SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

In the Matter of the Liquidation of MIDLAND INSURANCE COMPANY	Index No. 41294/86 Assigned to: Hon. Michael Stallman

SUPPLEMENTAL MEMORANDUM OF EVEREST REINSURANCE COMPANY

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases **Pages**

Other Authorities

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INTRODUCTION

Pursuant to the Court's November 8, 2006 Interim Decision and Order (the "Interim Order"), Everest Reinsurance Company f/k/a Prudential Reinsurance Company ("Everest") submits this supplemental memorandum to address the six questions raised by the Court.[1] Specifically, the Court directed the parties to address the following:

1) What obligations are imposed upon Midland and/or the Liquidator by the provisions permitted by Insurance law §1308(a)(3)?

2) What are Midland's and/or the Liquidator's contractual obligations under the reinsurance agreements?

3) What is Midland's and/or the Liquidator's current practice of handling claims?

4) To what extent does the current practice fulfill Midland's and/or the Liquidator's statutory and contractual obligations?

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[1] This supplemental submission is being made by Everest subject to a full reservation of rights and the objections stated in its pending motion to vacate the Interim Order.

5) If the current practice does not satisfy these obligations, what changes to the procedure can/must be implemented to achieve compliance?

6) How can those procedures be implemented while minimizing administrative expenses to the Midland estate?

The Court has asked the parties to address these six questions with regard to the provisions of Article 74 of the Insurance Law.

The existing statutory scheme allows an insolvent insurer to recover from its reinsurers on the basis of the full amount of an allowed insurance claim, even though the estate of the insolvent insurer ultimately will pay a fraction of that amount. This disproportionality between what is allowed and what is paid creates a disincentive for insolvent insurers to vigorously investigate, adjust and defend claims because the principal estate asset is reinsurance and the value of that asset is directly impacted by the magnitude of allowed claims. The New York Legislature recognized this disincentive and expressly permitted reinsurance contracts to include a provision that grants reinsurers the right to investigate claims and to interpose defenses on behalf of the insolvent insurer. This right afforded to reinsurers to participate in the claims process is a quid pro quo for their obligation to indemnify the insolvent insurer on the basis of the amount allowed, rather than the amount paid, on a claim.

Here, the reinsurance contracts between Everest and Midland either incorporate the language permitted by New York statute, N.Y. Ins. Law § 1308(a)(3), or contain substantially similar language. That language affords Everest – solely with respect to claims that potentially involve its reinsurance agreements with Midland – the absolute right to participate in all aspects of the claims-handling process, from initial investigation through the assertion of defenses or the denial of the claim.[2]

Neither Section 1308(a)(3) nor the reinsurance agreements themselves allow for any restrictions or conditions on Everest's right to participate in the claims-handling process based on Midland's insolvency or any other reason. Indeed, the contractual rights recognized by Section 1308(a)(3) arise upon insolvency. Similarly, Article 74, which pre-dates Section 1308(a)(3), does not permit the right of a reinsurer to participate in the claims-handling process to be impaired or disregarded in the slightest. Article 74 is, in fact, completely silent on the matter. That silence is compelling proof that the Legislature contemplated that the rights and obligations imposed by the reinsurance contract wording specifically authorized by Section 1308(a)(3) could not be trumped by Article 74 or the

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[2] Everest does not have a right, nor does it seek, to participate in the adjustment of claims that are presented only under Midland policies that are not reinsured by Everest.

general public policy supporting the resolution of claims against an insolvent insurer in a single proceeding.

Everest's right under the Midland contracts and Section 1308(a)(3) to investigate claims and to interpose defenses must be respected regardless of whether Midland is – as it is here – deficient in handling, settling, or defending claims. The exercise of that right lies solely in Everest's discretion, and Midland must place Everest in a position where it can make a reasoned determination whether to investigate a claim or interpose any defense. Accordingly, Midland must give Everest timely notice of claims and full opportunity to access and review claim files. Thereafter, Midland must afford Everest the opportunity to investigate claims, participate in settlement negotiations, and interpose defenses. These opportunities must be given well before Midland has made any decisions with respect to the allowance or disallowance claims. However, as detailed in Everest's prior submissions, Midland and the Liquidator have failed utterly to honor Everest's right to participate in the claims-handling process.

