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

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In the Matter of the Liquidation of :
MIDLAND INSURANCE COMPANY :

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MIDLAND'S SUPPLEMENTAL BRIEF REGARDING EVEREST REINSURANCE COMPANY'S MOTION TO MODIFY THE INJUNCTION TO PERMIT SUIT AGAINST THE LIQUIDATOR

Index No. 41294-86
Hon. Michael Stallman
I.A.S. PART 7

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Everest Reinsurance Company ("Everest") filed its Motion to Modify the Injunction to Permit Suit Against the Liquidator ("Everest's Motion") in the Matter of the Liquidation of Midland Insurance Company ("Midland"). On November 8, 2006, this Court issued its Interim Decision and Order (the "Order"), which adjourned and recalendared Everest's Motion to the Motion Submissions Part for March 8, 2007 in order to receive additional submissions.

The Order summarized Everest's Motion as follows: "Everest intends to bring an action against Midland to enforce contractual provisions contained in Midland's reinsurance contracts with Everest, which Everest contends permit Everest to participate in the claims handling procedure in the course of Midland's liquidation." (Order p. 1) The Court further requested that the parties submit supplemental briefs, which address the "issue" as to "how the provisions of Insurance Law § 1308 should be interpreted in the context of a liquidation under Article 74 of the Insurance Law" (the "Issue"). The Court also directed the parties to answer six specific questions (the "Questions"):

(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?

(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 expense to the Midland estate?

The answer to the Issue and the Questions can be summarized in one concise paragraph. New York's courts have consistently held that Article 74 of the Insurance Law is a comprehensive and exclusive statute that entrusts the complete management of the liquidation estate in the Superintendent of Insurance as Liquidator with respect to claims both for and against the insolvent insurance company, subject to the overall approval of the court. Allowing any reinsurer to usurp the Liquidator's role through the use of a reinsurance contract "interposition clause" provision or misinterpretation of Insurance Law § 1308(a)(3) would be an abrogation of long-established New York law. Midland's Liquidator has claims

procedures in effect that comply with the interposition clause in its reinsurance contracts. Midland does not believe that its procedures or practices *require* any amendments. However, in the interest of compromise, Midland will agree that the time period for reinsurers' review of potential allowances will be increased. This compromise position would involve a loss of investment income to the estate if the claim is a valid claim.

I. "THE ISSUE:" HOW TO INTERPRET AND HARMONIZE THE PROVISIONS OF § 1308(A)(3) IN THE CONTEXT OF ARTICLE 74 OF THE INSURANCE LAW

A. History of §1308

Section 1308 is the enabling legislation for what is commonly referred to in reinsurance contracts as the "Insolvency Clause." Only § 1308(a)(3), which contains the "interposition clause," is applicable to the issue presented by the Court. However, the provision that is most commonly referred to as "the Insolvency Clause" is actually § 1308(a)(2)(A)(i), which provides as follows:

> (a)(2)(A) No credit shall be allowed, as an admitted asset or deduction from liability, to any ceding insurer for reinsurance ceded, renewed, or otherwise becoming effective after January first, nineteen hundred forty, unless:
>
> (i) the reinsurance shall be payable by the assuming insurer on the basis of the liability of the ceding insurer under

the contracts reinsured without diminution because of the insolvency of the ceding insurer ....

The "interposition clause" provides:

> (a)(3) 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 an 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. 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 assuming insurer."

(Emphasis added.)

The reinsurance contracts between Everest and Midland all contain an Insolvency Clause which is identical or similar to the following:

> In the event of the insolvency of the reinsured Company, this reinsurance shall be payable directly to the Company, or to its liquidator, receiver, conservator or statutory successor on the basis of the liability of the Company without diminution because of the insolvency of the Company, ...
>
> ***
>
> the Reinsurer may investigate such claim and interpose, at its own expense, in the proceeding **where such claim is to be adjudicated** any defense or defenses that **it may deem available to the Company or their liquidator, receiver, conservator or statutory successor**.
>
> * * *

> When two or more Reinsurers are involved in the same claim and a majority in interest elect to interpose defense to such claim, the expense shall be apportioned in accordance with the terms of the reinsurance Agreement as though such expense had been incurred by the Company.

