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 REPLY 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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In its November 8, 2006 Interim Order, this Court ordered that the parties file supplemental briefs to address the "issue" of "how the provisions of Insurance Law § 1308 should be interpreted in the context of a liquidation under Article 74 of the Insurance Law" and directed the parties to answer six specific questions. The parties' Supplemental Briefs were served on December 7, 2006 and they provided a great deal of insight regarding the issues before the Court.

The Supplemental Briefs produced at least three (3) areas of agreement and several distinct areas of disagreement between the parties that should enable this Court to narrow its focus of the issues in order to render a decision. The key area of disagreement is the extent of a reinsurer's participation in the Liquidator's claims determination process pursuant to the "interposition clause" contained in the various reinsurance contracts. The first round of briefs made it clear that this clause was negotiated by the parties at arms length at a time when both parties were fully aware of the decisional law in New York concerning Article 74 and the exclusive responsibility of the Liquidator, on behalf of the Superintendent, in the claims adjudication process, subject only to the Court's supervision.

Everest's Supplemental Brief is a discourse on how the Liquidator should administer the assets of Midland's estate in order to satisfy the needs of a single reinsurer. It concludes that, as a reinsurer, it has the absolute right pursuant to § 1308 to take over the adjustment of any claim that it reinsures. Everest's Supplemental Brief never attempts to *harmonize* § 1308(a)(3) with Article 74 as this Court requested in the Interim Order, as it gives only passing reference to two of the key cases decided under Article 74. (Everest's Supp. Br., p. 11.) Basically, Everest's conclusions state that § 1308 was enacted to protect reinsurers from the Liquidator's independent handling of the claims. These assertions are unsupported by the law, the *only* legislative history behind § 1308[1] and the facts.

Midland's Reply will demonstrate that the areas upon which the parties agree are reasons for this Court to continue with the Allowance and Disallowance Orders currently in place. Midland will also reply to each of the areas of the parties' disagreement. Midland will show that, pursuant to § 1308(a)(3), Everest and Midland negotiated a contract provision which

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[1] The only case to discuss the legislative history of § 1308 was *In re Midland Ins. Co./Kemper Reinsurance Co. v. Corcoran*, 79 N.Y.2d 253, 590 N.E.2d 1186, 582 N.Y.S.2d 58 (1992), where the Court cited to a Memorandum of Superintendent Pink dated Feb. 26, 1940, Bill Jacket, L.1940, ch. 87) for its conclusion that the diminution clause "was intended to overcome that decision [*Pink*] by altering the indemnity nature of a reinsurance contract when the ceding company becomes insolvent."

provided Everest with certain limited contract rights with respect to claims processing in the event of Midland's insolvency. A good portion of Everest's brief, however: (a) misquotes that contract provision, (b) adds terms to the contract provision that are non-existent, and (c) utterly fails to inform the Court how Midland has fulfilled the terms of that contract provision.

ARGUMENT

I. This Court's Briefing Schedule Has Produced Some Agreement

First, Everest agrees with the Liquidator that reinsurers do not need to modify or change the Court's Ex Parte Approval Order dated January 30, 1997.[2] Everest states, "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." (Everest's Supp. Br. at pgs. 22-23) The Liquidator agrees that the interposition clause should permit reinsurers, when the Liquidator is considering a claim or recommending an allowance, to provide the Liquidator with potential defenses. (Midland's Supp. Br. at pgs. 11-12, 21) The parties both agree that any possible changes to procedure should

[2] For the same reasons, Everest should have no reason to challenge the Courts' March 3, 1994 "Order Approving the Petitioner's Proposed Procedure for Judicial Review of the Petitioner's Disallowance of Claims."

take place long before the claims are submitted to the Court for approval. (Everest's Supp. Br. at pgs 8 and 23; Midland's Supp. Br. pgs. 27-28)

Second, the parties both make the argument that the terms in the interposition clause, "in the proceeding where the claim is to be adjudicated" include the Liquidator's process for determining claims. Everest does not dispute this contention stating, "Section 1308(a)(3) was promulgated with due regard to the Article 74 requirement that such claims are to be filed and adjudicated in a single, omnibus insolvency proceeding." (Everest's Supp. Br., p. 8; emphasis added; *see also* p. 11.) Midland emphasized this point (Midland Supp. Br. pp. 8-10) because this process is the essence of Article 74. The courts have held that under Article 74, 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, 616-607 (1958); *see also In re Lawyers Title & Guaranty Co.*, 254 A.D. 491, 494, 5 N.Y.S.2d 484, 487 (1st Dept. 1938)("a complete procedure for the protection of the rights of all parties interested"). (Emphasis added.)