Moreover, as detailed in Everest's proposed Complaint, the perfunctory reinsurance reporting provided by Midland to Everest reveals that Midland has failed to engage in a competent or businesslike review and evaluation of claims submitted by its policyholders. Among other

things, Midland's own reports suggest that Midland is failing to follow binding legal precedent, failing to thoroughly investigate claims before soliciting settlement demands from policyholders, failing to conduct proper claims audits, and failing to evaluate claims and settlements based on up-to-date information. However, because Midland has failed to comply with its contractual and statutory obligations to give Everest timely and sufficient notice and opportunity to participate in the claims-handling process, Everest's first-hand knowledge of the particular claims-handling practices being followed by Midland is limited. That is why Everest has requested the opportunity to conduct discovery, as detailed in its motion to vacate.

As to the minimization of administrative expenses, Section 1308(a)(3) and the reinsurance contracts contain mechanisms to ensure a fair allocation of any costs occasioned by Everest's involvement. By statute and contract, Everest bears the expense of its own claims investigation. It also bears the initial expense of interposing defenses, subject to court approval of a charge to the Midland estate of a proportional part of such defense expense in relation to any benefit to Midland that accrues solely as a result of the defense undertaken by Everest. That expense charge to the estate is fair and reasonable because it only arises when the successful interposition of a defense has reduced Midland's liability exposure.

ARGUMENT

Questions 1 and 2: The Obligations Imposed Upon Midland by Section 1308(a)(3) and the Reinsurance Contracts

Everest seeks to enforce contractual rights that are consistent with, and further the aims of, Section 1308 of the Insurance Law. Those rights, which have been approved by the Legislature, are necessarily in harmony with the applicable provisions of the Insurance Law, including Article 74.

Insurance Law § 1308(a)(3)

The New York Legislature enacted Insurance Law § 1308 (originally codified as Insurance Law § 77) in response to the United States Supreme Court's decision in Fidelity & Deposit Co. v. Pink, 302 U.S. 224 (1937). In Pink, the Court held that a reinsurer only was obligated to indemnify an insolvent insurer for covered losses actually paid by the insurer under the reinsurance policies. Section 1308 was intended to overcome Pink by "altering the indemnity nature of a reinsurance contract when the ceding company becomes insolvent." In re Midland Ins. Co., 79 N.Y.2d 253, 263 (N.Y. 1992) citing Mem. of Superintendent Pink, dated Feb. 26, 1940, Bill Jacket, L.1940, ch. 87. The revised statute required reinsurance contracts to provide that the insurer's insolvency will not diminish the reinsurer's liability to the insurer. Report of the Joint Legislative Committee on

Revision of Insurance Laws, No. 101, at 11 (1939); see also Skandia Am. Reinsurance Corp. v. Schenck, 441 F. Supp. 715, 725 (S.D.N.Y. 1977).

While the reversal of Pink by legislative fiat allows an insolvent insurer to access its reinsurance coverage and to apply that coverage as a source of funds to pay other claims, the Legislature also recognized that the revised statutory scheme created a disincentive for insolvent insurers to competently and effectively adjust claims -- i.e., an insolvent insurer has little incentive to reduce claim allowances because reinsurance recoveries are based on the allowance amount, not the amount actually paid to any particular policyholder. In order to offset that disincentive, the Legislature permitted reinsurers to become involved in the insurance-level process of investigating, adjusting, and asserting defenses against claims. Thus, Section 1308(a)(3) provides, in pertinent part, as follows:

> Such reinsurance agreement may provide that the liquidator, receiver or statutory successor of an insolvent ceding insurer shall give written notice of the pendency of a claim against such insurer on the contract reinsured within a reasonable time after such claim is filed in the insolvency proceeding and that during the pendency of such claim any assuming insurer may investigate such claim and interpose, at its own expense, in the proceeding where such claim is to be adjudicated any defenses which it deems available to the ceding company, its liquidator, receiver or statutory successor.

Ins. Law. § 1308(a)(3).

