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**Electronically Filed**
**On**
**April 21, 2006**



**UNITED STATES BANKRUPTCY COURT**

**NORTHERN DISTRICT OF CALIFORNIA**

**OAKLAND DIVISION**

In re:

WESTERN ASBESTOS COMPANY, WESTERN MACARTHUR CO., and MACARTHUR CO.,

Debtors.

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

Chapter 11

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

Date: June 5, 2006
Time: 2:00 p.m.
Place: 1300 Clay Street, Room 300
Oakland, CA 94604

Western Asbestos Settlement Trust by and through its counsel, Janet L. Chubb, Esq., of Jones Vargas, hereby files its Second Annual Report and Accounting, which is attached.

DATED this 21st day of April, 2006.

JONES VARGAS

By: //s// Janet L. Chubb
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# SECOND ANNUAL REPORT AND ACCOUNTING OF WESTERN ASBESTOS SETTLEMENT TRUST

The Trustees of the Western Asbestos Settlement Trust ("Trust") hereby submit this Second Annual Report and Accounting ("Annual Report") covering Trust activities occurring between January 1, 2005 to and including December 31, 2005 ("Accounting Period"). The Annual Report 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, Western MacArthur Co., and MacArthur Co.,* Case no. 02-46284-T through 02-46286-T, Jointly Administered Under No. 02-46284 T, in accordance with the Second Amended Joint Plan of Reorganization ("Plan"),[1] 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 in Support of Motion to Approve and Settle Western Asbestos Settlement Trust's Second Annual Report, the Audited Financial Statements and the Claim Report as described in paragraphs 5 and 6 *infra*.

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' Representative's Motion for Approval of Appointment of Trustees for the Western Asbestos Settlement Trust, this Court approved the appointment of SANDRA R. HERNANDEZ, M.D., JOHN LUIKART and STEPHEN M. SNYDER as Trustees of the Trust, who have acted in that

[1] The Annual Report is filed in compliance with the following Plan documents: 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 the Western Asbestos Settlement Trust Agreement ("Trust Agreement"), Western Asbestos Settlement Trust Bylaws ("Trust Bylaws"), Case Valuation Matrix ("Matrix), Trust Distribution Procedures ("TDP") and other controlling documents approved by this Court.

capacity since that time. Unanimously elected in 2004 by the Trustees, Stephen M. Snyder continued to serve as Managing Trustee throughout 2005.

3. Tax Obligations: Section 2.2(b) of the Trust Agreement requires the Trustees to file income tax and other returns and statements in a timely manner, and comply with all withholding obligations as legally required, including fulfilling requirements to maintain its status as a Qualified Settlement Fund. The Trust has complied with state and federal tax obligations on a quarterly basis based upon the advice of the Trust's certified public accountants, Sitkoff /O'Neil Accountancy Corporation. The 2005 federal tax return must be filed on or before September 15, 2006. Nevada has no state income tax, thus the Trust, which resides in Nevada, is not obligated to pay state income taxes. Although the Trust is not subject to tax in California, the Trustees decided it would be prudent to file a tax return in California, attaching a copy of the Trust's 2005 federal tax return but showing no California state tax liability.

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

> The Trustees shall cause to be prepared and filed under seal with the Bankruptcy Court . . . an annual report containing financial statements of the Trust (including, without limitation, a statement of the net claimants' equity of the Trust as of the end of such fiscal year and a statement of changes in net claimants' equity for such 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 [in this Amendment].[2]

The Trust is required by the Internal Revenue Code to conduct business on a calendar-year basis. Therefore, all reports attached to this pleading cover the period between January 1, 2005, and fiscal year end, December 31, 2005.

5. Financial Report: In accordance with the requirements of Section 2.2(c)(i) of the Trust Agreement, the Trust has caused its accounts to be audited by independent Certified Public

[2] *See infra* ¶ 19 for a discussion of the Amendment.