Finally, while both parties agree that reinsurers have a contractual right, under the interposition clause, to be involved in the Liquidator's

process for determining claims, both parties agree that § 1308(a)(3) is not mandatory and that Everest's rights are based solely on the contract. Everest stated "The wording authorized by Section 1308 is not mandated for inclusion in reinsurance contracts." ... "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." (Everest's Supp. Br., pp. 10, 13) The parties likewise agree that there is no case law interpreting the interposition clause subsection of § 1308. (Everest's Supp. Br., p. 12) Unfortunately, Everest simply "creates" a legislative history and makes it appear as though it emanates from case law or § 1308 when nothing could be further from the truth.

That the parties are able to agree on these points is important. These provisions form the base of the remaining arguments.

II. Major Differences Between the Parties' Positions

A. The Extent of Everest's Participation in the Claims Determination Process

(1) Everest Misquotes the Notice Provision

On page 8 of its Supplemental Brief, Everest misleads the Court in regard to the interaction between the notice requirements of § 1308 and its own reinsurance contracts with Midland. Section 1308 (a)(3), prior to the "interposition clause," contains a "notice clause," which contains a

requirement that provides that a liquidator "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." However, for some reason, Everest fails to inform the Court that its contracts with Midland contain different language than the enabling statute in an important way. The terms of the contract, which are controlling, provide:

> It is agreed, however, that the liquidator, receiver, conservator or statutory successor of the Company shall give written notice to the Reinsurer of the pendency of a claim against the Company indicating the policy or bond reinsured which claim would involve a **possible liability** on the part of the Reinsurer within a reasonable time after such claim is filed in the conservation or liquidation proceeding, or in the Receivership, ... (Emphasis added.)

Section 1308(a)(3) does not contain the above underscored language. Everest would lead this Court to believe that Midland must provide it notice of all claims that are filed in Midland's liquidation shortly after such claims are filed, when in fact the notice must only be provided when such claims may "involve a possible liability" to Everest. Under Everest's argument, Midland should have provided Everest with notice, even where claims were contingent and there was no possibility, at the time the claim was filed, that it would impair a Midland policy. However, if the claim did not impair a

Midland policy, then by definition it would not involve a "possible liability" to Everest and no notice would be required under the contract.

Midland is, in fact, confused by Everest's demand for notice prior to the time of a "possible liability" when it does not agree to any of the allowances Midland has recommended to the Court. Under Everest's theory of claims adjustment as espoused in its briefs and motions, few claims will *ever* impair a Midland policy. Therefore, under the Midland/Everest contracts' notice provision, which is standard for Midland and its reinsurers, notice would not be necessary to reinsurers because there would not be a "claim [that] would involve a possible liability on the part of the reinsurer."

(2) Everest Inserts Non-Existent Terms in Contract

Everest then reads the interposition clause much more broadly than the actual language would allow. The pertinent part of the interposition clause provides that Everest (and Midland's other 400 reinsurers) "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 Liquidator." Everest argues that the phrase means that it has "an absolute right to participate in all aspects of the claim-handling process, from the initial investigation through the

assertion of defenses on the claim or denial of the claim." (Everest's Supp. Br., p. 3; emphasis added.) Everest also reads the contract to say that it (and assumedly scores of Midland's other reinsurers) may participate in settlement negotiations with the policyholders in addition to denying claims, without the consent of the Liquidator. A comparison of the words above (the contract and Everest's assertions) demonstrates that nowhere in the contract (or § 1308 (a)(3)) does the language provide any reinsurer with such broad powers. In fact, to grant such powers would fly in the face of the exclusive authority granted to the Liquidator under the supervision of the Court pursuant to Article 74 and the case law interpreting those statutes.

Fundamentally, Everest misunderstands the purpose behind § 1308 in regard to interposing defenses. If the legislature had intended that reinsurers could usurp the Liquidator and take over the claims, it would have made § 1308(a)(3) mandatory and it would have included the language permitting Everest to deny claims, negotiate with policyholders, etc. The legislature did not add such expansive language. The controlling provisions are, therefore, found in the parties' contract, when referring to the very limited ability of Everest to interpose defenses.

