

UNITED STATES DISTRICT COURT
DISTRICT OF VERMONT

JOHN J. CRANLEY III and JULIUS GRAD,
on behalf of themselves and all other similarly
situated policyholders of National Life of
Vermont,

Plaintiffs,

vs.

NATIONAL LIFE INSURANCE
COMPANY OF VERMONT
One National Life Drive
Montpelier, VT 05604

and

NATIONAL LIFE HOLDING COMPANY
One National Life Drive
Montpelier, Vermont 05604

and

NLV FINANCIAL CORPORATION
One National Life Drive
Montpelier, VT 05604

and

PATRICK E. WELCH,
Chairman of the Board of Directors
and Chief Executive Officer of
National Life Insurance Company
of Vermont
One National Life Drive
Montpelier, VT 05604

and

THOMAS H. MACLEAY,
President and Chief Operating Officer, and
member of the Board of Directors of
National Life Insurance Company of Vermont
One National Life Drive
Montpelier, VT 05604

Case No. _____
(Judge _____)

**VERIFIED CLASS ACTION
COMPLAINT WITH JURY
DEMAND**

and :

JAMES A. MALLON,
Executive Vice President and Chief Marketing
Officer of National Life Insurance Company
of Vermont
One National Life Drive
Montpelier, VT 05604

and :

WILLIAM A. SMITH,
Executive Vice President and Chief Financial
Officer of National Life Insurance Company
of Vermont
One National Life Drive
Montpelier, VT 05604

and :

RODNEY A. BUCK, :
Senior Vice President and Chief Investment
Officer of National Life Insurance Company
of Vermont
One National Life Drive
Montpelier, VT 05604

and :

GREGORY H. DOREMUS,
Senior Vice President of National Life
Insurance Company of Vermont
One National Life Drive
Montpelier, VT 05604

and :

CHARLES C. KITTREDGE,
Senior Vice President of National Life
Insurance Company of Vermont
One National Life Drive
Montpelier, VT 05604

and :

ROBERT E. BOARDMAN, :
Member of the Board of Directors of :
National Life Insurance Company of Vermont :
One National Life Drive :
Montpelier, VT 05604 :

and :
:

DAVID R. COATES, :
Member of the Board of Directors of :
National Life Insurance Company of Vermont :
One National Life Drive :
Montpelier, VT 05604 :

and :
:

BENJAMIN F. EDWARDS III, :
Member of the Board of Directors of National :
Life Insurance Company of Vermont :
One National Life Drive :
Montpelier, VT 05604 :

and :
:

EARLE H. HARBISON, JR., :
Member of the Board of Directors of National :
Life Insurance Company of Vermont :
One National Life Drive :
Montpelier, VT 05604 :

and :
:

ROGER B. PORTER, :
Member of the Board of Directors of National :
Life Insurance Company of Vermont :
One National Life Drive :
Montpelier, VT 05604 :

and :
:

E. MILES PRENTICE III,
Member of the Board of Directors of National
Life Insurance Company of Vermont
One National Life Drive
Montpelier, VT 05604

and

THOMAS P. SALMON,
Member of the Board of Directors of National
Life Insurance Company of Vermont
One National Life Drive
Montpelier, VT 05604

and

A. GARY SHILLING,
Member of the Board of Directors of National
Life Insurance Company of Vermont
One National Life Drive
Montpelier, VT 05604

and

THOMAS R. WILLIAMS,
Member of the Board of Directors of National
Life Insurance Company of Vermont
One National Life Drive
Montpelier, VT 05604

and

PATRICIA K. WOOLF,
Member of the Board of Directors of National
Life Insurance Company of Vermont
One National Life Drive
Montpelier, VT 05604

and

ELIZABETH COSTLE, :
Commissioner of the Department of Banking, :
Insurance, Securities, and Health Care :
Administration of the State of Vermont, :
In her Official Capacity, :
89 Main Street, Drawer 20 :
Montpelier, Vermont 05620-3101 :
:
Defendants. :

* * * * *

Plaintiffs, on behalf of themselves and all other similarly situated individuals, for their Class Action Complaint against Defendants, challenge the constitutionality and fairness to mutual policyholders of the conversion of National Life Insurance Company of Vermont from a mutual to a stock insurance company pursuant to a mutual holding company scheme described herein and state upon information and belief, except as to paragraphs 22 and 23, which are based upon personal knowledge, the following:

OVERVIEW

Characteristics of Mutual Insurance Companies

1. Mutual companies are organized and operated solely for the benefit of their policyholders, who, by purchasing individual policies of insurance, become the effective owners of the companies and who, by paying premiums, provide a mutual company with virtually all of its equity capital.

2. By providing the funds for reserves sufficient to cover expected liabilities, the mutual policyholders also provide the equity in a mutual, known as "surplus," which is an accumulated fund designed to cover a mutual company's unanticipated liabilities. A mutual

insurance company functions to provide insurance to policyholders at cost, and return dividends to policyholders rather than to generate profits in the ordinary for-profit business sense.

3. A mutual company has no outside investors, and is managed by a board of directors for the sole benefit of its policyholder members, who are a mutual company's sole owners. Members of a mutual insurance company possess rights and interests characteristic of ownership, including the right to nominate and elect directors, approve all changes to the charter or by-laws, call special meetings of the company, receive any dividends declared by their elected Board of Directors or as reflected in reduced premium payments, share in all remaining assets upon dissolution, transfer certain membership rights to another policyholder under some circumstances, and bring a derivative action on behalf of their corporation. Moreover, the surplus of a mutual insurance company is to be held for the exclusive benefit of its policyholders.