A reinsurance agreement that contains the language authorized by

Section 1308(a)(3) imposes an obligation on the insolvent ceding insurer to provide timely notice of claims to its reinsurers, i.e., "within a reasonable time after such claim is filed in the insolvency proceeding." Moreover, the insolvent ceding insurer may not allow a claim before its reinsurers have been afforded an opportunity to investigate the claim or to interpose defenses, i.e., "during the pendency of such claim any assuming insurer may investigate such claim and interpose, at its own expense, in the proceeding where such claim is to be adjudicated any defenses" (emphasis added).

The repetition in Section 1308(a)(3) of references to the filing of claims "in the insolvency proceeding" and to the interposition of defenses "in the proceeding where such claim is to be adjudicated" confirms that the reinsurer's right to investigate claims and to interpose defenses arises well before the insolvent insurer makes a recommendation to allow a claim. These repeated references to the insolvency proceeding signal that Section 1308(a)(3) was promulgated with due regard to the Article 74 requirement that all such claims are to be filed and adjudicated in the single, omnibus insolvency proceeding. See N.Y. Ins. Law §§ 7405, 7432, 7433. Indeed, in its opposition to Everest's motion to vacate the Interim Order, Midland concedes that the insolvency proceeding referenced in Section 1308(a)(3)

– as well as in its reinsurance contracts with Everest – encompasses the "entire claims process." See Midland's Memorandum of Law in Opposition to Everest Reinsurance Company's Motion to Vacate the November 8, 2006 Interim Decision and Order, dated December 5, 2006, at 12.[3] Thus, under Section 1308(a)(3), an insolvent insurer must allow its reinsurers to become involved at the very outset of the claims process and cannot block the effort of any reinsurer to raise defenses that such reinsurer deems available to the insolvent insurer.

The reinsurer, on the flip side, is afforded the absolute right, "during the pendency of [the] claim," to conduct an investigation and to interpose any defenses that the reinsurer "deems" available to the ceding insurer or its liquidator. See N.Y. Ins. Law § 1308(a)(3) (McKinney's 2006); 1939 N.Y. Laws ch. 882 § 77.[4] This particular part of Section 1308(a)(3) allows any reinsurer to affirmatively assert and pursue – not merely suggest or propose – defenses on behalf of the ceding insurer even if the ceding

[3] Although Midland recognizes that the references to the "insolvency proceeding" in Section 1308(a)(3) relate to the entire claims process, it somehow reaches the bizarre conclusion that the Legislature did not really mean what it said in Section 1308(a)(3). Id. at 12-13.

[4] The New York Insurance Department has recognized that reinsurers have the right to interpose defenses to claims against their insolvent ceding insurer. See 2000 NY Insurance GC Opinions LEXIS 42 at *4 (finding a reinsurance contract provision which apportioned expense between two or more reinsurers that elected to interpose defenses comported with Section 1308(a)(3)).

insurer or other reinsurers should object to the assertion of such defenses. Because Section 1308(a)(3) permits reinsurers to interpose defenses available to insolvent insurers, it must, by logical implication, be interpreted to permit reinsurers to deny claims. If reinsurers were relegated to suggesting defenses that could be rejected by Midland, then Section 1308(a)(3) would be rendered meaningless.

The statutory requirement that the reinsurer bear "its own expense" of raising defenses further confirms that the right afforded by Section 1308(a)(3) extends well beyond the limited ability to suggest or propose possible defenses to the insolvent ceding insurer. A special statutory provision is not needed to permit reinsurers to recommend coverage defenses to their cedents; they have that basic right simply by virtue of the parties' contractual relationship.

The wording authorized by Section 1308(a)(3) is not mandated for inclusion in reinsurance contracts. However, there is nothing in Section 1308(a)(3) which suggests that the enforcement of the authorized wording, when included in reinsurance contracts (as Midland and Everest knowingly agreed to do here), is somehow permissive or discretionary. A ceding insurer and its reinsurer may not be statutorily required to include such contract wording, but, if they do, it is fully binding and enforceable.

The force and effect of Section 1308(a)(3) is not trumped by Article 74, which sets forth the general process and procedure for the liquidation of insolvent insurers. Nor is Section 1308(a)(3), contrary to Midland's position, trumped by public policy. There can be no rational dispute that Section 1308(a)(3) is as much a reflection of public policy as Article 74.