Anything more than a reinsurer's ability to present defenses to the Liquidator during the claims adjustment period would vitiate Article 74. The provisions of Article 74 are exclusive and must be considered. Pursuant to Article 74, the Liquidator is directed to "take possession of the property of [the insolvent insurer] and to liquidate the business of the same and deal with such property and business of [the insolvent insurer] ...." Insurance Law § 7405(a). In addition, the Superintendent, as Liquidator, is "responsible for the proper administration of all assets coming into his possession or control," Insurance Law § 7409(b). Most importantly, for these purposes, is the following:

> Upon taking possession of the assets of a delinquent insurer the domiciliary receiver shall, subject to the direction of the court, immediately proceed to conduct the business of the insurer or to take such steps as are authorized by the laws of this state for the purpose of liquidating, rehabilitating, reorganizing or conserving the affairs of the insurer.

Insurance Law § 7409(c). (Emphasis added.) Nothing in Article 74 allows reinsurers to take over claims handling, which is part of the Liquidator's authority in "conduct[ing] the business of the insurer."

When reading § 1308(a)(3) *in pari materia* with these sections, the Liquidator trusts that this Court will conclude that the permissive sections of § 1308(a)(3) do not supersede Article 74 and, in fact, only supplement it. Reinsurers are, therefore, permitted to interpose defenses to the liquidator

when that language is contained in the reinsurance contract, but that does not allow them to take over the business of the liquidation.

Finally, the reinsurance contract and § 1308(a)(3) provide that reinsurers can only have their claims investigative expenses charged to the Midland estate "subject to approval by the Court" and then only a "pro rata share" if the defense raised by the reinsurer benefits the estate.[3] This provision is hardly an indication that the legislature intended for reinsurers to have *carte blanche* authority to usurp all claims handling, as it severely limits when a reinsurer could be compensated for such claims handling. In fact, if a defense raised against a policyholder by the reinsurer was unsuccessful (and Everest has been unsuccessful in every claim that the Liquidator has recommended for allowance), then, under the terms of the contract, the reinsurer's expenses for such defense would not even be submitted to the court for approval.

B. Reasonable Notice Under the Reinsurance Contract

(1) Case Reserve Notices and Meetings

As stated, the reinsurance contract provides that notice must be given when there is a "possible liability on the part of the Reinsurer."

[3] The specific language of § 1308(a)(3) and the contract states: "The expense thus incurred by the Reinsurer shall be chargeable, subject to the approval of the court, against the Company as part of the expense of conservation or liquidation to the extent of a pro rata share of the benefit which may accrue to the Company solely as a result of the defense undertaken by the Reinsurer."

Midland contends that notice was given to Everest when the Liquidator believed that there may be liability to Everest. As an example, two claims that were recently recommended for allowance were Bayer and Revlon. On these claims, case reserve notices were sent to all reinsurers at issue (including Everest) in 2004 when there was the first "possible liability" on the part of the Reinsurer because of questions that arose concerning certain decisions that came down from the New York Court of Appeals and Appellate Division in 2002 and 2003, among other considerations, that arguably changed prior case law on these claims. Everest has discussed what defenses the Liquidator raised in the negotiations with these and other policyholders, which Everest should know the Liquidator cannot address in this public brief.[4] These notices of case reserves were accompanied by detailed Captioned Reports setting out the Liquidator's rationale for the potential exposure. All of this was set out in the previous Supplemental Brief and attached Affidavits.

[4] Because the Liquidator is in continuing negotiations with similarly situated non-asbestos products policyholders where he *is* continuing to raise the "*LAQ*" defense, he cannot discuss his policy defenses or negotiating tactics with those policyholders in a public brief. The legal issues involved in these negotiations could also reach the Court after objections to a Disputed Claim or reinsurance collection proceeding, which is another reason they are not discussed herein.

Pursuant to the contracts' Access to Records clause,[5] Everest could have scheduled audits anytime during those two years as Midland's files were available. In addition, the Liquidator's representatives held a meeting with Everest's representatives at which these claims, and the outstanding reserves, were discussed.

