the Trustee other than under the Plan itself, and barring the Arm's Length Creditors from seeking any recovery from the Liquidator, Confed, CFSC and CFSL and their advisors, other than under the Plan itself.

51. The Plan will result in a settlement of the litigation currently pending in this Court (and discussed above in paragraph 25) between the Rehabilitator as plaintiff, the Trustee as defendant and the Liquidator as third party. The trial is scheduled for three months commencing in April, 1999.

B. Discussion of Certain Terms of the Plan

(i) Litigation Orders

52. The Plan includes a mechanism to deal with successful claims-over against CTSL by the Third Party Creditors by providing for certain indemnities and a procedure for applying a credit against judgment.

53. In the ordinary course, if the Rehabilitator obtained a judgment against one of the Third Party Creditors, and that Third Party Creditor was successful on its claim-over against CTSL, the Third Party Creditor would have to pay the Rehabilitator for the full amount of the Rehabilitator's judgment, but would receive a distribution from the estate of CTSL. The Plan provides that if the Rehabilitator obtains judgment against a Third Party Creditor, and that Third Party Creditor is successful on its claim-over, the distribution to which the Third Party Creditor would otherwise have been entitled out of the CTSL estate will not be made. Instead, the Rehabilitator will reduce his judgment by that amount. Accordingly, the Third Party Creditors will be in the same net position as if there were no Plan.

54. The Plan also provides for an indemnity in favour of CTSL and the Trustee, from the Liquidator or the Rehabilitator, as the case may be, in respect of claims-over.

55. The described credit mechanism is to be implemented by way of Court order in each of the Canadian and U.S. liquidations, which the Liquidator will ask the Court to grant on the return of this motion.

56. To date, the Liquidator has not commenced any actions which would result in a Claim-over Judgment.

(ii) Arrangements between the Liquidator and the Rehabilitator

57. It became clear that no settlement could be achieved unless the assets of CTSL were supplemented. The Liquidator considered the relative financial positions of the Canadian Estate and CLIC(U.S.) and the obligations each has to the other under the U.S. Settlement Agreement. The Liquidator considered it appropriate to pay the Contribution Amount in light of the benefits of the settlement to the Canadian Estate. However, consistent with the approach taken in reaching the U.S. Settlement Agreement, the Liquidator and the Rehabilitator agreed that, depending on the ultimate financial position of CLIC(U.S.), it was reasonable for the Rehabilitator to return the Contribution Amount to the Liquidator out of one-half of the net proceeds, if any, of the Rehabilitator's claims against the Former Officers and Directors.

58. Sharing of proceeds of the assigned claims against the Third Party Creditors by the Liquidator and the Rehabilitator will be as they may agree, depending on the ultimate respective financial position of the Canadian Estate and CLIC(U.S.).

(iii) Confed Residue

59. As discussed in paragraph 46, the Noteholders' Representative sought an adjustment mechanism to provide repayment to CTSL of amounts distributed to the Rehabilitator in the event that there was residue after Policyholders were paid in full. The sharing of the Confed Residue is that adjustment mechanism. It is an essential part of the compromise which enables CTSL to make an immediate distribution at a level acceptable to the parties. Additionally, claims by the Arm's Length Creditors, CTSUK and CTSL represent significant potential Ordinary Creditor claims. These claims are being released, thereby benefitting the other Ordinary Creditors. The Liquidator therefore also views the sharing

formula for the Confed Residue to be reasonable when considered together with the other benefits of the Plan.

60. After Plan implementation, UBS Inc., presently the Noteholders' Representative, will act as the Residue Certificate Holders' Representative. As such, UBS Inc. will be the only person with responsibility for making disclosure to the holders of the Residue Certificates concerning the Confed Estate. UBS Inc., as Residue Certificate Holders' Representative, will liaise with the Liquidator with respect to the financial condition of the estate in a manner to be agreed with the Liquidator. The manner of such liaison will be subject to the approval of this Court. The fee to UBS Inc. for carrying out this role will be deducted from the distribution to the Arm's Length Creditors and paid to UBS Inc. as set out in the Plan. The payment arrangements were incorporated at the request of the Noteholders' Representative and certain of the Arm's Length Creditors representing at least 20% of the claims. Such remuneration will not be payable from, or represent a liability of, the Confed Estate.