The genesis of the Insolvency Clause in reinsurance contracts can be traced to the U.S. Supreme Court decision in *Fidelity & Deposit Co. of Maryland v. Pink*, 302 U.S. 224, 58 S.Ct. 162 (1937), where the Court held that the Liquidator of an insolvent insurer could not recover from its reinsurer; rather, the reinsurer was required to pay the proceeds directly to the claimant. This holding led to the predecessor of Insurance Law § 1308, Insurance Law § 77, which effectively reversed *Pink* by not allowing ceding insurers a credit for reinsurance unless the contract contained the language found in § 1308(a)(2)(A)(i). Thus, this subsection is effectively mandatory, as 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.

On the other hand, the provisions of § 1308(a)(3), which permits reinsurers to interpose defenses, among other things, is not required under the statute; it is permissive or discretionary. The language of § 1308(a)(3) must, therefore, be reviewed in the context of and *in pari materia* with, Article 74 of the Insurance Law and the case law attendant thereto.

B. Article 74's Comprehensive and Exclusive Procedures

With respect to Article 74, the case law in New York is clear that the Liquidator, not reinsurers, is solely responsible for the adjudication of all creditor claims under the exclusive supervision of the Supervising Court.

> It is clear enough that, in order to assure orderly liquidation and a coordinated balancing of competing claims to a depleted fund, the Legislature could and did vest exclusive jurisdiction over all claims **against an insolvent insurer** in one body. Insurance Law, §§ 514, 526-528, 536-545.
>
> * * *
>
> For this reason, § 528 [now § 7419(b)], Insurance Law, authorizes the enjoining of actions or proceedings collateral to the liquidation proceeding, which §§ 543 and 544 [now §§ 7432 and 7433] provide for the filing, proof and allowance of claims in the liquidation proceeding. In this fashion individual claims affecting the fund and, therefore, every creditor and claimant, are considered in the context of a proceeding undertaking to balance the respective rights and equities of all interested parties. * * * 'Experience has demonstrated that, in order to secure an economical, efficient, and orderly liquidation and distribution of the assets of an insolvent corporation for the benefit of all creditors and stockholders, it is essential that the title, custody, and control of the assets be intrusted to **a single management** under the supervision of one court.' * * * *Motlow v. Southern Holding & Securities Corp.*, 95 F.2d 721, 725-26 (8th Cir. 1938) [interpreting New York law].

Matter of Knickerbocker Agency (Holz), 4 A.D.2d 71, 73 (1st Dept. 1957), *aff'd* 4 N.Y.2d 245 (1958). (Emphasis added.) There is no question that the words "single management," as used at the end of the above quote, refer to the actions of the Superintendent of Insurance, in his capacity as Liquidator, including his recommendations to the Court for allowance and

disallowance of claims. This statutory mechanism is "exclusive" and has no exceptions. *Id.* Under these "comprehensive" and "exclusive" insolvency law provisions, the supreme court, acting "with the agency of the Superintendent of Insurance, was intended to have **exclusive jurisdiction of claims both for and against an insurance company in liquidation**." *Knickerbocker Agency, Inc. v. Holz*, 4 N.Y.2d 245, 250, 149, N.E.2d 885, 889, 179 N.Y.S.2d 602, 606-607 (1958) (Emphasis added.)

On the other hand, § 1308(a)(3) only allows for *permissive* interposition of defenses by reinsurers in a limited capacity. The interposition clause statute must be read *in pari materia* with the comprehensive, exclusive insurance insolvency statutes that reserve the power to the Liquidator to adjudicate all claims subject only to court approval. *Kimberly's A Day Spa, Ltd. v. Hevesi*, 11 Misc.3d 954, 956, 810 N.Y.S.2d 616, 618 (Sup. Ct., Albany Cty 2006)("statutes *in pari materia* must be construed with reference to each other"). Moreover, the specific, mandatory provisions of Article 74 govern over the general permissive provision in § 1308(a)(3). *Thomas v. City of New York, Dep't of Housing Preservation and Development*, 12 Misc.3d 547, 817 N.Y.S.2d 864, 871 (Sup. Ct., New York Cty. 2006)(specific statutes govern over general.)