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Accountants. The Trust's audited financial statements ("Audited Financial Statements") are attached as Exhibit "A". These include a Statement of Net Claimants' Equity, a Statement of Changes in Net Claimants' Equity, a Statement of Cash Flows and explanatory Notes. The Statement of Net Claimants' Equity reflects total assets of the Trust (at market value and on the other comprehensive bases of accounting adopted by the Trust, as of December 31, 2005) that were available to pay claims and operate the Trust. The Net Claimants' Equity is equivalent to Retained Earnings on a corporate balance sheet. The Statement of Changes in Net Claimants' Equity reflects, on an accrual basis, the initial funding of the Trust, investment income received and accrued, and unrealized gains less disbursements that the Trust paid or accrued during the Accounting Period. The Statement of Cash Flows reflects the actual monies received and expended by the Trust on a cash basis during the Accounting Period. Among other things, the attached Audited Financial Statements show that the Trust began the Accounting Period with Net Claimants' Equity of $1,253,050,316 and ended the Accounting Period with Net Claimants' Equity of $1,161,412,077 after making payments to claimants totaling $50,718,012, realizing investment income (net of investment fees) of $35,089,663, and paying expenses (including legal fees and federal income taxes) of $11,540,674.

6. Claim Report: Section 2.2(c)(ii) of the Trust Agreement provides that along with the financial statements, the Trust shall file with the Court a report containing a summary regarding the number and type of claims disposed of during the period covered by the financial statements ("Western Asbestos Settlement Trust Claim Report As Of December 31, 2005" or "Claim Report") attached as Exhibit "B". During the Accounting Period the Trust received 1,704 claims, paid and closed 1,108 claims and made settlement offers on an additional 161 claims.

During the Accounting Period, the Trust has paid a small number of pre-petition

Default, Settlement and Matrix claims (hereafter "Pre-Petition Liquidated Claims").[3] Section 5.4 of the TDP provides that the Trust shall pay Pre-Petition Liquidated Claims "[a]s soon as practicable after the Effective Date". The vast majority of these claims were paid in 2004. During the Accounting Period, however, the Trust received 24 additional releases for Pre-Petition Liquidated Claims and paid out a total of $399,627.[4]

7. Biannual Review: Section 5.7(b) of the TDP requires that the Trust shall review bi-annually (or more frequently at the request of the TAC or the Futures' Representatives) filed claims, paid claims, average payments and disallowed claims, sufficient to allow an estimation of the adequacy of the Trust fund to compensate claimants as compared to the current claims forecast. In April 2005 and October 2005, the Trust prepared a biannual report in compliance with this provision and presented it for discussion with the Trustees, TAC and Futures' Representatives.

8. Trustees' Meetings: Article II, Section 4 of the Trust Bylaws provides that the Trustees shall meet in Nevada, or a state other than California, at least once per quarter as soon as practicable after the Effective Date, and on the anniversary of the Effective Date. The Trustees held seven meetings during the Accounting Period (on February 28, 2005, March 23-24, 2005, April 21-22, 2005, June 13, 2005, September 8, 2005, October 20, 2005, and December 14-15, 2005). All meetings were held outside of California.

9. Public Inspection: In compliance with Sections 2.2(c)(ii) and 2.2(c)(iii) of the Trust Agreement, the Claim Report has been sent to the Approving Entities, comprised of the Trust Advisory Committee ("TAC") and the Futures Representative, and the Office of the United States Trustee with responsibility for the Northern District of California, and has been made

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[3] See this Court's February 3, 2004 Memorandum of Decision After Confirmation Hearing.

[4] By December 31, 2005, the Trust had paid 99% of all pre-petition liquidated claims pursuant to the TDP. The Trust awaits the proper release documents for 39 remaining claims.

available for inspection by the public in accordance with procedures established by this Court.

10. Budget and Cash Flow Projections: Section 2.2(d) of the Trust Agreement requires the Trustees to cause to be prepared a budget and cash flow projections prior to the commencement of each fiscal year covering such fiscal year and the succeeding four fiscal years. The Trustees approved the 2006 budget and the required four-year budget and cash flow projections on December 15, 2005. Pursuant to the Trust Agreement these were provided to the Approving Entities and the Debtors. The budget for operating expenses in 2006 is $7,359,600 (net of claimant payments which are budgeted for $71 million, and net of tax payments which are budgeted for $1,565,000).