4. To pay obligations pursuant to policies in force, mutual insurance companies establish reserves for anticipated losses based upon actuarial data and regulatory requirements. In the event that a mutual insurance company's losses exceed reserves, claims are paid directly from its surplus, which in turn will decrease the dividends paid to policyholders and increase their premiums.

5. Benefits for policies issued by a mutual insurance company are affected by the amount of the company's dividends paid from surplus. If the surplus decreases, policyholders' dividend levels will be reduced. Conversely, because the mutual company is operated for the sole benefit of its policyholders, if the surplus grows, it should be used to pay dividends to policyholders. Thus, a mutual policyholder has a present beneficial interest in the surplus.

The Conversion of Mutual Insurance Companies to Mutual Holding Companies

6. Recently, a number of mid-sized mutual life insurance companies have converted their form of organization. The primary stated purpose for these conversions has been to enable companies to raise capital in the equity markets. Due at least in part to this movement, and stock market growth, several states, including Vermont, have enacted legislation permitting a mutual insurer to reorganize using a mutual holding company scheme described below.

7. Until recently, a mutual company wishing to change its structure to become a stock insurance company went through a "full" or "one-step" demutualization in which the mutual is converted directly into a stock company. Policyholders receive either a distribution of cash, stock or some other consideration to compensate them for the loss of their exclusive ownership interests.

8. Subsequent to or in connection with a traditional, demutualization after distributing stock to policyholders, capital may be raised by issuing stock in a public offering. If stock is sold to raise capital, policyholders still own their shares, which typically account for a majority of the stock of the converted company, and when outside shareholders contribute additional capital by purchasing shares, policyholders own a proportionate share of the larger company.

9. Several states, including Vermont, have recently enacted unconstitutional legislation purporting to allow a mutual company to become a stock insurance company, while paying no distribution of cash, stock or other consideration to compensate policyholders for the loss of their exclusive ownership interests. Such legislation permits the mutual company to convert into a stock insurance company, which is wholly owned by a so-called "mutual holding

company." *See* Vt. Stat. Ann. tit. 8, §3441 (the "Demutualization Act" or the "Act"). As part of this conversion, policyholders' membership rights are divided. The contractual rights remain with the insurance company (now a stock company), while the policyholders' valuable ownership rights (including voting rights) in the former mutual insurance company are extinguished in exchange for worthless ownership rights in a mutual holding company. To raise additional capital, stock in the stock insurance company may be sold to the investing public in a stock offering.

10. Typically, the directors and/or officers of the mutual company reward themselves for perpetrating this mutual holding company scheme by issuing themselves valuable stock options. These directors and officers thereby become shareholders, with ownership interests in the insurance company that were formerly vested solely in the policyholders, in return for which the policyholders receive no valuable consideration whatsoever.

11. The mutual holding company scheme is conversion without compensation and an improper attempt to deprive the mutual policyholders of their ownership rights. The officers and directors who profit from this scheme via valuable stock options do so at the direct expense of policyholders. Such officers and directors thereby act in breach of their fiduciary duties that they owe to policyholders.

The Conversion of National Life Insurance Company of Vermont to a Mutual Holding Company

12. Defendant National Life Insurance Company of Vermont ("National Life") was throughout its 150 year history, until 1999, a mutual company, solely owned by its policyholders. Policyholders' ownership rights include (a) the right to elect directors, (b) the right to share in

dividends declared by the board of directors, and (c) the exclusive right to National Life's profits and retained earnings (the "surplus").

13. As a mutual company, National Life was organized in the cooperative form, and was managed in trust by a board of directors on behalf of the policyholders who elect them. It is these elected Board members who set the dividends payable to the policyholders. National Life had no shareholders. Policyholders, as the sole owners of National Life and all of its assets, including its surplus, were entitled to dividends declared by its Board of Directors or indirectly provided in the form of lower premiums. National Life provided insurance at cost, given that there were no outside equity holders and all net income was returned to policyholders or retained for their exclusive benefit as surplus. Upon traditional demutualization (conversion to stock) policyholders alone were entitled to their proportionate share of National Life's surplus.

14. National Life is converting to a stock insurance company pursuant to the above-described mutual holding company scheme ("the Scheme"). Its officers and directors are in the process of converting ownership rights formerly held by the policyholders to whom they owe fiduciary obligations, leaving such policyholders with worthless so-called "ownership" interests in a meaningless holding company. Eventually, these officers and directors will own a substantial share of National Life stock, of which the policyholders will receive none.

15. The Scheme creates a mutual holding company which has been named "National Life Holding Company" ("National Life Holding"), and an intermediate stock holding company formed under the laws of the State of Delaware which has been named "NLV Financial Corporation" ("NLV Financial"). NLV Financial will hold all of the shares of the voting stock of National Life, and National Life Holding will initially hold all of the voting shares of NLV Financial. However, NLV Financial will subsequently sell (or issue to National Life's own

officers and directors) up to just under 50% of voting control, leaving National Life Holding with just over 50% of the voting control. National Life, now reorganized as a stock life insurance company, continues to hold the surplus and other assets formerly owned solely by policyholders. Policyholders' contractual rights will remain with National Life, but they will no longer receive insurance at cost, for now revenues must be generated for the benefit of NLV Financial's shareholders. The dividends on the policies will be set by the directors of National Life even though the policyholders will only be eligible to elect members of the shell company, National Life Holding. As for policyholders' ownership rights, they are transferred from National Life to National Life Holding – a shell that is essentially worthless. National Life's scheme is described in the Policyholder Information Statement, which was distributed by National Life.