The interposition clause is, in essence, very simple, as it provides that "the Reinsurer may investigate such claim and interpose, at its own expense, *in the proceeding where such claim is to be adjudicated* any defense or defenses that it may deem available to the Company or their liquidator, receiver, conservator or statutory successor...." In interpreting a reinsurance contract, New York courts give meaning to every sentence, clause and word of the contract. *Certain Underwriters at Lloyds, London v. Travelers Cas. and Sur. Co.*, 96 N.Y.2d 583, 594 (N.Y. 2001), *citing Northville Indus. Corp. v. National Union Fire Ins. Co.*, 89 N.Y.2d 621, 632-633 (N.Y. 1998).

The specific phrase in the interposition clause -- "in the proceeding in which the claim is to be adjudicated" – definitely involves the proceedings before the Liquidator as well as the proceedings before the court. In other words, all claims are being adjudicated by Midland's Liquidator in the sense that all claims have been "intrusted to a single management under the supervision of one court." *Matter of Knickerbocker*, 4 A.D.2d at 73. Again, that single management is unquestionably the Superintendent in his capacity as Liquidator. When the Court of Appeals affirmed the lower court in *Knickerbocker Agency, Inc. v. Holz*, the Court stated that: "Those provisions of the Insurance Law 'are exclusive in their operation and furnish

a complete procedure for the protection of the rights of all parties interested' (Matter of Lawyers Title & Guar. Co., 254 App. Div. 491, 492, 5 N.Y.S.2d 484, 486)." 4 N.Y.2d at 250, 149 N.E.2d at 889. (Emphasis added.)

Moreover, in *In re Lawyers Title & Guaranty Co.*, 254 A.D. 491, 494, 5 N.Y.S.2d 484, 487 (1st Dept. 1938), cited above approvingly by the Court of Appeals in *Knickerbocker*, the Court discussed the role of the Liquidator vis-à-vis the Supervising Court, holding that the Liquidator had the responsibility for handling all day-to-day affairs of the estate subject to the approval of the court::

> **The Superintendent may not be compelled to surrender his trust created by statute**. **The responsibility for the liquidation is that of the Superintendent of Insurance**. He may ask the help of the Court in solving the problems which arise from time to time but all propositions for the liquidation of the corporation must be approved by him. The broad powers lodged in the Superintendent carry with them the grave responsibility of liquidating these companies in a proper manner. There is nothing to prevent the Superintendent himself from negotiating with parties interested for the formulation of an appropriate plan of liquidation, and, when he has decided upon such plan, it may be submitted for the approval or disapproval of the court.
>
> This Court has recently held that when considering the sale of assets of a company in liquidation the court may not substitute its judgment for that of the Superintendent. Matter of National Surety Company, 248 App.Div. 111, 288 N.Y.S. 1014, affirmed 272 N.Y. 613, 5 N.E.2d 358. (Emphasis added.)

The Court in *Lawyers Title & Guaranty* made it clear that the Liquidator, not the reinsurers, handled the "responsibility for the liquidation." This undoubtedly involves the allowance and disallowance of claims – a key and primary role of a liquidator. The Court in *Lawyers Title & Guaranty* also discussed the Court approving the liquidator's "liquidation plan." 254 A.D. at 494. This Court approved the Midland Liquidator's formal liquidation report on December 23, 2005, which report contained the following statement concerning claims "adjudication:"

> A proof of claim is "adjudicated" upon the Liquidator's recommendation to the Court that it either be "allowed" or "disallowed." An "allowed" claim is a claim that has been approved by the liquidation court and is allowed to share in the distribution of assets. Subject to statutory limits, claims that are approved and meet the requirements for the Funds' coverage are paid by the Funds. A "disallowed" claim is a claim that has been rejected and will not share in any payments out of the estate's assets.

This Court's acceptance of that definition supports the concept that the lower court and Court of Appeals approved in the *Knickerbocker* cases and in the *Lawyers Title & Guaranty* case, i.e. the Liquidator recommends the allowance and disallowance of the claims as part of the adjudication process subject to the court's approval.

