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Electronically Filed on April 26, 2007

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

THIRD ANNUAL REPORT AND ACCOUNTING OF WESTERN ASBESTOS SETTLEMENT TRUST

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

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

DATED this 26th day of April, 2007.

JONES VARGAS

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

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

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

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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 capacity since that time. Elected in 2004 by the other two Trustees, Stephen M. Snyder has continued to serve as Managing Trustee throughout 2006.

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 2006 federal tax return must be filed on or before September 15, 2007. The Trust resides in Nevada and Nevada has no state income tax. Although the Trust is not subject to tax in California, the Trustees filed a 2004 and 2005 tax return in California, attached a copy of the Trust's 2004 and 2005 federal tax return but showed no California taxable income or 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 with the Bankruptcy Court, as soon as available, and in any event within 120 days following the end of each fiscal year, 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.

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

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Western Asbestos Settlement Trust Agreement, dated February 28, 2005. 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.

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

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 accountants, Grant Thornton LLP. The Trust's audited financial statements ("Audited Financial Statements") are attached hereto as Exhibit "B". 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, which is the equivalent of a corporate balance sheet, reflects total assets of the Trust at market value and on the other comprehensive bases of accounting adopted by the Trust. These Audited Financial Statements show, among other things, that as of December 31, 2006, total Trust assets were $1,198,941,975, total liabilities were $48,064,881, and Net Claimants' Equity was $1,150,877,094.

6. Claim Report: Section 2.2(c)(ii) of the Trust Agreement provides that along with the Audited 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. The Western Asbestos Settlement Trust Claim Report As Of December 31, 2006 ("Claim Report"), is attached hereto as Exhibit "C". During the Accounting Period, the Trust received 1,626 claims, paid and closed 1,408 claims, and made settlement offers on an

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additional 124 claims.

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

7. Bi-annual Review: Section 5.7(b) of the TDP requires that the Trust shall conduct a bi-annual (or more frequently at the request of the TAC or the Futures Representatives) review of 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. The Trust prepared a bi-annual report in compliance with this provision and presented it for discussion with the Trustees, TAC and Futures Representative at the April 20, 2006, meeting.

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 or about the anniversary of the Effective Date. The Trustees held four meetings during the Accounting Period (February 6, 2006, April 20, 2006, September 21, 2006, and December 14, 2006). All meetings were held at the Trust headquarters in Reno, Nevada.

9. Public Inspection: In compliance with Section 2.2(c) of the Trust Agreement, the Annual Report, including the Audited Financial Statements and Claim Report, has been sent to the Approving Entities and the Office of the United States Trustee with responsibility for the Northern District of California, and has been made available for inspection by the public in accordance with

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

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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 2007 budget and the required four-year budget and cash flow projections on December 14, 2006. Pursuant to the Trust Agreement, these were provided to the Approving Entities and the Debtors. The budget for operating expenses in 2007 is $4,152,591 (net of claimant payments which are budgeted for $71,890,000, and net of income tax payments which are budgeted for $9,500,000).

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. In 2005, the remainder of the 2004 MAP was carried over as the MAP for 2005. At the December 15, 2005, Trustees' meeting, the Trustees set the 2006 MAP at $90 Million. The Trustees re-evaluated the 2006 MAP amount at their April 20, 2006, meeting. Due to the increase in the Payment Percentage in 2006, from 31.5% to 34.2%, the 2006 MAP was increased from $90 million to $120 million. At the December 14, 2006, Trustees' meeting, the Trustees set the 2007 MAP at $155 million.

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

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

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

14. Set Aside Fund: The Trust continues to maintain a separate account with Wells 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.[3] No claims were made against any of these indemnity funds during the Accounting Period.

15. Indemnity Fund: Section 4.6 of the Trust Agreement 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

[2] The First Amendment to and Complete Restatement of Western Asbestos Company/Western Mac Arthur Co./Mac Arthur Co. Asbestos Personal Injury Settlement Trust Distribution Procedures dated December 14, 2006 is attached to the Appendix.

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

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 in the amount of $40 million[4] 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.

16. Special Budget Fund: A Special Budget fund was approved by this Court in 2005 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 Congress passes federal tort reform legislation that would seek to confiscate the Trust assets. The Special Budget Fund was established to permit the Trust to continue to operate on a limited basis so that if and when potential legislation is overturned, the Trust will be able to resume 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, the Managing Trustee is in charge of administering and reporting on the Special Budget Fund. In accordance with the May 18, 2005, Order, the Managing Trustee has reported regarding the disposition and status of these monies at each regular meeting in 2006 to determine whether to increase or decrease the amount in this Special Budget Fund. No changes were recommended to adjust the amount during the Accounting Period. As of December 31, 2006, the Special Budget Fund contained $33,272,920. ($2.1 million is part of the Special Budget Fund and was returned to the Trust from the Morgan law firm, but resides in the main custody account of the Trust. See paragraph 21 c *infra*).