(2) Audits

Everest did, finally, schedule audits of Midland's claim files in May and July of 2006 long after it received notices of "case reserves" being set on various claims in the Midland estate. Again, the previous brief's Affidavits covered this issue and the facts behind them. The key point is that Everest cannot complain that it did not receive sufficient prior notice of recommended claims allowances, when it had actually audited the claims files prior to those allowances. Other reinsurers of Midland have submitted written questions and received answers to all such questions. Still others have "wind up" sessions where any issues on claims are discussed and the parties attempt to work out differences. This is what has led to commutations with such other reinsurers.

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[5] "The Reinsurer or its duly accredited representative shall have free access to the books and records of the Company at all reasonable times for the purpose of obtaining information concerning this Agreement or the subject matter thereof."

(3) Claims Alerts

After the Case Reserve notices and the Audits, Midland sent "Claim Alerts" to all affected reinsurers (including Everest) prior to the allowance recommendations being sent to the Court. Most important, as the Court is now familiar, these are claims of which Everest was well aware as a direct insurer. The claims that have, thus far, been allowed, are claims with which the entire insurance industry is familiar.

(4) Disallowances

In regard to disallowance proceedings, the Court's *ex-parte* order states that the Liquidator serves the claimant with a Notice of Recommendation of Disallowance. The claimant may object to that notice within a sixty-day time period. If the claimant fails to object, then the Liquidator may submit an ex-parte motion to this Court for an order approving the disallowance. However, claimants that do file timely objections are generally referred to a referee.

For example, Midland has recommended that sixteen asbestos bodily injury cases be disallowed for various reasons, including that the claims do not impair Midland's policies under the Supreme Court decision *In re Liquidation of Midland Insurance Company/Claim of Lac D'Amiante Du Quebec Ltee*, 269 A.D.2d 50, 709 N.Y.S.2d 24 (1st Dept. 2000). As there

are certain legal issues that require determination, these claims have not yet been referred to the referee but will be, as necessary, once the legal issues have been determined. Midland mailed notices of the Disallowances, specifically referring to the Interposition Clause, to affected reinsurers (including Everest) once it received the claimants' objections. Everest is well aware of these proceedings and has, in fact, intervened, through separate counsel, pursuant to the Case Management Order entered by this Court on August 3, 2006.

(5) General "Access to Records"

In regard to the Access to Records clause, the Liquidator has provided Everest with what it has requested at all times. The Stuehrk and Banks Affidavits, filed with Midland's original and Supplemental briefs, demonstrate that the Liquidator has bent over backwards in an attempt to accommodate Everest. On the other hand, the contract only requires "reasonable" access and Everest went far beyond anything reasonable. Everest's representatives were on site for three weeks and only managed to get through six files. Everest was disrupting the normal business of the Midland estate (and the New York Liquidation Bureau) by seeking an extended stay in the audit rooms and dominating access to the thirty-four files that they requested.

As demonstrated, the Liquidator has fulfilled the contractual terms by providing notice of timely filed claims that are in danger of impairing Midland's policies that were reinsured by Everest, among others.

C. Everest's Misunderstanding of § 1308(a)(3)

(1) Everest's Fallacious Reasoning

As noted earlier, Everest's Supplemental Brief only references the provisions of Article 74, and case law pertinent thereto, on one occasion. (Everest Supp. Br. p. 11) Everest then makes huge leaps of conclusory judgments to allow it to supersede Article 74 and take over the management of Midland's estate, i.e. adjusting claims, negotiating with policyholders, determining settlement values and denying claims.

Indeed, Everest argues that the "rights" afforded to reinsurers under the statute 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." (Everest's Supp. Br., p. 2) It also argues that the legislature saw the need for reinsurers to "adjust claims" under the interposition clause as a "disincentive for insolvent insurers to competitively 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 any particular policyholder." (Everest's Supp. Br., p. 7)

There are a number of fallacies with this argument. Most of all, it assumes that having to pay the Liquidator based on the amount "allowed," i.e. the amount of the policy claim, is somehow out of the ordinary or unfair. Nothing could be further from the truth.

Ordinarily, reinsurers to pay 100% of their proportionate share, i.e., the full amount, of all claims ceded or transferred to them from solvent companies under the terms of their contracts. Likewise, the legislature made certain, in § 1308(a)(2)(A)(i), that reinsurers of insolvent companies would pay 100% of their proportionate share, i.e. the full amount of all claims ceded or transferred to them "without diminution because of such insolvency." Otherwise, insolvent companies would have greatly diminished assets. Prior to § 1308, under *Fidelity & Deposit Co. of Maryland v. Pink*, 302 U.S. 224, 58 S.Ct. 162 (1937), only policyholders that had the means to pursue the reinsurance would get paid directly. After *Pink*, the states set up insurance insolvency procedures to administer insurance liquidations with fiduciary responsibilities to ensure that claims are administered subject to the supervision of a court. *See, e.g.* New York's Uniform Insurance Liquidation Act of 1939.