Finally, in *Superintendent of Insurance of the State of N.Y. v. Bankers Life & Cas. Co.*, 401 F.Supp. 640 (S.D.N.Y. 1975), the court refused to

consider a motion by a claimant (the sole shareholder) of the insolvent insurance company to intervene in a pending federal court action, to seek an order to effectively unwind a settlement entered into by the Liquidator and to enjoin the parties to that action from "interposing ... any defenses" based on the New York Supreme Court's approval of that settlement. *Id.* at 641. The federal district court, even though it commented that it assumed the settlement was "improvident and inadequate," determined that the decision to settle was "exclusively a state interest." *Id.* at 646-647, *citing to Motlow* and the Court of Appeals' decision in *Knickerbocker.* The court stated that, "in our view, the Superintendent was "entitled to all the rights of a private litigant, including the absolute right, if authorized by the State court whose agent he is, to settle or discontinue on terms he considers proper ...." *Id.* at 651. (Emphasis added.)

The remainder of the interposition clause, cut to its essence, provides reinsurers with the ability to "**interpose any defenses which it deems available to the ... liquidator**" in the insolvency proceedings. Midland submits that the interposition clause should allow reinsurers to do exactly what the clause provides, i.e. when the Liquidator is considering recommending an allowance (the "pre-allowance stage" in Everest's

terms)[1], one or more reinsurers may provide the Liquidator with potential defenses. The Liquidator may review the "interposed" defenses concerning the proposed allowance and: a) reconsider the proposed allowance, b) reduce the amount of the proposed allowance, or c) proceed with the proposed allowance notwithstanding the defenses by such reinsurers. If the Liquidator proceeds with a "Notice of Determination" on the recommended allowance, and it is agreed to by the policyholder and approved by this Court, the Liquidator will bill the reinsurer for its proportionate share of the claim. The reinsurer may refuse to pay and the consequences are generally a lawsuit for collection.

If the Liquidator has recommended a disallowance of the claim, and the claimant has objected and the case has gone into judicial proceedings (as in the CMO proceedings), the reinsurer may request to intervene under the CPLR and, if permitted, raise all available defenses and appeal a ruling in that proceeding. There is no case law or other authority that permits the reinsurer more than that level of involvement.

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[1] The Liquidator does not agree with Everest's term "pre-allowance stage." The answers to the Questions, *infra*, will demonstrate that The Liquidator adjusts all claims without regard to whether the claim is going to be recommended for allowance or disallowance. There is not a concentration on "pre-allowances" (as the CMO proceedings demonstrate). Midland's Case Reserves notices (with "Captioned Reports") are sent to reinsurers advising them of claims activity during the pendency of claims; when that activity changes to a potential allowance, "Claims Alerts" are sent to reinsurers.

Finally, policyholders have no privity of contract with a reinsurer. This, however, only confirms that the claims handling process should be administered by the Liquidator – the party that *has* privity of contract with the policyholder.

C. Other States' Laws

Other states have adopted interposition statutes similar to § 1308. Indeed, almost all states have such statutes, but they all are permissive just like New York's statute. Yet almost all states entrust exclusive jurisdiction over claims handling to the Liquidator. The great majority of states' insurance insolvency laws specifically set forth the fact that the receiver or liquidator allows or disallows claims and, if the claim is disallowed, set forth appeal procedures with jurisdictional limits under the Insurers Supervision, Rehabilitation and Liquidation Act ("ISRLA"). *See e.g.* §§ 375.670, 375.1150 et seq., RSMo 2000 (providing for the Liquidator alone to allow claims).[2] Section 375.246.5(2)(d), RSMo also contains an "interposition provision" almost identical to § 1308(a)(3), so the legislature was well aware of

[2] Section 375.670.2, RSMo, 2000 provides: "Claims presented against the receivership shall be reviewed by the receiver. The receiver shall either consent to the claim in whole or in part or shall contest the claim. If the receiver consents to the claim in whole or in part, he shall also classify the claim according to the priority to which it is entitled under section 375.700. A written notice of his consent shall be given to the claimant or his attorney by first class mail at the address shown in the proof of claim. Whenever the receiver objects to all or any portion of the claim, the claim shall be subject to the provisions of section 375.1214.

reinsurers' possible rights, but excluded them from the allowance process. Under ISRLA, the Supervising Court is not involved in the claims allowance process if the claimant does not appeal the amount and classification of the allowance determination within the proscribed statutory period. If no appeal is filed, the amount of the allowance is final and not appealable.[3] In the thirty-two ISRLA states, the court is only involved if a claim is disallowed, the claimant objects, there is an appeal to a "referee" or special master and a subsequent appeal to the court.