Article 74 serves the principal functions of installing the Superintendent of Insurance as the liquidator of insolvent insurers domiciled in New York and providing that all claims involving the insolvent insurer shall be resolved in the context of an omnibus proceeding before a single court. See, e.g., Knickerbocker Agency v. Holz, 4 N.Y.2d 245 (1958); In re Lawyers Title & Guar. Co., 254 A.D. 491 (1st Dep't 1938); N.Y. Ins. Law § 7405. However, nothing in Article 74 allows the Liquidator or a court to disregard or restrict the rights of a reinsurer under a contract containing the language authorized by Section 1308(a)(3).

The vesting of exclusive authority in the Superintendent to act as the liquidator of insolvent insurers and of exclusive jurisdiction in a single New York court dates back to 1909. See Lawyers Title, at 254 A.D. at 492. The legislative authorization of a reinsurer's right to interpose claim defenses on behalf of an insolvent insurer took place decades later, in 1938, in response to the United States Supreme Court's decision in Fidelity &

Deposit Co. v. Pink. Because the legislation now embodied in Article 74 preexisted the predecessor of Section 1308(a)(3) by nearly 30 years, the Legislature must have deemed the rights afforded to reinsurers under Section 1308(a)(3) to be consistent with public policy and compatible with the general grant of authority to the Superintendent under Article 74. In other words, a claim that is investigated or controlled by a reinsurer under the wording authorized by Section 1308(a)(3) does not fall outside the ultimate control of the liquidation court and remains subject to the existing allowance procedures. The only change is that the reinsurer is entitled to take a leading role in the handling and defense of that claim, which will still be submitted to the Court for allowance or, if appropriate, disallowance.

Admittedly, there is no case law interpreting Section 1308(a)(3). However, it is an established rule of statutory construction that "legislative intent is to be ascertained from the words and language used, and statutory language is generally construed according to its natural and most obvious sense, without resorting to an artificial or forced construction." N.Y. Stat. Law § 94. See also N.Y. Stat. Law § 232 ("Words of ordinary import used in a statute are to be given their usual and commonly understood meaning, unless it is plain from the statute that a different meaning is intended"). Here, the "natural and most obvious sense" of the statutory language of

Section 1308(a)(3) contemplates and sanctions the very relief Everest seeks here, and nothing in Article 74 alters that result.

The Reinsurance Contracts Are Consistent with Section 1308(a)(3)

The reinsurance contracts between Everest and Midland (the "Midland Contracts") either incorporate the contract language permitted by Section 1308(a)(3) or contain substantially the same language. Midland had the option under Section 1308(a)(3) to refuse to enter into reinsurance contracts that included this language, but it agreed with Everest to do so.

Like Section 1308(a)(3), the reinsurance contracts provide that in the event of Midland's insolvency, Everest has the right to investigate claims and interpose defenses to coverage under Midland's insurance policies:

> during the pendency of such claim, [Everest] may investigate such claim and interpose, at its own expense, in the proceedings where such claim is to be adjudicated any defense or defenses that it may deem available to [Midland] or [its] liquidator.

(Complaint, ¶ 33). The obligations imposed on Midland and the Liquidator by this clause of the Midland Contracts are the same obligations imposed by Section 1308(a)(3), as discussed above.

Some of the Midland Contracts also give Everest the right to associate in the defense and control of any claim, suit or proceeding which may involve Everest's reinsurance obligations:

> [Everest] shall ... have the right and be given the opportunity to associate with the Company and its representatives ... in the defense and control of any claim, suit or proceeding which may involve this reinsurance with the full cooperation of the Company.

(Complaint, ¶ 34). This provision similarly comports with the intent and purpose of Section 1308(a)(3).

Consistent with Everest's right to participate in the claims adjustment process and to interpose defenses, the Midland Contracts place various obligations on Midland to provide notice of claims and material information concerning claims to Everest. For instance, Midland must provide Everest with timely notice of every insurance claim that might involve the Midland Contracts. (Complaint, ¶¶ 28-32). In addition, Everest has the express contractual right to access Midland's books and records to obtain any information concerning the subject matter of the Midland Contracts, including claims that might involve the reinsurance. In particular, Midland (or its Liquidator) is required to provide Everest with:

> free access to the books and records of the [Midland] at all reasonable times for the purpose of obtaining information concerning this Agreement or the subject matter thereof.

