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

REPLY SUPPLEMENTAL MEMORANDUM OF EVEREST REINSURANCE COMPANY

Joseph J. Schiavone, Esq.
Vincent J. Proto, Esq.
Nahum A. Kianovsky, Esq.
BUDD LARNER, P.C.
11 Penn Plaza, 5th Floor
New York, New York 10001
(212) 946-2798

Attorneys for Everest Reinsurance Company

TABLE OF CONTENTS

PAGE

TABLE OF AUTHORITIES

PAGE

CASES

STATUTES

OTHER AUTHORITIES

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

REPLY SUPPLEMENTAL MEMORANDUM OF EVEREST REINSURANCE COMPANY

INTRODUCTION

Pursuant to the Interim Order, Everest submits this reply to Midland's supplemental submission.[1] Everest's reply is focused on matters that were not previously raised by Midland or that were not fully addressed in prior submissions with respect to Everest's Intervention Motion.[2]

Midland continues to make the same factual distortions and legal misstatements that have characterized its prior submissions. One such example is Midland's assertion that its substantive contractual obligations to Everest are somehow restricted by the mere existence of this liquidation proceeding. For example, Midland again cites the 1938 opinion of the First Department in In re Lawyers Title & Guar. Co., 254 A.D. 491 (1st Dep't

[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.

[2] All capitalized phrases previously defined in Everest's supplemental memorandum will not be re-defined here.

1938), for the proposition that the Liquidator has sole responsibility for the liquidation, including matters relating to the allowance and disallowance of claims. Midland's Supplemental Brief ("Midland Br.") at 10. Midland, of course, overlooks the basic fact that Lawyers Title was decided before the Legislature even recognized a reinsurer's right to participate in the claims process in the statute now codified as N.Y. Ins. Law §1308. See Supplemental Memorandum of Everest Reinsurance Company ("Everest Br.") at 11-12. As a matter of simple logic, Lawyers Title cannot be read to limit the scope and application of a statute that did not even exist when that case was decided. Midland's proposed limitations on Everest's rights also would require this Court to find that Section 1308(a)(3) somehow was impliedly repealed by the Court of Appeals nearly 50 years ago in Knickerbocker Agency v. Holz, 4 N.Y.2d 245 (1958), a case that did not consider the right of reinsurers to investigate claims or to interpose defenses, but merely rejected arbitration as a forum for litigating claims between reinsurers and the liquidators of insolvent ceding insurers.

"[L]iquidation does not ... [place the liquidator] in a better position than the company he takes over." In re Liquidation of Indemnity Ins. Co., 89 N.Y.2d 94, 107-108 (1996) (enforcing the reinsurer's right of rescission against an insolvent cedent in liquidation). In other words, a ceding

insurer's liquidation does not impair the substantive rights of its reinsurers. See In re Midland Ins. Co., 79 N.Y.2d 253, 263-64 (1992) (in this liquidation, the Court of Appeals held that neither the fact of insolvency nor the "without diminution" language of Section 1308(a)(2)(A)(i) vitiates the reinsurer's substantive right to offset under Insurance Law §7427). Thus, Midland's implausible suggestion that Section 1308(a)(3) was repealed or limited by decisions such as Knickerbocker and Lawyers Title should be rejected.

In addition, as to Midland's claims-handling procedures and how they measure up to its contractual and statutory obligations, Midland's supplemental submission raises more questions than it answers. For example, Midland concedes that it does not maintain uniform, consistently-applied, claims procedures. To the contrary, Midland states, without more, that its procedures "vary" from claim to claim. This lack of consistency substantiates Everest's need for discovery concerning Midland's "standard" procedures and the degree to which Midland has varied from those procedures with regard to claims that involve policies reinsured by Everest.

ARGUMENT

Questions 1 and 2: Midland's Strained Reading of the "Right to Interpose"

A. Midland Distorts the Plain Meaning of "Interpose"

Midland seeks to undercut Everest's right to "interpose defenses" under the Reinsurance Contracts and Section 1308(a)(3) by asserting that "interpose" means only that Everest may suggest defenses to the Liquidator. This self-serving and illogical reading is belied by the plain meaning of the word "interpose." For instance, Black's Law Dictionary, Eighth Edition, defines "interposition" as "the act of submitting something (such as a pleading or motion) as a defense to an opponent's claim."