16. The Scheme constitutes an unlawful taking of policyholders' property without any compensation. The ultimate purpose of the Scheme is to effect a public stock offering of NLV Financial, and to issue generous stock options to National Life's officers and directors. Such action violates duties owed to policyholders by the directors and officers of National Life. Under the Scheme, the primary duties of the directors and officers of NLV Financial will be to the shareholders instead of the policyholders. The officers and directors will, without restriction, be able to propose an initial public offering and the issuance of stock options to themselves. Even though National Life policyholders will own a majority of the votes in National Life Holding, they will receive no compensation for their contributions to NLV Financial and its shareholders.

17. The Scheme materially changes the character of the insuring entity to the detriment of the present policyholders. As a mutual insurer, National Life existed to provide low cost insurance to process claims of policyholders in a fair and efficient manner and provide dividends to its policyholders out of National Life's surplus. Conduct antithetical to these duties

was prohibited. After the Scheme is completed, policyholders will be insured by a company with objectives diametrically opposed to the present purposes of National Life. National Life's main objective will be to earn profits for the shareholders, at the direct expense of policyholders and shareholders can now take actions that could adversely impact the value and security of the policies held by the insureds. While the same is true in a full demutualization, in a full demutualization the policyholders become stockholders at the time of demutualization, thereby receiving compensation for their equity interest and the changes in the objective of National Life.

18. The Vermont Demutualization Act requires that mutual insurers that wish to become a mutual holding company submit their Scheme to the Commissioner of Banking, Insurance, Securities for approval. Then, if approved, the Commissioner will authorize the Scheme to be submitted to the mutual holding company's policyholders for a vote. The Commissioner also approves the description of the Scheme to be provided to the voting policyholders. Here, National Life submitted a proposed Scheme to the Commissioners as described herein. On October 2, 1998, the Commissioner approved the Scheme, authorized a vote on the Scheme by policyholders and approved the form of notice to be sent to policyholders informing them of the Scheme.

19. On October 12th National Life submitted its Scheme to the policyholders for a vote. In the course of obtaining policyholder approval for the Scheme, National Life has failed to adequately disclose to its policyholders available alternatives to the scheme, including most importantly, the benefits that policyholders would derive from a traditional one-step demutualization in comparison to the losses policyholders sustain under the holding company approach. Policyholders were also not informed that the officers and directors intended to provide themselves with stock options, thereby enriching themselves with ownership interests in

National Life at the direct expense of policyholders. Policyholders were not presented with the opportunity to choose a demutualization approach that would inure to their own benefit, rather than to the benefit of National Life's officers and directors. Only the Scheme was presented to policyholders. Approximately 80% of National Life policyholders did not even cast a vote for or against the Scheme. National Life has deceptively suggested to policyholders that there will be no change to policyholders' rights or interests and that the Scheme is fair to policyholders without disclosing that policyholders would be deprived of their existing valuable ownership interests in exchange for stock in a mutual holding company that is essentially worthless and will not compensate them for their valuable ownership rights that they are being forced to surrender.

20. This action is brought on behalf of policyholders of National Life seeking an injunction prohibiting National Life from completing its reorganization into a mutual holding company, a declaration that the Scheme – the proposed reorganization of National Life from a mutual company to a mutual holding company and a stock operating life insurance company pursuant to the Demutualization Act, Vt. Stat. Ann. tit. 8, §3441 – violates the constitutional rights of policyholders under the United States Constitution, and/or constitutes an invalid corporate action. Plaintiffs also seek a declaration that the Act itself is unconstitutional, and that the Commissioner of Banking, Insurance, Securities and Health Care Administration violated the constitutional rights of policyholders by approving National Life's conversion scheme without adequate disclosures, which is unfair to its policyholders and is contrary to their best financial interests. Plaintiffs also seek damages from National Life's officers and directors for their inadequate disclosures regarding viable alternative methods of demutualization, and fraudulent concealment regarding the ways in which the Scheme was designed to enrich the officers and directors at policyholders' expense. Plaintiffs also seek damages for National Life's officers' and

directors' breach of fiduciary duties and conversion of funds belonging to policyholders perpetrated in connection with the Scheme.

PARTIES

21. Plaintiffs and each member of the class are policyholders in the mutual company known as the National Life (as defined in paragraph 12 above). Plaintiffs purchased and maintained their policies with National Life in reliance of their rights as members of a mutual insurance company, including their rights to nominate and elect directors; to approve all changes to the charter and by-laws; to call special meetings of the company; to receive any dividends declared or reflected in reduced premium payments; to share in all remaining assets upon dissolution; to transfer certain membership rights to another policyholder under some circumstances; to bring a derivative action on behalf of the corporation; and to have the surplus of the mutual insurance company held for their exclusive benefit.

22. Plaintiff John J. Cranley III is an individual residing in Hamilton County, Ohio, and is a participating policyholder pursuant to an individual Life Insurance Policy, issued June 1, 1994 by National Life. Plaintiff purchased his National Life policy in Hamilton County, State of Ohio. Plaintiff's claims are identical to those of the class of policyholders that he seeks to represent.