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

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

In 2004 the Maximum Annual Payment ("MAP") was set at $90 million. The Trust paid $6.7 million to claimants in 2004. In 2005 the remainder of the 2004 MAP, $83.3 million, was set as the MAP for 2005. At the December 15, 2005 Trustees' meeting, the Trustees set the MAP at $90 million for claim payments to be made in 2006.[5]

12. Custodial Accounts: Wells Fargo Bank, N.A., continues to act as custodian for the Trustees in connection with Trust investments.

13. Set Aside Fund: The Trust continues to maintain a separate account with Wells

[5] At the April 20, 2006 Trustees' meeting, the 2006 MAP was increased from $90 million to $120 million after taking into account i) the fact that MAPs set for 2004 and 2005 were not exhausted by actual claims paid by the Trust in those years, and ii) exigent circumstances that will be described in detail in the 2006 Annual Report.

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Fargo entitled "Claims Defense Fund for Ordway and Milwaukee, Van Packer, and Mac Arthur and Western Mac Arthur" as required by the Trust Documents. This account holds the legally required amount in cash and securities for certain indemnification obligations.[6] No claims were made against any of these indemnity funds during the Accounting Period. Accordingly, these funds remain intact at their original levels of funding.

14. Indemnity Fund: Section 4.6 of the Fourth Amended Trust Agreement (hereafter Section 4.6) provides that the Trust shall indemnify the Trustees, the Trust's officers and employees, the Futures Representative, the TAC and each of their respective agents. The Trustees, the Futures Representative, the TAC and their respective agents have a first priority lien upon the Trust's assets to secure the payment of any amounts payable to them pursuant to Section 4.6.

After significant research utilizing an expert in the insurance industry, the Trust determined in 2004 that not only was insurance prohibitively costly (the annual cost of the policy was $468,000), but the policies available would not cover all matters the Trust was seeking to insure. As a result of the findings, and upon the recommendation of the expert, an indemnity fund

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[6] The indemnification obligations are as follows:

1. Section 2.5 of the Trust Agreement provides that "for a period of ten years following 'substantial consummation' of the Plan, the Trustees shall make available to Western Mac Arthur and Mac Arthur funds in an amount not to exceed $5,000,000" aggregate for defense of claims potentially covered by the insurance policies USF&G issued to Western Asbestos, described in the form of "Stipulation and Order Re: Determination of Certain Issues and Stay of Trial Against USF&G", entered in *Western Mac Arthur Co., et al. v. USF&G, et al.,* Case No. 828101-2, Alameda Superior Court.

2. Pursuant to the Settlement Agreement with Hartford Accident and Indemnity Company ("Hartford") approved in connection with the Plan, the Trust is required to set aside $10 million, plus after-tax earnings, if any, for a period of twenty years to provide indemnity to the parties to the settlement for claims that otherwise may have been covered by Hartford's insurance policies.

3. Pursuant to section V.5.1(a) of the Hartford Settlement Agreement and ancillary agreements, the Trust set aside $500,000 to indemnify Van Packer in exchange for its release given in connection with Mac Arthur's insurance settlements.

in the amount of $40 million[7] was established. All interest earned by the fund is returned to the Trust quarterly. During the accounting period, no claims were made against the fund and no money was paid from the fund.

15. Special Budget Fund: A Special Budget fund, approved by this Court in 2005, resides at Wells Fargo to pay anticipated operating and litigation expenses of the Trust, including but not limited to expenses arising under the Trust Agreement and the Indemnity Agreement, in the event federal tort reform legislation that would seek to confiscate Trust accounts such as the FAIR Act (S.B. 852) passes. The Special Budget Fund was established to permit the Trust to continue to operate on a limited basis so that if and when the Act is overturned, the Trust will be able to begin paying claims with minimal interruption and expense. The Special Budget Fund was approved in this Court's May 18, 2005 Order to Approve and Settle Western Asbestos Settlement Trust's Annual Report and Accounting, Audited Financial Statements, and Claim Reports; and to Approve Resolution Regarding the FAIR Act ("May 18, 2005 Order"). In keeping with the May 18, 2005 Order and the Resolution re: the FAIR Act, the Managing Trustee has reported separately regarding the disposition and status of these monies at each regular meeting in 2005 to determine whether to increase or decrease the amount in this fund. No changes were recommended to adjust the amount in the fund during the Accounting Period. As of December 31, 2005, the Special Budget Fund held $30,225,818.[8]

16. Settlement Fund Control Account and Control Agreements: Section 4.7 of the

[7] The establishment of the fund was described in detail in the Trust's First Annual Report and Accounting.