Additionally, the reinsurer is paying 100 cents on the dollar of its proportionate share of the policy claim because it would be patently unfair for the reinsurer to pay anything other than 100% of such share of the policy claim solely because the insurance company was in liquidation. If the reinsurer paid anything other than 100% of the policy claim, it would have a windfall solely because of the insurer's insolvency and the policyholders would suffer immensely, as the estate would not be paid what the reinsurance contract required. The Midland estate would not have the full benefit of the reinsurance proceeds to distribute to the beneficiaries of the estate. This was the purpose of the diminution clause of § 1308 enacted after the *Pink* case.

Moreover, Everest makes it sound as though the Liquidator has a choice in "allowing" the full amount of the claim in certain instances. The Liquidator has a fiduciary duty to fairly and honestly adjust all claims. In many cases, a state guaranty fund/association or the New York Security Funds has already settled a claim and has billed the Liquidator for that claim. The Liquidator reviews that claim and, if that settlement was made in good faith, it allows the claim.[6] In other cases, there is simply no

[6] As noted in the Liquidator's Court report, Insurance Law § 7609 entitles the New York Security Funds to an automatic "valid claim" against midland for all claims payments those funds have made for "covered claims" under Midland policies.

question that a claim is valid and should be paid under the applicable policy at full limits or less than limits.

If, for instance, the Bayer claim is valid for (hypothetically) $1 million, and Midland's coverage was part of a $5 million "layer" in a "coverage block" of insurance in one year that is also covered by four other solvent insurance companies, each with $1 million in coverage, there is no question that the reinsurers of all of those companies must pay the claim (all other things being equal). Midland does not adjust the claim any differently because it is insolvent except based on binding case law directing otherwise. The claimant Bayer is clearly entitled to an "allowance" of $1 million as its policy of insurance provides for $1 million in coverage from Midland and insolvency certainly does not abrogate that contract right.

There is yet another fallacy with Everest's argument that, in enacting § 1308(a)(3), the legislature recognized that "the insolvent insurer has little incentive to reduce claim allowances." If this were true, and if it were actually a *quid pro quo* for permitting reinsurers to take over claims handling, the legislature would have made the § 1308(a)(3) mandatory and linked it to credits as it did with § 1308(a)(2). It did not. Section 1308(a)(3) allows the parties to enter into a contractual arrangement – no more, no less. A *quid pro quo* is an equal exchange of something for something, but

when one thing is mandatory and the other thing is permissive, there is no *quid pro quo*.

The final fallacy in Everest's argument is that all insurance insolvencies pay less than 100 cents on the dollar, a premise upon which Everest bases its argument that, after the *Pink* case, there was a disincentive for a Liquidator to properly process claims. There are insurance insolvencies that have paid near to or over 100%, including some in New York that have paid over 100%. (Stuehrk Affidavit, ¶ 9) Transit Casualty Company in Receivership will pay well in excess of 80%. Clearly, the legislature in 1939 was not thinking that a liquidator was going to adjust claims improperly solely because he may pay out 80-95% of claims instead of 100%. The reasons could be many but the point is that insolvent insurer do not have "little incentive to reduce claim allowance" for the reasons that Everest proposes. Midland is also careful to ensure that its recommendation for allowances will be both approved by the court and pass scrutiny in any reinsurance collection proceeding.

(2) Rules of Contract Construction

Everest's argues that "the force and effect of section 1308(a)(3) is not trumped by Article 74" because there is nothing in Article 74 which "allows the Liquidator or a court to disregard or restrict the rights of a reinsurer."

Although it cites obliquely to the leading cases of *Knickerbocker* and *In Re Lawyers Title and Guaranty Co.*, interpretation of Article 74, upon which the Liquidator relies heavily, Everest then proceeds to ignore their holdings and instead concludes that the reinsurer is "entitled to take **a leading role** in the handling and defense of that claim." (Everest's Supp. Br., pgs. 11 and 12; emphasis added) Everest does not explain where it obtained this conclusion but apparently believes that if it keeps repeating this mantra, it will be true. Everest does cite the correct test for statutory construction, but then completely disregards it.