23. Plaintiff Julius Grad is an individual residing in Hamilton County, Ohio, and is a participating policyholder pursuant to individual Life Insurance Policy issued May 1, 1941 by National Life; Individual Life Insurance Policy issued May 24, 1947 by National Life; and Individual Life Insurance Policy issued July 19, 1958 by National Life. Plaintiff purchased his policies in Hamilton County, State of Ohio. Plaintiff's claims are identical to those of the class of policyholders that he seeks to represent.

24. National Life was, until January 1999, a mutual life insurance company, and is currently in the process of reorganizing as a stock insurance company, under Vermont law, with its principal place of business in Montpelier, Vermont, and doing business in all 50 states, including Ohio. Prior to reorganization, National Life was among the top 15 largest mutual life insurers in the nation.

25. National Life Holding (as defined in paragraph 15 above) is a mutual holding company, organized under Vermont law, with its principal place of business in Montpelier, Vermont, and owned by policyholders in all 50 states.

26. NLV Financial (as defined in paragraph 15 above) is a stock holding company, organized under Delaware law, with its principal place of business in Montpelier, Vermont. NLV Financial is currently wholly owned by National Life Holding, and, in turn, is the sole shareholder of National Life. Collectively, National Life, National Life Holding and NLV Financial will be referred to as the "Corporate Defendants."

27. At all times relevant hereto, Individual Defendants Patrick E. Welch, Thomas H. Macleay, James A. Mallon, William A. Smith, Rodney A. Buck, Gregory H. Doremus, Charles C. Kittredge, Robert E. Boardman, David R. Coates, Benjamin F. Edwards III, Earle H. Harbison, Jr., Roger B. Porter, E. Miles Prentice III, Thomas P. Salmon, A. Gary Shilling, Thomas R. Williams, and Patricia K. Woolf, (collectively, the "Individual Defendants"), are the officers and directors of National Life, doing business in Montpelier, Vermont.

28. Elizabeth Costle is the Commissioner of the Department of Banking, Insurance, Securities, and Health Care Administration of the State of Vermont (collectively, the "Government Defendant"). She is sued in her official capacity for her role in enacting and

applying Vermont legislation regarding demutualization via a mutual holding company scheme – legislation challenged herein as being unconstitutional.

JURISDICTION AND VENUE

29. This Court has subject matter jurisdiction over the claims asserted herein under 28 U.S.C. §§1331 and 1367. Alternatively, the Court has subject matter jurisdiction under 28 U.S.C. §1332, because complete diversity of citizenship exists between the representative Plaintiffs and Defendants and the amount in controversy exceeds the sum of \$75,000.

30. This Court has personal jurisdiction over each of the Defendants insofar as the Company's headquarters are located in this District and they have engaged in conduct described herein.

31. Venue is proper in this Court pursuant to 28 U.S.C. §1391(b)(2).

APPLICATION OF SCHEME TO THE CLASS

The Scheme, National Life's Inadequate Disclosures and the Insurance Commissioner's Approval of the Scheme

32. On May 8, 1998, National Life's Board of Directors unanimously approved and adopted the Scheme. As required by the Demutualization Act, National Life filed the Scheme with Vermont's Department of Banking, Insurance, Securities, and Health Care Administration and sought the Commissioner's approval of the Scheme. The Commissioner approved the Scheme on October 2, 1998. National Life submitted the Scheme to the vote of policyholders on or about October 12, 1998. The vote was held on November 30, 1998.

33. Under the Scheme, all rights of the policyholders as members of National Life are being terminated. Policyholders become, instead, members of National Life Holding. They receive no other consideration for their ownership rights. While each share of newly-issued

National Life stock will indeed have an economic value, policyholders will derive no benefit therefrom. Meanwhile, each policyholder's ownership interest in National Life Holding is essentially worthless. Membership in National Life Holding will provide policyholders with no economic benefit whatsoever.

34. In the course of obtaining policyholder votes in favor of the Scheme, National Life issued a Policy Information Statement regarding the Scheme to its policyholders. However, such communications deceptively suggested to policyholders that there would be no prejudice to their rights or interests and that the Scheme is fair to them. These communications also omitted or failed to describe several negative aspects of the Scheme from the point of view of the policyholders. These material omissions include the following:

- (a) that policyholders' ownership interests will be diluted relative to market values (not just book value), without any compensatory payment;
- (b) the essentially worthless consideration which policyholders would receive in a full traditional demutualization;
- (c) that the Scheme avoids protections that would have been afforded to policyowners by a traditional full demutualization;
- (d) changes in policy dividend rights and detail regarding the assets that will be allocated to the "Closed Block";
- (e) reduction in the amount of surplus available to pay policyholder dividends in accordance with the provisions of the contracts of insurance of national Life policyholders;
- (f) that the Scheme will limit policyholders' opportunities to participate in the future growth of National Life's investment portfolio and other lines of business;
- (g) the potential impact of the United States Bankruptcy Code upon policyholders' post-reorganization liquidation rights;
- (h) potential Federal Income Tax consequences for policyholders; and
- (i) the ability of the market to control the actions of the individual directors and officers.

35. National Life also did not reveal that alternative forms of reorganizations are available that would achieve the same ability to raise capital, but would be less harmful to policyholders' interests and permit policyholders to obtain value for their interests.

36. Policyholders were also not informed that the officers and directors intended to provide themselves with stock options, thereby enriching themselves with ownership interests in National Life at the direct expense of policyholders.