(iv) Barring of Claims of CTSL

61. The Arm's Length Creditors and the Trustee required that the Plan include provisions barring Policyholders and creditors of Confed from claiming in the CTSL estate. The Liquidator understands the Trustee's desire for certainty, given the complexity of the issues that have surrounded the litigation and the fact that there will be a distribution of all CTSL assets under the Plan as contemplated. The Liquidator is of the view that these provisions cause no prejudice to the policyholders and creditors of Confed who, in the Liquidator's view, do not have independent claims against CTSL and who have not filed claims in response to calls for claims by the Trustee.

C. Impact of CTSL Plan on Canadian Estate

62. The Plan will result in:
- (a) the release of the Liquidator's obligations to the Rehabilitator under the Liquidator's CTSL Guarantee of \$150 million;
 - (b) the release by CTSL of the Trustee's CFSL-CREF Claims, totalling \$34 million;
 - (c) the release by the Trustee of the CTSL-Confed Claim-Over for which the Liquidator had received the Rehabilitator's CTSL Indemnity for liability of the Liquidator in excess of \$150 million;
 - (d) the release by the Noteholders of any rights or claims against Confed which the Noteholders may have arising out of or in connection with the subordination provisions contained in guarantees of CTSL indebtedness given by Confed to the Noteholders, except as set out above;
 - (e) the release of Confed by the Arm's Length Creditors and CTSUK;
 - (f) assignment of the Liquidator's Claim, having a value which depends on the ultimate outcome of the CTSL litigation and the attendant distribution, to the Arm's Length Creditors;
 - (g) payment of the Contribution Amount to a maximum of \$25 million, but in respect of which the Liquidator may receive certain proceeds from the Rehabilitator;
 - (h) a release by CTSL of any claims against the first \$20 million of Confed Residue;
 - (i) payment to CTSL of 75% of the next \$155 million of Confed Residue; and
 - (j) the appointment of a representative of the Arm's Length Creditors whose mandate will be to liaise with the Liquidator with respect to the financial condition of the Confed Estate in a manner to be agreed with the Liquidator. The manner of such liason will be subject to the approval of this Court.

D. Benefits of CTSL Plan

63. The Liquidator is of the view that the Plan has the following benefits:
- (a) It removes significant contingent obligations of the Canadian Estate;

- (b) It gives the Liquidator and the Rehabilitator the necessary certainty and liquidity to take advantage of the present favourable economic conditions in the U.S. and Canada;
- (c) It increases the likelihood that the Canadian Policyholders will be paid in full on a timely basis. In particular, on Plan implementation, the Liquidator expects to increase the interim distribution percentage by 5%, having a value of approximately \$175 million;
- (d) The Rehabilitator considers the Plan to be beneficial to U.S. Policyholders. The Liquidator concurs in this view. As it becomes more likely that Canadian Policyholders will be paid in full and that there will be a surplus paid to the Rehabilitator, there is a convergence of interest between the Liquidator and the Rehabilitator, particularly in minimizing litigation costs; and
- (e) Since the Ordinary Creditors will only receive any recovery if there is a residue remaining after all Policyholders are paid in full, it is also beneficial to them to have litigation costs minimized and to increase the likelihood of full recovery to all Policyholders on a timely basis. In addition, the release of significant contingent claims against Confed coupled with the payment of the first \$20 million of Confed Residue solely to the Ordinary Creditors, excluding the Arm's Length Creditors, CTSL and CTSUK, will increase their percentage return.

V. REPRESENTATIVE COUNSEL AND SERVICE

64. The Liquidator is of the view that the Plan is in the best interests of the Canadian Estate. However, in recognition of the different classes of persons having interests in the Canadian Estate, the Liquidator sought the appointment by this Court of counsel to represent those classes who may not be specifically represented.

65. On May 19, 1998, this Court made an order:

- (a) appointing James H. Grout to represent the interests of Canadian Policyholders;
- (b) appointing Nancy J. Spies to represent the interests of the Ordinary Creditors; and
- (c) giving directions for the service of the notice of this motion.

Attached as Schedule "O" hereto is a copy of the Order.

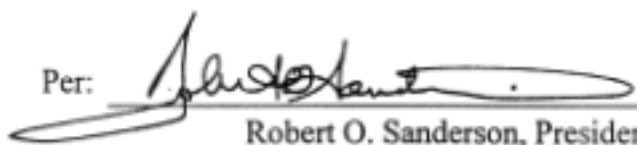
VI. RELIEF SOUGHT

66. The Liquidator, therefore, respectfully requests that this Honourable Court approve and authorize the Liquidator's entry into, participation in, and voting for the Plan.

ALL OF WHICH IS RESPECTFULLY
SUBMITTED

KPMG INC., the Liquidator of Confederation Life
Insurance Company

Per:



Robert O. Sanderson, President

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