[8] For reasons described in paragraph 20 *infra*, during the Accounting Period, $2.2 million was paid to the firm of Gibson Dunn & Crutcher LLP ("GDC") from the Special Budget Fund. When GDC withdrew its representation, it returned $2,113,102 to the Trust. A subsequent $1.4 million was paid to the Cooper & Kirk PLLC in February 2006 to take over from GDC and the difference of $713,102 was replaced in the Special Budget Fund. In addition, $4.2 million was paid from the Special Budget Fund to Morgan Lewis & Bockius LLP as a retainer, which amount is fully intact as the Trust has continued to pay Morgan, Lewis & Bockius bills as they become due.

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Fourth Amended Trust Agreement grants to the Trustees, the Futures Representative and the TAC a security interest in all of the assets of the Trust to secure the indemnification obligations of the Trust to such parties. The Trustees, the TAC, the Futures Representative and their agents have a security interest in the assets of the Trust, including, but not limited to the five Wells Fargo sub-accounts, including the Set Aside Fund, Indemnity Fund, Operating Account, Special Budget Fund and the Settlement Fund Account ("Specific Funds"). The Trust has entered into five separate Control Agreements with respect to the funds in these five accounts. The security interests of the indemnified parties are perfected through Control Agreements. Under each of these Control Agreements, Wells Fargo acts as the custodian of the funds and holds the funds to perfect the rights of various indemnitees, beneficiaries and/or secured parties who may have an interest in such funds. Under each of the Control Agreements an individual is appointed to act on behalf of the indemnitees, the beneficiaries or the secured party (collectively the "Managing Secured Party"). The Managing Secured Party for each of the Control Agreements is Stephen M. Snyder, Managing Trustee of the Western Trust. Until the Custodian, Wells Fargo, is notified otherwise by the Managing Secured Party, the Trust may give instructions to the Custodian to continue to make draws on the various accounts. But, if the Managing Secured Party gives notice of a claim, then the Custodian cannot make further disbursements from the respective account without a court order or the consent of the Managing Secured Party.

17. Resolution Regarding Payment Percentage: Section 4.2 of the TDP provides that, commencing on the first day of January, the Trustees shall reconsider the Payment Percentage to assure that it is based on accurate current information and may, after such reconsideration, change the Payment Percentage if necessary with the consent of the TAC and the Futures Representative. In its April 14, 2004 Order Under Fed.R.Bankr.P. 9019 Approving Compromises with Settling Insurers, this Court approved a payment percentage to Western Asbestos claimants of 31.5

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percent. At the June 13, 2005 Trustees' Meeting, the Chairman of the TAC requested reconsideration of the payment percentage. Soon thereafter, the TAC and the Futures Representative each retained experts to evaluate the advisability of raising the payment percentage. Expert reports and their subsequent revisions were reviewed and discussed by the Trustees, the TAC and the Futures Representative throughout the Fall of 2005. The Trustees also retained an expert to evaluate the expert reports that the TAC and Futures Representative had commissioned. On February 6, 2006, after full consideration of the experts' opinions and written evaluations, and lengthy debate and discussion among the parties over several months, the Trustees recommended the payment percentage be adjusted to 34.2 percent. The Trustees' recommendation was based upon the report and conclusions of their expert, Dr. Thomas Vasquez from Analysis Research Planning Corporation, dated January 18, 2006. The TAC and the Futures Representative consented to the adjustment.