37. By approving the Scheme, the Insurance Commissioner applied the Act unconstitutionally in that she allowed the Scheme to be submitted to policyholders that failed to disclose material information and condoned National Life's breach of fiduciary duty to disclose the foregoing material information. Defendants' failure to provide material information impeded policyholders' ability to understand the Scheme and how to vote.

38. National Life's failure to disclose material information in breach of its fiduciary duties (and as condoned by the Insurance Commissioner) effectively deprived policyholders of any meaningful opportunity to determine whether and how to vote.

Policyholders' Rights and Interests Before and After Reorganization

39. Before reorganization, policyholders of National Life were entitled to elect the board of directors, to attend annual meetings, to approve changes to the corporate charter, to receive all dividends declared leading to greater policy benefits, to receive its assets upon liquidation, dissolution or conversion to stock, to vote on future stock offerings and to sue management derivatively. Policyholders were the sole owners of National Life, which was organized for their exclusive benefit, and they were owed complete fiduciary duty by directors and management.

40. Prior to the implementation of the Scheme, policyholders enjoyed 100% of the control over National Life, including 100% of the votes for directors who set their dividends. Under the Scheme, National Life policyholders, through National Life Holding, retain only a bare majority interest (50% plus one share) over National Life. The benefits of the policyholders' membership interests, including voting interests, is thereby diluted.

41. There is no requirement that National Life Holding's directors will also be directors of the stock companies National Life and NLV Financial. Therefore, under the Scheme, the directors elected by the policyholders will not have undivided loyalties to policyholders, as they do now; rather, the directors will also owe duties to the stock companies' stockholders whose interests will frequently conflict with the policyholders' interests. Directors of National Life Holding who are elected by the policyholders will no longer be setting the dividends payable to the policyholders. The dividends will now be set by the directors of National Life. This change takes away a valuable right of the policyholders to elect the directors setting dividends on their policies.

42. The Scheme does not afford policyholders any preference regarding opportunities to obtain NLV Financial stock. Under a traditional one-step demutualization, policyholders would enjoy such an opportunity.

43. Prior to the implementation of the Scheme, National Life policyholders enjoyed an exclusive claim on National Life's surplus. As a mutual insurer, National Life typically distributed its divisible surplus to policyholders on an annual basis in the forms of dividends. But under the Scheme, the surplus of National Life will be transferred to NLV Financial, and in turn to shareholders. National Life policyholders will no longer have a claim on National Life's surplus.

44. The Scheme provides for an arrangement known as a "Closed Block" under which dividends are reasonably expected to be issued at the 1998 pre-reorganization rate to existing policyholders, although not to new policyholders. The Closed Block includes policies that generated dividends when National Life was a mutual company. The stated objective of the Closed Block is to provide reasonable assurance to pre-reorganization policyholders that assets will remain available to provide for continuation of the dividend scales payable in 1998, although future distributions are not guaranteed. The Policy Information Statement does not provide the amount of assets that will be used to fund the Closed Block nor does it disclose that it will be substantially less than the reserves held by National Life on behalf of those policies.

45. The Closed Block is grossly inadequate for the purpose of protecting policyholder's interests in receiving dividends. The proposed Closed Block does not permit profits made by the shell holding company to inure to the benefit of policyholders. The Closed Block purports to lock in existing dividend rates by setting aside existing assets on the assumption that the yields available in the recent past will be available on the portfolio and, therefore, does not provide the policyholders with the financial benefits of the new company. In particular, the Closed Block does not assure policyholders any benefit derived from the enormous additional capital that is expected to flow to National Life from the sale of NLV Financial shares to the investing public. Only the shareholders are assured dividends for their ownership interest. Thus, the Closed Block prevents the policyholders from receiving the economic benefit of growth that was intended to result from the Scheme.

46. In fact, the potential exists for policyholders to shoulder all losses and a reduction in the amount of dividends paid, while the profits go to the NLV Financial's shareholders. The Scheme deprives policyholders of the opportunity to benefit economically from the growth of

National Life, while subjecting them to the risks or impairments to National Life's ability to perform under the policies. If growth creates financial difficulties for the stock company, its surplus and ultimately its reserves could be reduced, thus resulting in higher premiums and/or decreased ability of National Life to pay its policy obligations.

47. The reorganization contemplated by the Scheme does not contain the restrictions on management benefits that would exist in the case of a traditional demutualization. Management will be greatly enriched by stock options. The requirement that National Life Holding maintain a bare majority ownership of National Life will remove the market controls inherent in a typical stock company. Managers and directors will be entrenched due to the removal of the possibility of a takeover while they reap the benefits of stock options and other compensation methods available to stock companies but not mutual companies.

CLASS ACTION ALLEGATIONS

48. Plaintiffs bring this action individually and on behalf of all persons similarly situated, as members of the Class, defined as: All Participating Policyholders of National Life as of November 30, 1998.

49. Specifically excluded from the Class are the Defendants, and any entity in which the Defendants have a controlling interest, and the officers, directors, affiliates, legal representatives, heirs, successors, subsidiaries, and/or assigns of any such individual or entity.

50. The members of the Class are numerous. Joinder is impracticable. The number of policyholders who are eligible to participate in the Class is approximately 300,000. Defendants' Scheme will affect all Class Members in an identical manner.