(*Id.* ¶ 38).

These provisions require Midland and the Liquidator to provide Everest with specific information concerning any claims that might impact

Everest as soon as practicable and, in any event, before settlement negotiations with Midland's policyholders are commenced with respect to such claims. (Complaint, ¶ 32). All of these requirements further the aims of Section 1308(a)(3) to give prompt notice of claims to reinsurers and to afford them a meaningful opportunity to participate in the claims process.

Questions 3 and 4: Midland's Current Claims-Handling Practices Fail to Meet Its Obligations

In paragraphs 3 and 4 of the Interim Order, the Court has required Everest to evaluate the current claims-handling practices of the New York Liquidation Bureau ("NYLB") and the extent to which those practices fulfill Midland's statutory and contractual obligations. Although Everest's allegations of inadequate claims-handling in its proposed complaint are supported by written claim reports provided by Midland, Midland is otherwise in exclusive possession of the facts sought here by the Court, and Everest cannot fully address those issues at this premature juncture, before any discovery has taken place. See Memorandum in Support of Everest Reinsurance Company's Motion to Vacate the November 8, 2006 Interim Decision and Order, dated November 22, 2006, at 13-17.

Everest has alleged, upon information and belief, that Midland's practices fail to comply with its contractual and statutory obligations, *inter alia,* in the following ways:

Failure to Provide Timely and Adequate Notice

Under the Midland Contracts and Section 1308(a)(3), Midland has the obligation to provide Everest with timely notice of claims filed in the insolvency proceeding that may involve Everest's reinsurance agreements with Midland. In many instances, the Liquidator, without justification and in violation of the reinsurance contacts, waited over 15 years before giving notice of claims that could give rise to liability by Everest. (Complaint, ¶¶ 41-45). For most of the time since Midland became insolvent in 1986, the Liquidator apparently did not have in place a system for ensuring that reinsurers received notice of claims. (*Id.* ¶ 46).

The Liquidator, through its agent, Navigant Consulting, Inc. ("Navigant"), has provided Everest with notices of some major policyholder ("MPH") claims. (Complaint, ¶ 74). However, these notices have not advised Everest of the Liquidator's plans for dealing with specific MPH claims, and the notices have also been misleading. (*Id.* ¶ 75). For example, notices to Everest have discussed the Liquidator's intent to assert coverage defenses that the Liquidator subsequently did not assert - without ever advising Everest of the Liquidator's changes in position. (*Id.*).

Failure to Notify Everest of Changes in Claims-Handling Practices

By way of example, in 2004, the Liquidator advised Everest that the

decision in *In re Liquidation of Midland Ins. Co.,* 709 N.Y.S.2d 24 (1st Dep't 2000) ("*LAQ*"), was the controlling law in the Midland estate and that the Liquidator would enforce the *LAQ* decision to the fullest extent possible as a defense to coverage. That decision had a substantive effect on the validity of claims.[5] (Complaint, ¶ 76). Despite admitting that the *LAQ* decision is "controlling" case law for the Midland estate, the Liquidator abandoned his former position regarding *LAQ* (again without informing Everest) and has negotiated settlements with MPHs without asserting *LAQ* as a defense to coverage. (*Id.* ¶¶ 76, 78-79).

Failure to Provide Access to Records

Everest has detailed Midland's failure to provide sufficient access to records in its prior submissions. See Memorandum in Support of Everest Reinsurance Company's Motion to Modify the Injunction to Permit Suit against the Liquidator, dated August 10, 2006 ("Moving Br."), at 16-17; Reply Memorandum in Further Support of Everest Reinsurance Company's Motion to Modify the Injunction to Permit Suit against the Liquidator, dated September 19, 2006 ("Reply Br."), at 10-11. Among other things, Midland

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[5] The Appellate Division in *LAQ* ruled, in connection with a claim for coverage under a Midland policy, that (i) the underlying claimant must prove contact with the injury-causing agent during the policy period, and (ii) all other solvent insurance must be exhausted before the Midland policy could be accessed. (*Id.* ¶ 77).

improperly sought to condition Everest's access to records on a guarantee that Everest would pay all outstanding billings on the claims subject to review immediately following the audit and impeded Everest's efforts to copy and scan files. Moving Br. at 17.