The cost-shifting provisions of Section 1308(a)(3) and the Reinsurance Contracts – which Midland wholly disregards – further confirm that "interpose" is to be interpreted in accordance with its plain meaning. The fact that Section 1308(a)(3) provides for the reinsurer to bear the initial cost of interposing defenses, and then allows those costs to be reallocated to the estate to the extent that the reinsurer's defenses are successful, can mean only one thing: the reinsurer that interposes a defense takes over the prosecution of that defense.

Midland itself recognizes Everest's right to assert defenses and to intervene in the claims process. Midland has submitted a "Summary" of its claims-handling practices with the Affidavit of Jacqueline Bazemore, the Director of the Reinsurance Estate Management Division of the New York Liquidation Bureau ("NYLB"). Exhibit A to the Summary is a form "Claim Alert" letter, which advises reinsurers that Midland is considering a policyholder's claims for allowance. The first page of that form letter states: "Pursuant to your reinsurance contract(s) with Midland, you have a right to interpose defenses in this matter and assert any arguments or defenses you believe may apply." Midland then block quotes the very language authorized by Section 1308(a)(3), stating that "[y]our reinsurance contract(s) provides expressly or implicitly wording to [that] effect." Finally, Midland advises each reinsurer that it is entitled to "formally intervene ... and interpose any defenses that you believe should be raised."

In light of Midland's unequivocal acknowledgement that reinsurers are entitled to "intervene," "interpose defenses." and "assert any arguments or defenses you believe may apply," its current position that reinsurers are limited to "suggesting" defenses is inexplicable and has no merit.

B. Midland's Reliance on the Laws of Other States Is Misplaced

Midland cites to the insolvency laws of other states as support for its tortured application of Section 1308(a)(3). In particular, Midland references states that have adopted the Insurers Supervision, Rehabilitation and Liquidation Act ("ISRLA"). Midland Br. at 13.

However, as Midland concedes, New York is different from those other states in that it does not follow ISRLA. Midland Br. at 14. In fact, in Phase I of the disputed claim proceedings, Midland distinguished this liquidation from the Missouri liquidation of Transit Casualty Company ("Transit"), stating that "we are not in Missouri" and "[p]ublic policy in New York has simply been decided differently than Missouri." See Superintendent's Response in Opposition to Policyholder's Memorandum of Law Supporting Application of New York Choice of Law Principles to Claims against Midland Insurance Company in Liquidation ("Midland Choice of Law Br.") at 18. In light of that fundamental admission, Midland's contradictory reliance on the laws of Missouri and other states that have adopted some variation of ISRLA is ill-founded.

The Liquidator, in his capacity as the Superintendent of the New York Department of Insurance, is a member of the National Association of

Insurance Commissioners ("NAIC"), which, among other things, drafts model legislation. Notably, the NAIC has replaced ISRLA with the Insurer Receivership Model Act ("IRMA"). In drafting IRMA, the NAIC clearly contemplated the very relief sought by Everest here:

> The receiver shall give written notice, in accordance with the terms of the contract, to each reinsurer obligated in relation to the claim of the pendency of a claim against the reinsured company.... The reinsurer may interpose, at its own expense, in the proceeding in which the claim is to be adjudicated, any defense or defenses that it may deem available to the reinsured company or its receiver.

NAIC 555-1 § 611(E) (emphasis added).

Further evidence that the NAIC contemplated the kind of intervention Everest seeks here is found in another section of IRMA, which permits the liquidator to allow or disallow claims "subject to any statutory or contractual rights of the affected reinsurers to participate in the claims allowance process." NAIC 555-1 § 703(A) (emphasis added). This provision confirms that the Liquidator's right to administer the claims process does not absolve him from his contractual obligations. On the contrary, the Liquidator's right to allow or disallow claims, rather than being unfettered, is constrained by "the rights of affected reinsurers to participate" in that process.

C. Liquidations in Other States Are Irrelevant

Midland also argues that this Court should be guided by liquidations in other states, including the Home Insurance Company Liquidation and the Transit Receivership, despite the fact that those proceedings are in other states with different statutory schemes and policies. Midland Br. at 15. This is curious, to say the least, given Midland's stated position that developments in the Transit liquidation are not controlling here because "we are not in Missouri." Midland Choice of Law Br. at 18. Indeed, as Midland concedes, "public policy in New York has been decided differently." Id.