51. The claims of Plaintiffs are typical of those of the Class. Plaintiffs, like Class Members, are the victims of Vermont's unconstitutional demutualization statute and National

Life's illegal Scheme. Plaintiffs' policy and rights pursuant thereto will be impacted by the Scheme in the same manner as all Class Members' policies. The wrongs against Class Members will be proven through proof of the wrong against Plaintiffs. Plaintiffs are members of the Class. Plaintiffs have no interests that are adverse or antagonistic to that of the Class.

52. Plaintiffs will fairly and adequately protect the interests of the Class. Plaintiffs have hired counsel experienced in this type of litigation to ensure the thorough prosecution of the claims. Plaintiffs are aware of the nature of the claims and committed to the vigorous prosecution of the claims and those of the Class.

53. Final injunctive and declaratory relief is appropriate with respect to the Class as a whole. The acts of Defendants that are complained of herein are applicable to all Class Members. The focal point of the acts complained of is the Vermont's unconstitutional statute and National Life's illegal Plan. Class Members share identical or similar constitutional, legal and contractual rights prohibiting such actions. A declaration that the Scheme and/or Vermont's Demutualization Act is unconstitutional, illegal or a breach of the contract between National Life and Class Members is a key component of the relief prayed for by Class Members. An injunction prohibiting National Life from consummating the Scheme is also a key component of the relief prayed for by Class Members. The Scheme is certain to result in actual and substantial injury to Class Members. Class Members have already been injured by the wasteful expenditures made in connection with the Scheme and other acts pursuant thereto. Class Members have a vested property interest in the substantial property taken by the Scheme. Class Members will also suffer irreparable harm if the Scheme is consummated. Under the Scheme, Class Members will lose the company that they presently own.

54. The claims of Plaintiffs and Class Members are the result of a common course of conduct by Defendants. All claims arise out of a common Scheme that will affect common policies of insurance between Defendants and Class Members. All claims will be prosecuted on a common theory of liability, applicable to Defendants' wrongful acts committed against all Class Members. All Class Members seek common forms of relief and present a common factual underpinning.

55. Common questions of law and fact predominate over individual issues. Common questions of law and fact include:

- (a) whether Vermont's Demutualization Act is unconstitutional;
- (b) whether the Scheme violates Class Members' rights guaranteed by the Constitution;
- (c) whether the Scheme is fair to the Class Members financial interests;
- (d) whether the Scheme provides inadequate protection for Class Members' property interests;
- (e) whether National Life adequately disclosed details of the Scheme to policyholders;
- (f) whether the Scheme creates impermissible conflicts of interest for National Life's Board of Directors;
- (g) whether the Individual Defendants breached their fiduciary duties to policyholders in their implementation of the Scheme; and
- (h) whether Vermont's Demutualization Act was unconstitutionally applied by the Commissioner?

56. A class action is superior to all other procedural methods for the fair and just adjudication of Class Members' claims. The relatively small dollar amount of individual Class Members' claims when compared to the impact that an adjudication of liability in an individual action would present for Defendants makes costly individual suits impracticable for Class Members. Defendants would pour tremendous resources into litigation of an individual suit,

forcing Individual Plaintiffs to expend comparable sums that would most likely consume the entire dollar amount of their claims. Absent a class action, Class Members will have no cost-effective form of relief.

57. A class action is in the best interest of judicial economy. Proof of the wrong committed against Plaintiffs will provide proof of the wrong committed against all Class Members. Identification of Class Members can be easily determined from records kept in the ordinary course of business by Defendants. Notice can easily be provided to all Class Members through ordinary mail addressed to addresses maintained by Defendants. One court can thoroughly adjudicate all Class Members' claims with respect to the conduct complained of herein.

COUNT I
[VIOLATION OF ARTICLE I, §10 OF THE UNITED STATES
CONSTITUTION (IMPAIRMENT OF CONTRACT CLAUSE)]

58. Plaintiffs incorporate by reference all averments set forth in the preceding paragraphs as if fully restated herein.

59. The insurance policies issued by National Life to Plaintiffs and Class Members are contracts within the meaning of Article I, §10, of the United States Constitution, which prohibits any State from passing any law impairing the obligation of contracts.

60. Vermont has enacted a Demutualization Act, Vt. Stat. Ann. tit. 8, §3441, which allows a mutual company to become a stock insurance company, while paying no distribution of cash, stock or other consideration of any value to compensate policyholders for the loss of their exclusive ownership interests which constitutes an unconstitutional taking of Plaintiffs' interests in the Company.

61. Vermont's Demutualization Act, Vt. Stat. Ann. tit. 8, §3441, both facially, and as applied to the Scheme, deprives policyholders of mutual insurance companies from their contractual rights involving ownership of the mutual insurance company, which constitutes a substantial impairment of a contractual relationship. The Scheme further fails to provide policyholders with any compensation for deprivation of their rights, and instead actually eliminates the value of their ownership interests.

62. Such impairment is not reasonable and necessary to any important public purpose.

63. Plaintiffs and Class Members are therefore entitled to a declaration that Vermont's Demutualization Act, Vt. Stat. Ann. tit. 8, §3441 is unconstitutional both on its face and as applied, and to a permanent injunction prohibiting the Government Defendant from engaging in any further implementation, enforcement or application of such Act.

64. Plaintiffs and Class Members are further entitled to an Order against the Corporate Defendants declaring that the Scheme was instituted pursuant to unconstitutional legislative authority, and that therefore Defendants' implementation of the Scheme to date must be unwound, and the policyholders must be restored their full ownership rights as existed prior to the reorganization under the Scheme.