18. Resolution Regarding Inflation Adjustment: The original payment percentage approved by this Court was based upon projections of future claims costs adjusted annually for inflation. In the interests of treating all claimants equitably in accordance with the Plan, the Trustees therefore recommended all payments made during each calendar year include a Cost of Living Adjustment for inflation based upon the Federal Bureau of Labor Statistics' *Consumer Price Index for Urban Wage Earners and Clerical Workers* (CPI-W) announced in October each year. The TAC and the Futures Representative consented to this adjustment. Consequently, as of January 1, 2006, all payments made during the calendar year will be increased by 3.4% to account for inflation. The resolution also states that in each succeeding December, the Trust shall review the CPI-W from the previous October and make a determination as to whether that adjustment shall be included in payments made in the next year.

19. Amendments to the Trust Agreement: The Trustees approved two amendments to

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the Trust Agreement during the Accounting Period:

(1) Third Amendment to and Complete Restatement of the WAST Agreement, dated February 28, 2005. As explained in more detail in the Third Amendment and Restatement and in "Notes to Financial Statements", A.2, the Trust's financial statements are prepared using special-purpose accounting methods that depart from Generally Accepted Accounting Principles (GAAP) in certain instances, in order to better disclose the amount and changes in net claimants' equity. After discussions with the Trust's accountants and legal counsel in March 2005, the Trustees and the Approving Entities amended the Trust Agreement to employ specialized accounting principles in certain instances due to the "special purpose" nature of the Trust.

(2) Fourth Amendment to and Complete Restatement of Western Asbestos Settlement Trust Agreement, approved April 22, 2005, revised the Trust Agreement to remove the requirement that the Annual Report be filed under seal, thus allowing it to be noticed publicly. It additionally provides that the Trustees shall file materials under seal which they determine should remain confidential, and that these are made available to the TAC and the Futures' Representative.

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

(1) *Stephen Snyder, Sandra Hernandez and John Luikart in Their Capacity as Trustees of the Western Asbestos Settlement Trust v. The Bank of New York Company, et al.*, Alameda Sup. Ct., November 9, 2004, Case No. BG04184438, and removed by Defendant Bank of New York on Dec. 9, 2004 to U.S. Dist. Ct., N.D.Cal. (Oakland Division), Case No. 04-04372, under jointly administered Case No. 02-46284T. The Trustees retained Pinnacle Law Group to represent them in the *Bank of New York* case under a contingency fee agreement in which the stated fee, as a percentage of any recovery, escalated over time to thirty percent.

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1. The complaint alleged that the Bank of New York unlawfully charged excessive fees when acting in a fiduciary capacity as the escrow holder of settlement funds before the establishment of the Trust. Also, as part of its fiduciary obligation, Bank of New York ("BONY") was required to send an invoice to USF&G for payment of the fees but instead improperly took those fees from the escrow accounts without authority to do so. The Trust also alleged that BONY engaged in self-dealing and fraud in contravention of its duties as a fiduciary under the Escrow Agreements. In June 2005, BONY remitted $4,114,051 to the Trust. This amount was the sum of all the Investment Charges improperly deducted plus investment interest that BONY estimated would have been earned had it not deducted the charges. On September 28, 2005, this Court issued a Memorandum of Decision denying Plaintiffs' motion for partial summary judgment on the sixth claim for relief in the First Amended Complaint. In January 2006 the parties submitted the dispute to mediation and reached an agreement in principal under which the Trust will pay BONY $650,000 for the escrow services that BONY provided to the Trust for holding the Escrow Accounts, and the Trust will retain $3,464,051 of the total investment charges assessed by BONY originally.

This Court approved the parties' settlement in an Order dated March 1, 2006. However, upon circulation of the Full Settlement Agreement and Mutual Release (the "Original Settlement") approved by the Order, the Trust determined that many of the signatories desired to make, from the Trust's perspective, certain non-substantive changes to the Original Settlement, which the Trust was, subject to the Court's approval, willing to accommodate. Accordingly, since that time, the Original Settlement has been revised and shall be filed with this Court shortly, along with appropriate motion papers and an amended form of order

(2) *Western Asbestos Settlement Trust, et al. v. Zurich-American Insurance Co., et al.*, San Francisco Sup.Ct., Case No. CGC04-436181, November 9, 2004, is an insurance coverage action against various insurers for recovery under numerous primary and excess policies issued to the Debtors starting in 1946. The Trustees retained Morgan Lewis & Bockius LLP ("Morgan") to represent the Trust in the *Zurich* litigation pursuant to an hourly fee arrangement,

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capped monthly, in addition to a contingency payment based on the amount of the final award.