When read *in pari materia* § 1308 and Article 74 are consistent and require that the Liquidator have full control over the business of the insolvent company, including claims adjustment. Section 1308 requires that, if the ceding insurer wants to claim reinsurance as a credit, an insolvency clause must be contained in the reinsurance contract. It also permits the parties to include a contractual provision allowing the reinsurer to interpose defenses to the Liquidator. The two statutes are, therefore, entirely consistent and to which the Liquidator adheres.

Therefore, with the statutory issues resolved, ultimately, the issues between the parties are a matter of contract. The meaning of the contract is a legal question for the court to determine. In reinsurance agreements,

like all contracts, the intention of the parties is the controlling factor. *Excess Ins. Co. Ltd. v. Factory Mut. Ins. Co.*, 3 N.Y.3d 577, 583, 822 N.E.2d 768, 770-71, 789 N.Y.S.2d 461, 463-64 (2004). In order to discover the parties' intentions, the court should construe the agreements to give full meaning and effect to the material provisions. *Id.* Terms must be interpreted in light of the language and purpose of the entire agreement. *Haber v. Firemen's Fund Ins. Co.*, 2000 WL 943562 (S.D.N.Y. 2000), slip op. at *3, *citing Margolin v. New York Life Ins. Co.*, 344 N.Y.S.2d 336, 339 (Ct. App. 1973). The court is not to insert words or phrases into a contract under the guise of interpretation. *Massachusetts Mut. Life Ins. Co. v. Thorpe*, 260 A.D.2d 706, 708, 687 N.Y.S.2d 490, 492 (3rd Dept. 1999).

The reinsurance contracts at issue are not ambiguous and should be interpreted according to their terms. Given that Everest's argument for an "absolute right to participate in all aspects of the clams process" and the "right to deny claims" and the "right to negotiate settlements" and to "adjust claims" are all based upon language that does not actually appear in the contract, the Court should disregard these arguments.

The Liquidator asserts that the impact of the interposition clause is exactly as Midland described in his Supplemental Brief and that Everest's rights are limited to has those described in great detail in pages 11-12 and

21 of that brief because of the exclusive duties legislated to the Liquidator under Article 74.

D. Everest's Allegations of Midland's Disincentive to Properly Adjust Claims are Unsupported by Any Evidence

Everest again makes unsubstantiated accusations against the New York Liquidation Bureau and its consultants regarding claims handling and concludes that, under § 1308, there is a disincentive to properly adjust claims. Everest has no basis for these defamatory remarks and its repetitive statements that it cannot formulate the basis for these attacks without traditional discovery (i.e. it apparently needs to look at every single claims file in the estate and depose all of the claims handlers on their jobs), is patently unreasonable.

It is worthy of note that the only specific examples cited by Everest of claims that the Liquidator has allegedly failed to properly adjust are claims that Everest has either settled and paid as a direct insurer or paid as a reinsurer. Everest expects the Liquidator to treat the claimants differently than Everest itself has treated them. Apparently, according to Everest, the Liquidator is to be held to a much higher standard of diligence than Everest has been, as Everest has paid on the very claims that it now asserts the Liquidator should never consider.

As noted in Midland's opening brief, Everest has an avenue to address its assertions of inadequate claims handling. If Midland attempts to collect from Everest on claims for which it can prove its assertions, Everest can raise the same as an affirmative defense and avoid payment in full. The remainder of Everest's complaints are likewise typical defenses to payment demands rather than defenses to the underlying claims themselves. This Court will be provided with evidence in the form of Affidavits and other briefs from other policyholders and it will discover that Midland's claims handling practices are in line with industry standards. The only difference in this case is that Everest wants the opportunity to deny claims where it believes that it cannot be sued for acting under the auspices of the Midland Liquidator.

The Liquidator will continue to listen to all defenses interposed by Everest and utilize the defenses he believes are appropriate. The Liquidator will respond to Everest as to why such referenced defenses have not been raised with policyholders if and when Everest reasonably requests such in writing and affords Midland a reasonable time to respond.