COUNT II
**[VIOLATION OF THE DUE PROCESS CLAUSE OF THE FOURTEENTH
AMENDMENT TO THE UNITED STATES CONSTITUTION]**

65. Plaintiffs incorporate by reference all averments set forth in the preceding paragraphs as if fully restated herein.

66. The Fourteenth Amendment to the United States Constitution protects Plaintiffs from the arbitrary or capricious acts of state governments.

67. Vermont's Demutualization Act, Vt. Stat. Ann. tit. 8, §3441, both facially, and as applied to the Scheme, is arbitrary and capricious. The Act provides that a domestic mutual insurance company may reorganize under a mutual holding company scheme, but only where such reorganization is found by the Commissioner of the Department of Banking, Insurance, Securities and Health Care Administration to be fair to policyholders and in accordance with their financial interests. However, the mutual holding company scheme as prescribed in the Act will never be fair to policyholders or in policyholders' financial interests. This internal inconsistency inherent in the Act prevents the Act from ever being properly applied. Thus, any application of the Act, including the application of the Act to the Scheme, cannot avoid arbitrariness or capriciousness.

68. Plaintiffs and Class Members are therefore entitled to a declaration that Vermont's Demutualization Act, Vt. Stat. Ann. tit. 8, §3441 is unconstitutional both on its face and as applied, and to a permanent injunction prohibiting the Government Defendants from engaging in any further implementation, enforcement or application of such Act.

69. Plaintiffs and Class Members are further entitled to an Order against the Corporate Defendants declaring that the Scheme was instituted pursuant to unconstitutional legislative authority, and that therefore Defendants' implementation of the Scheme to date must be undone, and the policyholders must be restored their full ownership rights as existed prior to the reorganization under the Scheme.

COUNT III
**[UNLAWFUL PERMANENT TAKING IN VIOLATION OF THE
FOURTEENTH AMENDMENT TO THE UNITED STATES CONSTITUTION]**

70. Plaintiffs incorporate by reference all the averments set forth in the preceding paragraphs as if fully restated herein.

71. The ownership rights and interests of policyholders of Defendant are property within the meaning of the Fourteenth Amendment to the United States Constitution.

72. Because the Demutualization Act purports to authorize Defendants to effect their Scheme without compensating Plaintiffs for the loss of their rights and interests, including the loss of their exclusive interests in Defendant's surplus, the Act is unconstitutional on its face.

73. The Scheme will result in a taking of Plaintiffs property without providing to them adequate compensation in violation of the Fourteenth Amendment to the United States Constitution, and 42 U.S.C. §1983.

74. By reason of the foregoing, Plaintiffs are entitled to a declaration that the Scheme, or alternatively, the Demutualization Act if it is deemed to authorize the Scheme, constitutes an unlawful taking of policyholders' interests, including Plaintiffs', in violation of the Fourteenth Amendment of the United States Constitution and §1983.

**Allegations Relating to Policyholder or Shareholder Derivative Claims
Against the Individual Defendants Set Forth in Counts IV-VI of the Complaint**

75. Plaintiffs incorporate by reference all of the averments set forth in the preceding paragraphs as if fully restated herein.

76. Plaintiffs bring the following three counts against the Individual Defendants derivatively in the right of, and for the benefit of, National Life Policyholders and/or shareholders to redress injuries suffered by National Life policyholders and/or shareholders. These injuries are the direct result of the breaches of fiduciary duties, breaches of trust, waste of National Life assets, acts of fraud, and acts of conversion, which led to the violations of law complained of herein.

77. Until January 1999, the policyholders, including Plaintiffs, were the owners of National Life. If the Scheme is consummated, the policyholders will remain the owners of an entity most closely resembling National Life's successor under the terms of the Scheme.

78. This action is not a collusive one to confer jurisdiction on a court of the United States that it would not otherwise have.

79. Plaintiffs will adequately and fairly represent the interests of National Life policyholders and Class Members in enforcing and protecting their rights. Plaintiffs have retained competent counsel experienced in derivative litigation to further ensure such protection, and intend to pursue this action vigorously. Plaintiffs are aware of their duties and obligations as a result of the following policyholder or shareholder derivative claims and are prepared to fulfill those duties and obligations.

80. Plaintiffs have made no demand on the present board of directors of National Life to institute an action against the Individual Defendants for their breaches of fiduciary duties and breaches of trust and other wrongful acts as particularized herein. Such demand would be a futile and useless act, and is therefore excused, for the following reasons:

- (a) Every member of the Board of Directors of National Life directly participated in the promulgation of the Scheme which gives to them potential to control a large percent of the stock company formed by the reorganization for no or grossly insufficient consideration;
- (b) A reasonable doubt exists that the Individual Defendants exercised valid business judgment because their wrongful actions alleged herein amounted to self-dealing, personal aggrandizement, breaches of their fiduciary duties of good faith, disclosure, due care, and loyalty to National Life and their owners, or an abdication of their responsibilities as directors, which breaches and abdication gave rise to Defendants' liability for the illegal wrongdoing alleged herein, the ratification of which would be improper and unlawful; and
- (c) The Board of Directors of National Life cannot be relied upon to reach an independent decision as to whether to commence the demanded action against themselves. Every member of the Board of Directors of National

Life is a Defendant herein and stands to personally profit as a result of the improper and unlawful acts alleged herein.