After repeated requests, Everest finally has been able to arrange an inspection of 34 (out of more than 170) MPH claim files that is scheduled to commence on December 11, 2006. Based on prior experience, it remains to be seen whether Midland will actually accommodate Everest's exercise of its contractual right to review Midland's claim files. Although Midland repeatedly represents to this Court that it has always afforded Everest complete access to "all" of Midland's claim files, the correspondence between Everest and Midland proves the contrary. That correspondence – which Everest has submitted to the Court with its prior submissions in support of its motion to modify the injunction against suit and its motion to vacate the Interim Order – shows that Midland has, at most, begrudgingly agreed (after inexcusably ignoring repeated requests) to provide Everest access to a small fraction of the universe of claims that will be considered for allowance under policies reinsured by Everest.

Failure to Permit Everest to Participate in the Claims Process

The Liquidator and his agents have consistently deprived Everest of

the opportunity to become involved in the claims adjustment process. At every step, Everest has been rebuffed or hindered in its efforts to review records, to participate in settlement negotiations with policyholders, and to interpose defenses. See Moving Br. at 10-13; Reply Br. at 8-11. The only instances in which Midland has requested "input" from Everest on claim allowances have taken place after Midland already had agreed to settle claims with policyholders and recommend the allowances to the Court. And, when Everest did offer defenses, they were ignored by Midland.

Failure to Conduct Businesslike Investigations

Contrary to reasonable and prudent claims-handling standards, upon being presented with a claim from an individual MPH, the Liquidator (through Navigant) simply solicits a settlement demand from the MPH rather than initiating a thorough investigation of the claim to determine its legitimacy and value. This approach is in direct contradiction to the statements to reinsurers that the Liquidator would conduct a coverage analysis and assert all available coverage defenses. (Complaint, ¶ 81). Thus, abandoning any effort to assert legitimate defenses to coverage, the Liquidator through Navigant merely asks the MPH to state the amount of the claim that should be allowed. (*Id.*).

Sometimes the underlying claims paid by the MPH are audited;

however, it appears that the purpose of the audits is merely to confirm that the MPH paid claims that were filed against it, rather than to evaluate the validity of those claims in the context of whether such claims are covered by the Midland policies. (*Id.* ¶ 82).

Failure to Evaluate Claims and Vigorously Negotiate Settlements

While it appears that the Liquidator and/or Navigant have retained a third party to allocate the claims allegedly paid by the MPH to the relevant Midland policy period(s) and to opine on whether the MPH's settlement demand is "reasonable," these opinions are prepared solely for the purpose of supporting an allowance of the full amount of the MPH's claim. (Complaint, ¶¶ 83-84). As a result, for the claims allowed to date, the amount recommended by Midland for allowance has always fallen within the amount demanded by the MPH. (*Id.* ¶¶ 85-86).

Apparently, each settlement recommended by Navigant (which is, in turn, then recommended for allowance by the Liquidator) is based largely, if not exclusively, on the entire amount of the initial MPH settlement demand made many years prior to the allowance recommendation. The settlement recommendation is thus based on outdated and insufficiently scrutinized information. It is not based, as it should be, on a reasonable investigation of the claims or a proper coverage analysis. (*Id.* ¶ 87).

* * *

Although the foregoing allegations in Everest's proposed complaint are directly supported by written notices and reports provided by Midland to Everest, Everest is entitled to written and oral discovery, including depositions of claim handlers from the NYLB and Navigant, in order to fully respond to the Court's questions and to have a fair opportunity to refute the alleged facts (in Midland's exclusive possession) that Midland will undoubtedly proffer in response to these questions. Among other things, Everest wants the opportunity to conduct document discovery and take depositions concerning (a) the processes and procedures established by the NYLB and/or Navigant concerning the handling and investigation of claims, the evaluation of the alleged exhaustion of underlying policy limits, the assertion of coverage defenses, and the performance of claim and financial audits of policyholder records, and (b) the material claims-handling deficiencies outlined in Everest's prior submissions. See, e.g., Reply Br. at 15-16.