(3) Tort Reform Representation and Claims against Gibson Dunn & Crutcher LLP: At the February 28, 2005 Trustees' meeting, the Trustees decided it would be in the best interests of the Trust's beneficiaries to join with multiple asbestos settlement trusts to protect the Trust's interests in the face of certain confiscatory provisions in the proposed federal tort reform legislation entitled the "Fairness in Asbestos Injury Resolution" or "FAIR Act" legislation. Comprised of NGC Bodily Injury Trust, Fuller-Austin Asbestos Settlement Trust, the Celotex Asbestos Settlement Trust, and the DII Industries, LLC Asbestos PI Trust), this "Common Interest Group" of Trusts retained GDC to help develop and implement a strategy to protect the interests of the Trusts from those features of the proposed FAIR Act which if passed, would confiscate all Trust assets for inclusion in a national claim resolution fund.[9] The Western Trustees caused the Trust to prepay GDC $2.2 million for legal fees, costs and expert witness costs. GDC was also to be paid a "success fee" if its efforts were successful and certain conditions were met. GDC was paid from the Trust's Special Budget Fund Account, *see supra* para. 15, pursuant to the Resolution Regarding the FAIR Act which this Court approved in its May 18, 2005 Order.

In July of 2005, GDC withdrew from its representation of the Common Interest Group ("CIG") on the stated grounds that it had identified a conflict of interest that prevented it from continuing to represent the trusts. As a result of that withdrawal, the CIG retained new counsel, Cooper & Kirk PLLC of Washington D.C., to represent its interests with respect to these

[9] At the same time, the Trust continued to use Morgan to assist in its FAIR Act efforts and to act as back-up counsel in the event conflicts of interest arose within the Common Interest Group. As described *supra,* under the fee arrangement with Morgan, the Trust advanced fees and expenses in the amount of $4.2 million which was approved in the Special Budget. Morgan agreed to segregate the funds and draw on them to pay each month's fees and costs for work done on the FAIR Act. The arrangement provided that the Trust would recover all remaining funds in the event that the FAIR Act did not pass.

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same issues.[10] The CIG also retained ethics counsel, Zuckerman Spaeder LLP of Washington, D.C., to represent its members with respect to their claims for recovery of prepaid fixed fees held by GDC, disgorgement of other fees and costs, including costs of retaining ethics counsel and substitute counsel, occasioned by GDC's decision to withdraw. The Western Trust's share of the total CIG claim was $2,633,838 of which $2,113,102 (representing most of the prepaid fixed fee paid by Western) has been returned by GDC. Discussions continue with regard to recovery of the remaining $520,736 claimed by the Western Trust.

(4) Minnesota Interest Issue: In the fall of 2004, Minnesota claimants who had *Miller-Shugart* settlement agreements with the Debtors requested the Trust pay $1,521,323 worth of post-judgment interest on claims under Minn. Statute § 549.09 and *Miller v. Shugart*, 316 N.W.2d (Mn. 1982). The Trust retained Minnesota counsel to research the issue and concluded that no interest was owed. The parties mediated and reached resolution of the controversy in December 2005. In January 2006 the Trust paid Minnesota claimants $212,000 in final settlement of the dispute.

21. Final Fee Application: Pursuant to this Court's Order dated February 1, 2005, Baron and Budd, P.C., was compensated in the amount of $101,628 for legal services rendered during the bankruptcy cases between November 22, 2002 and April 22, 2004.

22. Trustees' Compensation: Section 4.5(c) of the Trust Agreement requires the Trust to report the amounts paid to the Trustees for per annum compensation and expenses. Pursuant to section 4.5(a) of the amended Trust Agreement, the Trustees receive $50,000 per annum, payable on the anniversary of the Effective Date, plus $2,000 per eight-hour day for working on Trust business or attending Trustees' meetings. This amount is pro-rated for any work less than eight

[10] The CIG retained Cooper & Kirk PLLC for a fixed nonrefundable fee under an agreement very similar to the GDC agreement but reflecting a narrower scope of work. The Trust's share of the CIG's obligation to Cooper & Kirk was $1.4 million. Cooper & Kirk may also receive success fees depending in part on the timing of the litigation and the outcome of the FAIR Act.