Massachusetts, which like New York, is in the distinct minority utilizing the old Uniform Insurers Liquidation Act (Mass. Gen. Laws, c, 175, §§ 180A – 180L), allows interposition (Mass. Gen. Laws c. 175, § 20A(4)(C)) but also follows New York law as to exclusive jurisdiction. *See Matter of Liquidation of American Mut. Liability Ins. Co.*, 417 Mass. 724, 736, 632 N.E.2d 1209, 1215 (Mass. 1994)(Mass. Gen. Laws c. 175, §§ 6 and 180C "expressly allows the receiver to 'compromise *all* choses in action'").

The Liquidation Plans of other large insolvent estates also provide insight into this issue. They confirm that the Midland Supervising Court's current Allowance and Disallowance Orders, entered by Judge Beverly

[3] In this estate, the Liquidator recommends a disallowance and, if the claimant fails to object within sixty days from the notice date, seeks approval of such from this Court.

Cohen, along with the Midland Receivership's current claims handling process based thereon, are consistent with the practices of the other major insolvent estates in the nation. The Home Insurance Company in Liquidation, arguably the nation's largest insurance insolvency, adopted a local court rule entitled "Order Establishing Procedures Regarding Claims Filed With The Home Insurance Company In Liquidation." (Rule 6-20) Transit Casualty Company in Receivership, another one of the nation's largest insolvencies, currently has in force its Third Amended Local Rule (75.7-75.9). Both of these local court rules call for the Liquidator to be the sole adjudicator of claims allowances with attendant statutory appeals periods. (Owen Affirmation, ¶2-3) If an appeal is perfected, The Home's and Transit's rules provide for all claims to be heard by special masters or "referees" and provide for a system of appeals in that state court system.

In Massachusetts, which does not follow ISRLA, under a typical Liquidation Plan the Liquidator adjudicates all claims within the Receivership Court process, with appeals through Special Masters and subsequent appeals through the Court. *See e.g. Plan of Liquidation, Abington Mutual Liquidating Trust, Massachusetts Supreme Judicial Court for Suffolk County*, § II (A)(1-8) (Owen Affirmation, ¶4) Again, the power is solely with the Liquidator with no provision for reinsurers to be involved notwithstanding

Massachusetts interposition statute (Mass. Gen. Laws c. 175, § 20A(4)(C)). Several of the other large insolvencies in the United States provide the same and Midland knows of no others that provide for reinsurers to intervene in the allowance process. (Owen Affirmation ¶5-6)

It is clear from New York law and the other states' laws that, despite the presence of interposition statutes, the legislatures and Supervising Courts enacting local court rules (including Judge Beverly Cohen's allowance and disallowance orders) reflect that reinsurers do not have a role in the claims allowance process. The states all have laws that permit reinsurers to negotiate with insurers to have a contract provision that will allow the reinsurer to interpose defenses available to the liquidator in the insolvency proceedings, but there are no other statutory mandates concerning a reinsurer's involvement in the process.

In the instant case, if the interposition clause was interpreted to mean that the reinsurer could take over the claims allowance process, it would fly in the face of the New York statutes and case law that provide "comprehensive" procedures for the "exclusive jurisdiction of claims both for and against an insurance company in liquidation" (*Knickerbocker Agency, Inc. v. Holz*, 4 N.Y.2d at 250) and "a complete procedure for the

protection of the rights of all parties interested" (*Matter of Lawyers Title & Guar. Co.*, 254 App.Div. at 492).