While Everest has been afforded access to a limited number of MPH claim files to date and will commence the review of additional claims files next week, the inspection of such records is not a substitute for, and will not be sufficient to satisfy, Everest's need for traditional discovery. Midland's

claims-handling practices and procedures are not fully reflected in the claim files themselves, but must be extracted from depositions of claim handlers and their superiors and the production of manuals, guidelines or other documentary evidence of those practices and procedures.

Question 5: Changes to Be Implemented

The changes that need to be implemented to bring Midland's practices into compliance are the very same changes Everest outlines in its proposed Complaint. Midland must make all changes necessary to protect Everest's rights, including, the right to participate in the defense and control of policyholder claims, the right to interpose defenses, the right to timely and complete notice and reporting of claims, and the right to inspect Midland's books and records. These changes must include (i) giving Everest timely notice of claims to permit Everest to become involved in the process from the outset, including conducting its own investigation, (ii) permitting Everest to access and review records, (iii) allowing Everest to participate in settlement negotiations, and (iv) allowing Everest to raise defenses and to deny claims as appropriate.

As set forth above, the participation that Everest seeks does not necessarily implicate any amendments or modifications to the Court's standing order approving the Liquidator's recommended procedure for the

allowance of claims. The corrective actions required to bring Midland's practices in line with its statutory and contractual obligations are changes that need to be instituted and effectuated long before claims are ripe for final consideration for allowance or disallowance. If a policyholder objects to the disallowance or allowance recommendations to the Court, a referee dispute process is already in place. Everest requests the same level of participation in that process as it has been afforded under the CMO in the disallowance proceedings currently pending before this Court, which the policyholders clearly have not objected to.

The implementation of these changes will not impose any unnecessary burden or expense on Midland. Rather, all that Midland must do is timely send its claim advices to Everest and give Everest adequate time to review claim records and, if Everest so elects, to investigate the claim itself or to participate in claim meetings or settlement negotiations with the policyholder. In this regard, Midland must refrain from presenting any settlement offers to the policyholder or advising the policyholder of a decision to allow or disallow a claim until such time as Everest either exercises its right to participate or chooses not to do so. Further, if Everest makes a good faith determination to interpose defenses and, if necessary, to deny a claim, Midland cannot obstruct Everest from taking such actions.

Question 6: Minimization of Administrative Expenses

The Midland estate already bears administrative costs in responding to policyholder claims. The participation of Everest in the claims-handling process should serve to lessen that administrative burden because Everest has the resources to fully and competently investigate claims, i.e., the burden can be shifted to Everest when Everest opts to investigate, adjust or defend claims potentially involving the Midland Contracts. In addition, Section 1308(a)(3), as well as the Midland Contracts, contemplate that Everest will absorb the costs of its own claim investigations.

The costs of interposing defenses are also borne in the first instance by Everest. Those costs ultimately may be shared with Midland as provided in Section 1308(a)(3) and the Midland Contracts, which provide in relevant part:

> Such expense shall be chargeable subject to court approval against the insolvent ceding insurer as part of the expense of liquidation to the extent of a proportionate share of the benefit which may accrue to the ceding insurer solely as a result of the defense undertaken by the [reinsurer].

Ins. Law §1308(a)(3). Thus, while a reinsurer which interposes a defense does so at its own expense, where the reinsurer's assertion of the defense is successful, resulting in a reduction in the ceding insurer's liability exposure, the ceding insurer may bear its share of that cost, relative to the

benefit it receives.

Section 1308(a)(3), and the Midland Contracts, give the liquidation court final approval authority with respect to the shifting of defense costs to the insolvent estate. This particular provision allows the Court to apportion costs fairly, recognizing the benefit to the estate of a successful defense while considering the impact on the estate's financial resources.

CONCLUSION

For the foregoing reasons, the Court should grant Everest's motion to modify the injunction and grant Everest such other and further relief that the Court deems just and proper.

Dated: New York, New York
December 7, 2006

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