As Midland explains throughout its Supplemental Brief, New York has adopted a policy and procedure different from many other states. Midland has offered no reason why this Court should reject the clear public policy and statutory requirements of New York in favor of policies adopted by other states, which are admittedly at odds with the policy of New York.

D. Midland Distorts the Import of the Liquidation Court's "Exclusive Jurisdiction"

Midland's argument that Section 1308(a)(3) is inconsistent with the "comprehensive" procedure set forth in Article 47 entirely misses the mark. The Knickerbocker and Superintendent of Ins. v. Bankers Life & Cas. Co.,

401 F. Supp. 640 (S.D.N.Y. 1975), cases cited by Midland simply upheld the exclusive jurisdiction of the liquidation court in the face of attempts to place claims involving the insolvent insurer into federal court or arbitration. Those procedural decisions have no impact on Everest's substantive rights. See Everest's Reply Brief in Support of Its Motion to Vacate ("Everest's Vacate Reply Br.") at 16-17.

E. Midland's "Mandatory/Permissive" Dichotomy Is Meaningless

Midland contends that Section 1308(a)(3) should not be enforced by the Court because it is merely "permissive," in contrast to the supposedly "mandatory" nature of Section 1308(a)(2)(A)(i), which provides that a ceding company will not be allowed a credit for reinsurance unless the reinsurance contract includes language that requires the reinsurer to pay "on the basis of the liability of the ceding insurer ... without diminution because of the insolvency of the ceding insurer." Midland Br. at 3-5. While Everest already has established that Midland's assertion that Section 1308(a)(3) is "permissive" is unsound (Everest's Vacate Reply Br. at 8-11), Midland's related assertion that Section 1308(a)(2)(A)(i) is "mandatory" also is incorrect.

Section 1308(a)(2)(A)(i) does not require that all reinsurance contracts contain the "without diminution" language; it merely provides that, where such language is absent, the ceding insurer may not take credit on its books for reinsurance under statutory accounting principles. Midland contends that this section is nonetheless "mandatory" because "no ceding insurer (e.g. Midland) would enter into a reinsurance contract if it could not take credit for the transaction on its financial statement." Midland Br. at 5. That contention is unpersuasive.

In view of Section 1308(a)(2)(A)(i), what sensible reinsurer would enter into a reinsurance contract if it could not exercise its right to investigate claims and interpose defenses as set forth in Section 1308(a)(3)? Indeed, in its form "Claim Alert" letters to reinsurers, Midland acknowledges that its reinsurance contracts, either "expressly or impliedly," contain the wording authorized by Section 1308(a)(3). See Exhibit A of the Summary attached to the Affidavit of Jacqueline Bazemore.

Both provisions of Section 1308, once included in a reinsurance contract, are equally enforceable. There is no sound reason for concluding otherwise.

F. Midland Ignores Everest's Right to Investigate

While Midland acknowledges Everest's right to interpose defenses (all the while proposing an absurd definition of that term), Midland ignores the first section of that clause which provides that the "Reinsurer may investigate such claim...." Midland Br. at 4. Midland ignores the fact that this, too, is an obligation Midland has failed to fulfill and which Everest seeks to enforce.

G. Midland's Privity Argument Is Inapposite

Midland concedes that its policyholders are not in privity with Everest, but argues that "the claims handling process should be administered by the Liquidator—the party that has privity of contract with the policyholder." Midland Br. at 13. Midland fails to recognize the interposition issue has nothing to do with its policyholders, but is concerned with the Liquidator's contractual obligations to Everest.

H. Midland's "400 Reinsurers" Argument Is Disingenuous

Midland disingenuously asserts that, because there are 400 reinsurers that might take differing positions on the handling and defense of claims, the interposition clause should not be given effect. Specifically, Midland conjures a scenario where reinsurers will take conflicting positions

on "trigger and allocation" in order to minimize their exposure. Midland Br. at 22. This argument is a red herring.