New York courts have held that, when it comes to the administration of the insolvent estates of insurance companies, public policy considerations take precedence over the contractual rights of a reinsurer. For example, in both *Knickerbocker* cases, the courts denied the reinsurer arbitration based on New York public policy even though the reinsurance contracts contained arbitration provisions. Then, in *Corcoran v. Ardra Ins. Co., Ltd.*, 156 A.D.2d 70, 75, 553 N.Y.S.2d 695, 698 (1st Dept. 1990), the court was faced with the issue again under *federal* and *international* law when the Court denied Ardra, a Bermuda reinsurer, its request for arbitration notwithstanding the passage of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, as implemented by the Federal Arbitration Act, 9 U.S.C. § 201 *et seq.* The Court rejected the reinsurer's arguments that the reinsurance contract called for arbitration, and that federal and international law (as well as public policy) called for enforcement of that contract provision. The Court stated:

> Therefore, Ardra must be deemed to have had knowledge, at the time it entered into the contract with Nassau, regarding the exclusive jurisdiction of the State Supreme Court with respect to the liquidation of Nassau, and the probable implications of this jurisdiction for the enforceability of each Reinsurance Agreement's arbitration provisions. (*Corcoran v Ardra Ins. Co.,*

> *Ltd., supra,* at 1232 n 6.) *** **Since the dispute which arose is not between Ardra and Nassau, but between Ardra and the Superintendent as Liquidator of Nassau, it is not a "commercial" matter. The Liquidator sues Ardra as a fiduciary protecting not only the interests of Nassau, but also policyholders and the general public in the State of New York** (*see, Knickerbocker Agency, Inc. v. Holz, supra,* 4 N.Y.2d at 251, 173 N.Y.S.2d 602, 149 N.E.2d 885; *but cf. Corcoran v. AIG Multi-Line Syndicate, Inc.,* 143 Misc.2d 62, 68, 539 N.Y.S.2d 630, 635).

(Emphasis added.) *See also Curiale v. Ardra Ins. Co., Ltd.*, 189 A.D.2d 217, 595 N.Y.S.2d 186 (1st Dept. 1993).

The issue here concerns not only the rights of reinsurers, but also the rights of all policyholders and the general public. The Liquidator has an obligation to all of those policyholders and the general public and the New York courts have recognized that this duty supersedes the contract right of reinsurers, despite the obvious importance of that arbitration right in most any other realm.

D. Midland's 400 Reinsurers

The attached Affidavit of Diane Banks demonstrates that Midland had upwards of 400 reinsurers protecting its policies of insurance. (Banks Affidavit ¶7) This issue was the subject of Midland's original brief (pp.5-6) so it will not be repeated at length here. Suffice it to say that the legislature must have been aware that it would be absurd to have the administration of claims in a receivership entrusted not to a "single management," but to a

decision making process of ten, twenty or perhaps many more parties all with their own agendas. A primary rule of statutory construction is to avoid an interpretation that would lead to an unreasonable or absurd result. *Zappone v. Home Ins. Co.*, 55 N.Y.2d 131, 140-41, 432 N.E.2d 783, 788-89, 447 N.Y.S.2d 911, 916-17 (1982).

E. Conclusion on Reconciling § 1308 and Article 74

The only conclusion that can be drawn is that, when read together, Insurance Law § 1308 and Article 74 may be harmonized only insofar as they provide that the Liquidator has exclusive jurisdiction over the adjudication of claims that are filed in the insolvent's estate. The Liquidator, as a matter of practice, reviews the defenses that one or more reinsurers offer to the Liquidator for his consideration. Regardless of whether the Liquidator agrees with none, some or all of the defenses offered by one or more of the reinsurers, the law reserves full authority to the Liquidator to recommend the allowance or disallowance of claims to the Supervising Court. If the claim is disallowed and the claimant does not timely object in the 60-day appeal period (based on this Court's Disallowance Order), the interposition issue is moot as the disallowance is final. If a timely objection is filed and the CPLR applies, or on the appeal of a referee's report, the reinsurer may request to intervene under the CPLR,

pursuant to the interposition clause, in a manner similar to the reinsurers that have intervened in the CMO proceedings.

II. ANSWERS TO THE COURT'S SIX QUESTIONS

QUESTION 1

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

As stated, Insurance Law § 1308(a)(3) is a permissive section. It allows the parties to negotiate whether they want to include a provision in the reinsurance contract concerning notice of claims to reinsurers and their ability to interpose defenses on those claims. Thus, this discretionary part of the statute *imposed* no obligation on Midland at the time of contracting.