III. Miscellaneous Arguments

A. Discovery

Midland respectfully submits to the Court that there is no actual issue of whether Everest needs to obtain discovery because they have had full access to records in multiple audits. Moreover, the current issues are, as a matter of law: (1) what are Everest's legal rights under § 1308(a)(3), Article 74 and the reinsurance contracts, and (2) whether the Liquidator has denied Everest of the rights it is entitled to under the statutes and the contracts. These are primarily legal issues that do not require extensive fact-finding and they are the only issues before this Court.

B. Claims Adjustment

Many of the claims upon which Everest seeks discovery are still in the adjustment phase and the Liquidator's determinations and discussions regarding those claims are confidential. Further discussions of the Liquidator's actions regarding claims adjustment would not be proper in a public document.

C. Cooperation Clause

Everest points out that a few contracts have what is generally referred to as a "cooperation clause." One such contract is a "Security Guard" contract where Everest reinsures 30% and Gerling Global reinsured

50% of the risk for these night watchman liabilities and, therefore, there was good reason for these reinsurers to have the right to take over the claims as they were in essence standing in the shoes of the insurance company. (Stuehrk Affidavit ¶ 6) There are other "facultative contracts" that have cooperation clauses that are one sentence long and much less detailed. *Id.*[7]

However, upon insolvency, the specific "Insolvency Clause" prevails over the Cooperation Clause and Notice clause in a reinsurance contract. Thereafter, Article 74 governs, all claimants must file their claims or their equivalent in the Midland proceedings and the Liquidator handles the claims. It follows then that all reinsurance proceeds from Everest must still be paid to the Liquidator. This explains why Everest makes only passing reference to the Cooperation Clause in the few contracts, as it has no meaning in a liquidation. The Affidavit of Andrew Stuehrk, who has worked as the reinsurance consultant in three of the nations' largest insolvencies as an employee or consultant, confirms that he has never witnessed a reinsurer attempt to utilize a Cooperation Clause in an insolvency in lieu of the interposition clause. (Stuehrk Affidavit ¶ 8.)

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[7] A facultative reinsurance contract, as opposed to a treaty reinsurance contract, is reinsurance on *one* particular policyholder or risk, as opposed to a pro-rata share or percentage above an excess layer of *all* risks in a certain period, usually a year.

D. History of § 1308

As noted earlier, the only case to discuss the legislative history of § 1308 was *In re Midland Ins. Co./Kemper Reinsurance Co. v. Corcoran*, 79 N.Y. 2d at 263. The Court decided that:

> [I]f the contract contains a statutory insolvency clause, the reinsurer is obligated to pay the liquidator his or her allocated share of any losses due under the reinsurance contract even though the insolvent ceding company has not first made payment to the insureds on the underlying policies. Nothing in the language of section 1308(a)(2)(A) or its history, however, support the conclusion that the statute was enacted to destroy a reinsurer's right of offset under Insurance Law § 7427.

Id. at 263-264.

Thus, Midland is at a loss for Everest's unsupported assertions concerning the legislative intent behind § 1308(a)(3), especially when it is contrary to the prevailing case law on Article 74. In the Kemper decision, the Court harmonized the offset provision of Article 74 with the diminution clause of § 1308. Midland asked that this court do the same here with respect to the claims handling provisions of Article 74 as interpreted by *Knickerbocker* and *In re Lawyers Title & Guaranty Co.*

IV. Conclusion

Everest's allegations in its Supplemental Brief are, in essence, that Midland has breached its contract with Everest. In fact, a review of the "Prayer for Relief" in the draft lawsuit, which Everest attached to its Motion

to Modify the Permanent Injunction, has eight paragraphs of substance, four of which ask the court to declare that it has certain rights and four of which ask for the court to declare that those rights have been breached. The allegations in that draft lawsuit likewise assert contract "rights" that do not appear in the contract between the parties.

Now that Everest is being billed for claims and expected to pay pursuant to the terms of the contract, it asserts that Midland's claims are not being properly adjusted. These complaints are *all* the types of complaints that reinsurers assert in the defense of a reinsurance collection action by the ceding insurer. Everest is attempting to "get the upper hand" by stopping the claims before the claims can be billed to it -- an arguably ingenious but wholly disingenuous theory – all under the guise of the interposition clause. Everest has absolutely no statutory or decisional law to support its unique position, which is literally too good to be true.

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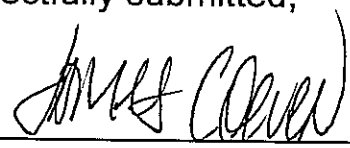
Respectfully submitted,



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