In Phase I of the disputed claim proceedings, Midland has taken the position that the decision in In re Liquidation of Midland Ins. Co., 709 N.Y.S.2d 24 (1st Dep't 2000) ("LAQ"), constitutes the law of the case with respect to the universal application of New York law to claims arising under Midland's policies. As Midland stated to this Court in its October 16, 2006 choice of law brief, "the Superintendent and this Court are legally obligated to follow LAQ, a decision of the Appellate Division in this Department, which provides that the claims under Midland policies are to be interpreted in the liquidation proceeding under New York law." Midland Choice of Law Br. at 11. If LAQ is confirmed as the law of the case by this Court (or, if the Court otherwise finds that New York law should apply to all Midland policies), issues as to trigger and allocation will be decided uniformly in accordance with New York law. In other words, the application of New York law will eliminate the imagined specter of numerous reinsurers asserting conflicting positions on coverage issues.

In addition, several reinsurers, including Everest have intervened in the Phase I proceedings. Each of those reinsurers will be joining Midland

in advancing the argument that New York law should apply to claims under Midland's policies in this liquidation.

The number 400 is a phantom number. Midland admits that 400 is not an accurate count because it includes reinsurers with which Midland has commuted (settled) and combined companies. Affidavit of Diane Banks, at ¶ 7. That number most likely includes various reinsurers that are themselves insolvent. Moreover, as a practical matter, the likelihood that large numbers of reinsurers will interpose defenses to any claim is grossly overstated. Most reinsurers are likely to have participations that will not warrant the significant expense of becoming involved in the claims process. Notably, few than ten reinsurers, including Everest, have intervened in Phase I of the disputed claim proceedings. Finally, no evidence has been presented that there are risks that are reinsured by all 400 reinsurers. Midland's unsubstantiated "concern" about the potential involvement of 400 reinsurers is pure speculation.[3]

[3] Of course, even if other reinsurers were to seek involvement, their involvement could not affect Everest's contractual rights.

Questions 3 and 4: Midland's Discussion of Its Claims Policies Underscores Everest's Need For Discovery

Midland's supplemental submission highlights Everest's need for discovery in this matter. The affidavits submitted by Midland contain new factual assertions and create more questions than they purport to answer. For example, Midland attaches what it calls a "summary" of its claims practices to the Bazemore affidavit. That summary appears on its face to have been prepared specifically for the purposes of Midland's submission to this Court (and specifically tailored to support Midland's opposition to Everest's Intervention Motion). Everest is entitled to discover when, how and for what purpose Midland's summary was prepared.

Midland's summary also begs the question of whether and to what extent Midland actually complies with the procedures contained therein, as well as the makeup and function of the "Large Claim Committee." Midland contends that its "claims handling process ... is extremely complex and varies from claim to claim." Midland Br. at 23. Midland fails to explain how its procedures vary from claim to claim, or indeed what right it has to vary its procedures. On the contrary, Midland's admission that it lacks a uniform procedure for investigating, evaluating and processing claims supports Everest's position all along. Curiously, the summary attached to the

Bazemore Affidavit makes no mention of this "variable" claims protocol. Midland's failure to account more particularly for its claims handling practices cries out for discovery so that Everest and the Court will have an accurate understanding of Midland's actual practices. At the very least, Everest is entitled to conduct discovery on Midland's overall procedures and how its handling of the claims affecting Everest may have varied from those procedures.

Questions 5 and 6: The Required Changes Will Not Be Unduly Expensive

For the reasons previously explained, Midland's current practices do not satisfy its obligations to Everest. Everest Br. at 20-22. Accordingly, Everest rejects Midland's assertion that "no changes are required to be made." Midland Br. at 27.

The "compromise" suggested by Midland is grossly inadequate. Midland's suggestion that it will afford Everest sixty days' notice does not remedy the fundamental flaw in Midland's current practices, namely, that the Liquidator considers himself free to ignore Everest's right to investigate claims and interpose defenses. The addition of 30 days to an already deficient procedure does nothing to protect Everest's rights.

CONCLUSION

For the foregoing reasons, and those set forth in Everest's moving papers and supplemental submission, the Court should grant Everest's Intervention Motion, together with such other and further relief that the Court deems just and proper.

Dated: New York, New York
December 20, 2006

BUDD LARNER, P.C.
Attorneys for Everest Reinsurance Company f/k/a Prudential Reinsurance Company

By: _____
Joseph J. Schiavone
Vincent J. Proto
Nahum A. Kianovsky
11 Penn Plaza, 5th Floor
New York, New York
(212) 946-2798

624219w