In this case, at the time the contracts were negotiated, Midland and Everest determined that the contracts would contain an Insolvency Clause, which provides that: a) the reinsurance was payable directly to the Liquidator; b) required notice after Midland was aware that a claim involved liability to the reinsurer; and c) Everest may investigate claims and interpose defenses available to the Liquidator. The Liquidator and the reinsurers are bound by those and all other contractual obligations not altered by overriding New York statute or decisional law (e.g. as noted in Section I).

QUESTION 2

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

This question has been addressed in detail in Section I of this Supplemental Brief, most specifically at page 12. In short, the reinsurers can interpose defenses available to the Liquidator prior to its issuance of a Notice of Determination of a recommended allowance and the Liquidator may utilize none, some, or all of the defenses offered by one or more of the reinsurers. However, New York law reserves full authority to the Liquidator to recommend the allowance or disallowance of claims.

One subsection of the Insolvency Clause can alter or impose different obligations on the Liquidator depending on the circumstances of each case, to wit:

> When two or more Reinsurers are involved in the same claim and a majority in interest elect to interpose defense to such claim, the expense shall be apportioned in accordance with the terms of the reinsurance Agreement as though such expense had been incurred by the Company.

This is a distinct issue with Midland as there are multiple reinsurers on most of the insurance policies and each reinsurer has a nearly identical provision in their contract. Midland makes every attempt to treat all of the reinsurers equally but it can become difficult when the reinsurers are taking different positions on various claims. Because of the concept of "trigger"

and "allocation" of losses, one reinsurer can take a position on a claim that triggers certain years and/or allocates certain losses into policy years or "layers" of insurance within those years that could or could not involve that particular reinsurer.

Midland's Liquidator must always be cautious that a reinsurer is not only offering a defense with reference to the validity of the claim itself. He must also consider whether the reinsurer is offering the defense solely because it wants to avoid having its years or layers of reinsurance impacted by the losses as opposed to another of Midland's reinsurers impacted by the loss. This is a distinct reality as two of the key questions in all of Midland's major policyholders' claims are trigger and allocation. In short, the reinsurers' motives may not be consistent with those of the Liquidator, i.e. a fiduciary with the responsibility to fairly and impartially adjust the claim. The reinsurer's primary goal is to avoid liability and this is not consistent with the Liquidator's fiduciary duty.

QUESTION 3

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

Midland has provided a summary of the Liquidator of Midland's current claims handling practices. Exhibit 1 to Bazemore Affidavit, ¶4 (the "Bazemore Summary.") Copies of documentation that is used in that

process (e.g. Claim Alerts) are attached as exhibits to the Bazemore Summary. Additionally, Midland has filed Affidavits of Diane Banks and Andrew Stuehrk, similar to the affidavits filed in Opposition to Everest Reinsurance Company's ("Everest") Motion to Vacate this Court's November 8, 2006 Interim Decision and Order and to Preclude the Reference, Use or Admission of Certain Evidence in Connection with Everest's Motion to Modify the Injunction Against Suit. The Banks and Stuehrk affidavits set forth in detail how Midland has been responsive to Everest (and other reinsurers) in sending out detailed notices to Everest on Claims Reserves (potential impairment on policies insured by Midland and reinsured by Everest), Claims Alerts on potential allowances and in permitting claims audits, including three audits in 2006.

The "claims handling process" for Midland is extremely complex and varies from claim to claim. In general, however, each policyholder claim accepted in the proceeding as timely by the liquidator is referred to an examiner for coverage determination, evaluation and recommended adjudication. If there is a potential for "impairment" to a Midland policy, the examiner recommends initial reserves (in some cases precautionary reserves of $9) which are periodically adjusted as additional information becomes available.

An Initial Captioned Report is prepared that summarizes the available information, provides a preliminary coverage analysis and claim evaluation and outlines steps required to bring the claim to conclusion. Supplemental Captioned Reports are prepared periodically as warranted by developments, and particularly changes in the coverage or claim evaluation. A final Supplemental Captioned Report – Recommended Allowance/Disallowance is prepared when the claim evaluation is completed. This process ultimately leads to a final claim evaluation resulting in an allowance or disallowance recommendation. All of these Captioned Reports are sent to the participating reinsurers during the process of the claims handling.