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hours. In October 2005, the Managing Trustee's compensation was reviewed and set at $500 per hour. In addition, it was decided that although the other Trustees are not compensated for work in excess of eight hours in one day, the Managing Trustee should receive compensation for work in excess of eight hours in one day. The October 2005 adjustment to the Managing Trustee's compensation will be reviewed in April 2006.

23. Thorpe Trust Administration: An order of confirmation confirming the First Amended Joint Plan Of Reorganization dated August 5, 2005 (the "Thorpe Plan"), in the Bankruptcy case of J.T. Thorpe and its three affiliated companies ("Thorpe") was signed by the Bankruptcy Judge September 6, 2005 and issued by the District Court Judge on January 19, 2006 ("Confirmation Order"). The Plan was proposed by Thorpe, the Official Thorpe Creditors Committee and the Thorpe Futures Representative (the "Thorpe Plan Proponents").[11]

The Thorpe Trust will have a Matrix and TDP closely resembling those of the Western Trust. The Thorpe Plan Proponents approached the Western Trust to discuss whether it would consider sharing resources in administering assets and processing claims. The Hon. Charles B. Renfrew, Futures Representative to the Western Trust, has been appointed as the Thorpe Trust Futures Representative. The TAC Chairman of the Western Trust, Mr. Alan Brayton, is the chairman of the Thorpe Trust's Official Committees of Creditors Holding Unsecured Claims. Mike Ahrens and Gary Fergus, counsel to the Western Trust's TAC and Futures Representative, respectively, are counsel to the TAC and Futures Representative of the Thorpe Trust.

[11] Certain insurers who had filed objections to the Thorpe Plan (collectively the "Objecting Insurers") filed a notice of appeal of the Confirmation Order on January 30, 2006. The Objecting Insurers requested that the Thorpe Plan Proponents agree that the Effective Date of the Plan would not take place prior to February 21, 2006. In order to allow the Objecting Insurers to attempt to obtain a stay pending their appeal, the Thorpe Plan Proponents agreed that the Effective Date would not take place prior to February 21, 2006. The Objecting Insurers sought a stay of the implementation of the Thorpe Plan from the District Court, the Ninth Circuit and the United States Supreme Court. All such courts denied the Objecting Insurers' application for a stay. The United States Supreme Court denied two separate applications for a stay on February 20, 2006 and on February 21, 2006, respectively. The Thorpe Plan Proponents are now preparing to cause the Plan to become effective by, among other things, preparing closing documents needed on the Effective Date of the Plan.



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Additionally, on March 23, 2006, the Central District Court approved the appointment of Stephen M. Snyder, the Western Trust's Managing Trustee, to serve as the Thorpe Trust's sole and Managing Trustee as of the Effective Date of the Thorpe Plan, which has yet to occur. According to the revised J.T. Thorpe Settlement Trust Agreement, the Managing Trustee will be compensated $15,000 annually plus an hourly billable rate of $450 "for each hour . . . dedicated to Trust Business." The Western Trustees, other than Mr. Snyder, who will abstain from voting on any decision, are in the process of considering whether it is in the best interests of the Western Trust beneficiaries and in accordance with the Plan and Plan documents, to share with the Thorpe Trust the costs and resources necessary to administer the claims and assets of both trusts.

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24. Filing Fee Refunds: Section 6.4 of the TDP provides that there will be a filing fee of $250 for each unliquidated claim filed with the Trust which will be refunded if the claim is allowed. During the Accounting Period, the Trust implemented two new policies at the direction of the Trustees to promote additional fairness in the refund of filing fees. First, filing fees are refunded when a claim is based upon exposure at a job site or ship which the Trust drops from its official site list subsequent to the filing of that claim. Second, law firms submitting claims to the Trust for the first time are eligible to withdraw claims within sixty days of submission and receive a full refund of the filing fee for their first ten claims. The purpose of this policy is to give new firms a chance to become familiar with the Trust's claims requirements and to avoid penalizing new law firms that are making good-faith efforts to file valid claims.