81. Plaintiff Grad made a demand on the Board of National Life to obtain the identity of policyholders of National Life, but his demand was ignored. Plaintiff Cranley did not make a demand on the Board of Directors to obtain the identity of policyholders of National Life or to initiate this action because it would be a futile act because:

- (a) National Life has approximately 300,000 policyholders;
- (b) making demand on such a large and geographically dispersed number of policyholders would be impossible for Plaintiffs, who have no way of finding out the names, addresses, or phone numbers of the policyholders; and
- (c) assuming all policyholders could be individually identified, making demand upon all of them would force Plaintiffs to incur enormous expenses, clearly unreasonable in lieu of the apparent futility of the act.

COUNT IV
[POLICYHOLDER OR SHAREHOLDER DERIVATIVE CLAIMS
AGAINST THE INDIVIDUAL DEFENDANTS
FOR BREACH OF FIDUCIARY DUTY,
SELF-DEALING, AND WASTE OF CORPORATE ASSETS]

82. The Individual Defendants owe a duty to National Life, National Life Holding and NLV Financial policyholders and/or shareholders to act as fiduciaries and protect the interests of such policyholders and/or shareholders, to avoid engaging in self-dealing, and not to waste corporate assets. They have breached these duties by the acts alleged in the preceding paragraphs.

83. In approving the Scheme, the Individual Defendants have violated their fiduciary duties to National Life, National Life Holding and NLV Financial policyholders and/or shareholders not to engage in acts of self-dealing and not to waste corporate assets.

84. Such breaches of fiduciary duties have proximately resulted in damages to National Life, National Life Holding and NLV Financial, and their policyholders and/or shareholders, in an amount to be determined at trial.

85. Unless enjoined by this Court, the Individual Defendants will continue the process of implementing the Scheme, which will result in further harm to the policyholders and/or shareholders.

86. By reason of the foregoing, National Life policyholders and Class Members are entitled to an order enjoining the Individual Defendants from completing the Scheme, and to recover from the Individual Defendants damages in an amount to be determined at trial resulting from these breaches of fiduciary duty, acts of self-dealing and waste of assets.

COUNT V
[POLICYHOLDER OR SHAREHOLDER DERIVATIVE
CLAIMS AGAINST THE INDIVIDUAL DEFENDANTS
FOR FRAUDULENT CONCEALMENT OR NEGLIGENT OMISSION]

87. Plaintiffs incorporate by reference all the averments set forth in the preceding paragraphs as if fully restated herein.

88. Prior to November 30, 1998, in their communications with policyholders regarding the Scheme, the Individual Defendants, acting either with fraudulent intent or without reasonable care, concealed from policyholders or omitted the pertinent information set forth in paragraphs 32-36 above.

89. Plaintiffs and other Class Members were policyholders at the time National Life and the Individual Defendants disseminated the information concerning the proposed Scheme and were, therefore, in privity with Defendants. The Individual Defendants had a duty to disclose all material information regarding the Scheme to the policyholders.

90. The concealment or omission of all material facts regarding the Scheme described above misled the Class into either not voting at all or voting in favor of the Scheme.

91. But for such concealment or omission, policyholders were not given enough information from which to make an informed decision on how to vote regarding the Scheme.

92. By reason of the foregoing, Defendant National Life and the Individual Defendants are liable to National Life policyholders and the Class for damages in an amount to be determined at trial and such other relief that the Court deems appropriate.

COUNT VI
**[POLICYHOLDER OR SHAREHOLDER DERIVATIVE
CLAIM AGAINST THE INDIVIDUAL DEFENDANTS FOR CONVERSION]**

93. Plaintiffs incorporate by reference all the averments set forth in the preceding paragraphs as if fully restated herein.

94. The Scheme operates to convert the property of Plaintiffs and the Class to the benefit of the Individual Defendants. The Scheme purports to take away the vested property interest of the policyholders in the surplus of National Life, either their consent and/or approval, and/or with consent or approval obtained by the Individual Defendants through improper concealment or omission. Under the Scheme, the Individual Defendants will wrongfully exercise dominion and control over the property of the Class Members.

95. By reason of the foregoing, the Individual Defendants are liable to Plaintiffs and the Class for damages in an amount to be determined at trial and such other relief that the Court deems appropriate.

WHEREFORE, Plaintiffs demand judgment for themselves and for the Class as follows:

(A) A declaration that Vermont's Demutualization Act, Vt. Stat. Ann. tit. 8, §3441, is unconstitutional both on its face and as applied;

(B) A permanent injunction prohibiting the Government Defendant from engaging in any further implementation, enforcement or application of such Act;

(C) A declaration that the Scheme was instituted pursuant to unconstitutional legislative authority;

(D) A permanent injunction ordering the Corporate Defendants to unwind their implementation of the Scheme to date, and restoring the ownership rights of the policyholders to the state in which they existed prior to the reorganization under the Scheme.

(E) An award of compensatory and punitive damages against the Individual Defendants in an amount to be determined at trial;

(F) Interest, costs and attorneys' fees; and

(G) Such other equitable and non-equitable relief as may be allowed by law and as the Court may deem just and proper.

Dated: October __, 1999

Respectfully submitted,

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JURY DEMAND

Pursuant to Rule 38 of the Federal Rules of Civil Procedure, Plaintiffs and the members of the Class hereby demand a trial by jury of all issues so triable.

Geoffrey W. Crawford

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