If the Liquidator believes that an allowance should be recommended, a "Supplemental Captioned Report – Recommended Allowance" is prepared and submitted to a committee described in the Bazemore affidavit for approval of the recommendation. The report is detailed in the affidavit attachment, but it generally details the rationale for the recommended allowance describes the activities that have been completed in furtherance of the recommendation. If the committee approves the recommended allowance range, a reinsurance "cession" is prepared that identifies which reinsurers would be impacted by the proposed recommended allowance

and the Claim Alerts are sent to all such reinsurers along with the cession, the captioned report and sometimes other documentation, such as audit and allocation reports.

Reinsurers are given a minimum of 30 days to file any response or inquiry to the Claim Alert. Reinsurers may interpose whatever defenses that they believe are available to the Liquidator and question any aspects of the recommended allowance. The Liquidator considers the comments from reinsurers and incorporates what is relevant in its evaluation of the claim. If in the Liquidator's judgment the reinsurers' proposed defenses do not impact the proposed recommended allowance, the Liquidator may commence negotiations with the policyholder.

The Settlement Agreement and/or Notice of Determination (NOD) between the policyholder and the Liquidator is executed and presented to this Court for approval pursuant to the "Order Approving the Liquidator's Proposed Procedures for Judicial Review of Recommendations for Allowance of Claims" signed by Judge Beverly Cohen on January 30, 1997. The billing process is described in more detail in Bazemore Summary.

The claims examination processes as outlined above, generally pertain to disallowances procedures as well. Once it has been determined that the claims should not be allowed, a disallowance Notice of

Determination is prepared and mailed to the policyholder pursuant to the "Order Approving the Petitioner's Proposed Procedure for Judicial Review of the Petitioner's Disallowance of Claims" the policyholder may file written objections to the disallowance within sixty days of the date of the NOD recommending disallowance.

If the Policyholder files a timely written Objection, the Liquidator will review and determine whether the recommended disallowance should be reconsidered. If not, the claim is referred to the referee appointed by the Court (or to the Court itself in certain instances if the issue is purely a legal one) to hear and rule on the policyholder's objections. Contemporaneously, affected reinsurers are notified with a Reinsurer Notice.

If the Policyholder fails to file a timely Objection, then the Liquidator submits an ex parte order to the Court to confirm the Liquidator's disallowance recommendation. Once the Liquidator receives the ex parte order confirming the disallowance, the claim file is closed, the reserve reduced to zero dollars ($0) and the reinsurers on the risk are notified.

QUESTION 4

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

Midland and the Liquidator's current practices and procedures fully comply with its contract provisions with Everest, including the interposition clause. Again, the only statutory requirement of § 1308 was that Midland was permitted to negotiate the interposition clause with Everest and other reinsurers, which it did.

QUESTION 5

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

Because Midland and the Liquidator's current practices and procedures fully comply with its contract provisions with Everest, including the interposition clause, no changes are required to be made. As noted at the outset, in answer to Question 6, the Liquidator will offer a suggested compromise position that could provide Everest and other reinsurers with more confidence that the defenses that it interposes are being considered in a more full and meaningful fashion.

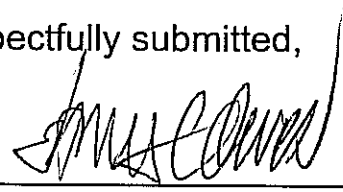
QUESTION 6

How can those procedures be implemented while minimizing administrative expense to the Midland estate?

Although Midland does not believe that its procedures or practices set forth in the answer to Question #3 *require* any amendments, in the interest of compromise, Midland will agree to one accommodation. The Liquidator will agree to increase the current time period for reinsurers' review of potential allowances in "Claim Alerts" from thirty (30) to sixty (60) days. The Court has asked about the attendant administrative expense. While there would not be any additional "expense," this delay would, if the defenses that were interposed proved to be without merit, delay an otherwise valid allowance. That delay would forestall the collection of the reinsurance balance on that allowance by the additional thirty days, which equates to lost investment income on that reinsurance recovery during that extra time period.

Dated: New York, New York
December 6, 2006

Respectfully submitted,



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