[4] The establishment of the Indemnity Fund was described in detail in the Trust's First Annual Report and Accounting.

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17. Settlement Fund Control Account and Control Agreements: Section 4.7 of the 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 Settlement Fund Account ("Specific Funds"). The Trust has entered into five separate Control Agreements with respect to the Specific Funds. The security interests of the indemnified parties are perfected through Control Agreements. The Managing Secured Party for each of the Control Agreements is Stephen M. Snyder, Managing Trustee of the Trust. There has been no change in these Control Agreements during the Accounting Period.

18. Resolution Regarding Payment Percentage: Section 4.2 of the TDP provides that, commencing on the first day of January, after the Plan has been confirmed and no less frequently that once every three years thereafter, 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 the Trust's claimants of 31.5%. In December 2005, the Trustees and the Approving Entities relied upon Dr. Thomas Vasquez of Analysis Research Planning Corporation to review data to determine if the Payment Percentage could or should be adjusted. After Dr. Vasquez's report of January 18, 2006, was submitted, the TAC proposed that the Payment Percentage be increased. At their February 6, 2006, meeting, the Trustees increased the Payment Percentage to 34.2% effective January 1, 2006, based upon the report and conclusions of Dr. Vasquez. The TAC and the Futures Representative consented to the

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adjustment.

19. Resolution Regarding Inflation Adjustment: The original Payment Percentage approved by this Court was based upon projections of future claims payments adjusted annually for inflation. In the interest of treating all claimants equitably in accordance with the Plan, the Trustees recommended all claims payments made during a 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 January each year. The TAC and the Futures Representative consented to this adjustment. Consequently, as of January 1, 2006, all claims payments made during the calendar year were increased by 3.4% to account for inflation. The resolution also stated that in each succeeding January, the Trust shall review the CPI-W from the previous year and make a determination as to whether that adjustment shall be included in claims payments made in that year.

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

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

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

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Section VIII of the Matrix is attached to the Appendix.

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

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

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

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

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

a. *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

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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 brought this action to recover escrow fees alleged to be excessive that were incurred before the Trust came into being. Counsel to the Trust, Pinnacle Law Group, undertook this representation on a contingency fee basis.

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

b. *Western Asbestos Settlement Trust, et al. v. Zurich-American Insurance Co., et al.*, San Francisco Sup.Ct., Case No. CGC04-436181, November 9, 2004: This 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, capped monthly, in addition to a contingency payment based on the amount of the final award. The Trust reports on the amounts paid and accrued to Morgan at each Trustee's meeting.

c. 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, ("Common Interest

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Group") to protect the Trust's interests in the face of certain confiscatory provisions in proposed federal tort reform legislation. The Common Interest Group retained Gibson Dunn & Crutcher ("GDC") to help develop and implement a strategy to protect the interests of the Trust's beneficiaries from those features of the proposed legislation which, if passed, would confiscate all Trust assets for inclusion in a national claim resolution fund likely resulting in smaller payments or no payments to some trust beneficiaries. The Trust initially paid GDC $2.2 million for legal fees, costs and expert witness costs. At the same time, the Trust continued to use Morgan to assist and to act as back-up counsel in the event conflicts of interest arose within the Common Interest Group. Under the parallel fee arrangement with Morgan, the Trust advanced fees and expenses in the amount of $4.2 million. The arrangement provided that the Trust would recover all remaining funds in the event the proposed legislation did not pass.

In July of 2005, GDC withdrew from its representation of the Common Interest Group ("CIG") and as a result of that withdrawal, the CIG retained new counsel, Cooper & Kirk PLLC of Washington D.C. ("C&K"), to represent its interests with respect to these same issues. 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 Trust claimed that it was owed $2,633,838k, of which $2,113,102 (representing most of the prepaid fixed fee paid by the Trust) was returned by GDC in 2005. The CIG entered into a settlement agreement with GDC and of the remaining $520,736 claimed by the Trust, $300,091 was returned by GDC during the Accounting Period.

In February 2006, the CIG entered into a Joint Representation Agreement and fixed fee arrangement with C&K. The Trust paid C&K $1.4 million for legal fees and costs,

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

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

d. 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 in 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 and in December 2005, the parties mediated and reached resolution of the controversy. The Trust approved a settlement in the amount of $212,000 at the February 6, 2006, meeting.