25. Statute of Limitations and Jurisdiction Clarifications: Section 5 of the TDP provides the threshold legal requirements for filing a valid claim with the Trust. The Trust retained counsel to research statute of limitations and jurisdictional issues for claims filed in states other than those states where one of the Debtors was subject to personal jurisdiction as of July 1, 2002 (i.e., California, Minnesota and North Dakota). Based on that research, the Trustees, with

the consent of the TAC and the Futures Representative, adopted policy language to clarify and explain the Trust's approach to evaluating statute of limitations and jurisdictional issues. Briefly stated, where a claimant asserts personal jurisdiction over one or more of the Debtors outside of California, Minnesota or North Dakota, the Trust will evaluate the legal basis of that assertion as of July 1, 2002. If no basis for personal jurisdiction is found, the claim will be rejected. If personal jurisdiction exists, the Trust will then evaluate whether the claim was, or could have been, timely filed in that jurisdiction.

26. Significant Vendors: Although the Trust has many vendors, the most significant of these during the Accounting Period were:

(1) Analysis Research Planning Corporation ("ARPC"): Consulting firm hired to help the Trust to develop a claims manual and claims processing procedures. Also hired to create a system to process claims after it was discovered that no existing vendor would be able to meet the requirements of the Matrix and TDP in a timely manner. Also offers ongoing advice concerning improvements to the claims processing system.

(2) BlackRock Financial Management: One of five investment managers for the Trust.

(3) Cooper & Kirk PLLC: Law firm that took over from GDC in representing the Trust and the CIG.

(4) Callan Associates: Investment adviser for the Trust.

(5) Fergus, a Law Firm: Counsel to Judge Renfrew, Futures' Representative.

(6) Gibson Dunn & Crutcher LLP: Law firm employed to prepare constitutional defense of the FAIR Act.

(7) Hamilton, Rabinovitz & Alschuler: Expert hired by the Futures' Representative.

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(8) Hosie, McArthur LLP: Law firm utilized by the Trust to analyze and research statute of limitations and jurisdictional questions.

(9) Jones, Vargas Law Firm: Nevada counsel responsible for the legal administration of the Trust and bankruptcy matters.

(10) Morgan Lewis & Bockius LLP: Counsel to Debtors, counsel to the Trust in the *Zurich* litigation described in paragraph 20 *supra* and counsel assisting in the constitutional analysis of the FAIR Act.

(11) Pinnacle Law Group: Counsel to the Trust in the *Bank of New York* litigation described in paragraph 20 *supra*.

(12) Sheppard, Mullin, Richter & Hampton LLP: Legal counsel to the TAC.

(13) Standish Mellon Asset Management Company: One of five investment managers for the Trust.

(14) State Street Global Advisors: One of five investment managers for the Trust.

(15) Zuckerman Spaeder LLP: Ethics firm retained by the Trust and the CIG in connection with GDC's decision to withdraw from representing the CIG on the basis of ethical conflicts of interest.

27. Trust Investment Management: Article 3 of the Trust Agreement authorizes the Trust to administer the investment of funds in the manner in which individuals of ordinary prudence, discretion and judgment would act in the management of their own affairs, subject to certain limitations. Callan & Associates continued to assist the Trust during the Accounting Period in developing an investment policy and selecting investment managers. Hired by the Trustees in 2004, Standish Mellon Asset Management Company, LLC and BlackRock Financial Management, Inc. have continued to act as two of the Trust's investment managers. The Trust

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hired Dwight Asset Management Company, Eagle Capital Management, LLC, and State Street Global Advisors during the Accounting Period to act as additional investment managers to the Trust.

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In conclusion, the Annual Report and attached exhibits demonstrate that the Trust acted prudently and expeditiously in executing its legal obligations during the Accounting Period. 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. Finally, in discharging their fiduciary duties to the Trust beneficiaries, the Trustees have made a concerted effort to address the special challenges that would arise in the event the FAIR Act passes. In so doing, the Trust carefully complied with all Plan documents and the mandates of this Court.

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