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

a. Updates to the site and ships lists. (6/2/2006; 7/5/2006; 10/4/2006)

b. Notice of amendment to Section VII c of the Matrix. (6/13/2006)

c. Policy that the filing fee will be refunded for a claim submitted based upon a site and/or ship which is subsequently removed from the official list. (5/11/2006)

d. Notice of the 2006 Payment Percentage increase and 2006 inflation adjustment. (4/14/2006)

e. Additions to the Traditional Occupation List. (7/29/2005)

f. Policy that the first ten claims submitted by a law firm may be eligible for a

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refund of the filing fee, should those claims be denied or withdrawn within 60 days. (1/6/2005)

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

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

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

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

23. Claim Processing Issues:

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

b. At the February 6, 2006, Trustees' meeting, the Executive Director reported that the Trust was incurring excessive costs as a result of repetitive claim resubmissions by claimants whose claims the Trust had returned as deficient. After discussion, the Trustees, TAC and Futures Representative arrived at and agreed on the following policy concerning multiple submissions of a claim: The Trust will deem a claim to be withdrawn after it is submitted three times (the original submission and two subsequent submissions). The claim may be resubmitted at

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any time after it has been withdrawn by the Trust upon payment of an additional filing fee. It was agreed that the Trust would give fair warning to any firm who was in serious violation of the policy to give them an opportunity to correct the problem prior to enforcement.

c. A revised form of the approved release was implemented on April 20, 2006. The revised form clarifies that the Trust will accept as adequate and authentic the signature of any heir or their successor in interest, a personal representative of the estate, or one holding a valid power of attorney for any of the aforementioned persons. The Trust will only accept signatures of individuals on behalf of the injured party if the Trust is provided with appropriate documentation establishing the authority of the signatory. In the event the person holding a valid power of attorney is a representative of the law firm which submitted the claim, appropriate documentation must be provided to verify that the law firm's client understands, accepts, and has authorized settlement of the claim. The approved release was also revised to replace the specific payment amount with a reference that the payment amount will be that of the current Payment Percentage value plus any applicable inflation adjustment then in effect. The revised release is attached to the Appendix.

d. To date the Trust has utilized land and ship site exposure lists provided to it at the commencement of the Trust by the Approving Entities. The Trust continues to conduct research on the lists as claims are received and from time to time receives information concerning various sites on the lists which indicate that the site should be removed as one where Western Asbestos or Mac Arthur performed work. The Trust also receives information periodically concerning sites that should be added to these lists. At least one claimant contended that fairness required that a site once listed should not be dropped from the list. The Trustees, after consulting with the Approving Entities, concluded that the Trust should continue with its current practice to avoid compensating invalid claims in violation of Trust Agreement and the TDP.

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e. Pursuant to Section 5.7 of the TDP, the Trustees, with the agreement of the TAC and Futures Representative, contracted with Mr. David Maxam to conduct a Claims Processing and Internal Controls Audit. Mr. Maxam reported his findings at the September 21, 2006, meeting. Among other things he found that of 48 claims randomly selected, each claim had been processed and paid correctly according to Trust documents and policies. His Executive Summary and resume is attached to the Appendix. Mr. Maxam also made several suggestions for more efficient processing and administration of the Trust (creating a standard practice manual, creating a worksheet in Excel which would calculate the total liquidated values of claims to double check the claims processing system's calculations, open separate bank accounts for filing fees and claims payments, fire-proof storage for written releases, and the addition of a third summary review of claims with liquidated values over $100,000). The Trust implemented all but one of these recommendations. The Trustees determined that a third review of claims over $100,000 would add unnecessary expense and was not warranted since every claim is reviewed twice, with spot reviews by the lead processor and the Executive Director before any offer is authorized.

f. At the September 21, 2006, meeting, the Trustees, with the consent of the TAC and the Futures Representative, approved certain administrative revisions to the Claim Form. The list of the approved revisions and a complete copy of the revised Claim Form are attached to the Appendix.

24. 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 Trust Agreement "per annum compensation payable to the Trustees…shall be reviewed every three years and … adjusted with the consent of the Approving Entities." At the September 21, 2006, meeting, the Managing Trustee was instructed to conduct a survey prior to

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the December meeting concerning the payments made by other similarly-situated trusts. The survey was conducted by ARPC and the results were reported at the December 14, 2006, meeting. The Trustees, TAC, and Futures Representative resolved that as of January 1, 2007, the Trustees' annual payment will be increased from $50,000 to $65,000, and the non-managing Trustees' and TAC members' hourly rate for purposes of calculating per diem compensation will be increased from $250 to $450.

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

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

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consent of the Approving Entities provides:

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

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

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

A copy of the Agreement is attached to the Appendix.

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

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

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

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

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

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

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f. Fergus, a Law Firm: Counsel to The Honorable Charles Renfrew, Futures Representative.

g. Jones Vargas: Law firm that acts as Nevada counsel responsible for the legal administration of the Trust and bankruptcy matters.

h. Legal Analysis Systems: Expert hired by the TAC.

i. 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 proposed federal tort reform legislation.

j. Sheppard, Mullin, Richter & Hampton LLP: Legal counsel to the TAC.

k. Standish Mellon Asset Management Company: One of five investment managers for the Trust.

l. State Street Global Advisors: One of five investment managers for the Trust.

m. Sitkoff/O'Neil Accountancy Corporation: CPA and Tax Firm for the Trust

28. 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 as its manager of investment managers. BlackRock Financial Management, Inc., Dwight Asset Management Company, Eagle Capital Management, LLC, Standish Mellon Asset Management Company, LLC, and State Street Global Advisors have continued to act as investment managers to the Trust.

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

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

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