

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

MEMORANDUM IN SUPPORT OF EVEREST REINSURANCE COMPANY'S MOTION
TO MODIFY THE INJUNCTION TO PERMIT SUIT AGAINST THE LIQUIDATOR

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**MEMORANDUM IN SUPPORT OF EVEREST REINSURANCE
COMPANY'S MOTION TO MODIFY THE INJUNCTION TO PERMIT SUIT
AGAINST THE LIQUIDATOR**

Midland Insurance Company ("Midland") issued a number of insurance policies which provided general liability coverage to various policyholders for third-party claims alleging bodily injury or property damage. Between 1972 and 1986, Everest Reinsurance Company f/k/a Prudential Reinsurance Company ("Everest") reinsured certain of these Midland policies. Subject to the terms, conditions, obligations and warranties of the reinsurance agreements, Everest agreed to indemnify Midland for legitimately covered losses under the Midland policies that Midland paid to its policyholders.

Midland was declared insolvent by this Court in 1986, and a liquidator was appointed to oversee the run-off the Midland estate. Prior to its insolvency, Midland and its reinsurers shared essentially identical interests with respect to claims made by Midland's policyholders. In light of the fact that claim payments came out of their respective pockets, both Midland and its reinsurers had an interest in ensuring that only meritorious claims that were actually covered under the Midland policies were paid by Midland. Given Midland's interest in operating a financially sound and ongoing business, Everest was able to rely on the professional claims handling operation within Midland. However, Midland's financial interests have changed as a result of

Midland's insolvency, and the system of checks and balances that had existed to ensure that only meritorious and legitimate claims were being paid while Midland was a going-concern, and, thereby, protect Everest's interests as reinsurer, are no longer in existence.

Instead, the Midland liquidator's paramount interest is now to maximize the estate assets for the benefit of Midland's various creditors, including the liquidator's agents and representatives. In this case, this means maximizing recoveries from reinsurers such as Everest. To that end, the liquidator has surrounded himself with consultants and legal counsel whose conduct thus far suggests that they are motivated by the wholly improper objective to maximize reinsurance recoveries at any cost rather than to vigorously respect and protect Midland's contractual rights under its insurance policies in order to preserve the estate assets and to ensure that only legitimately covered claims are paid and submitted for reimbursement under the Everest reinsurance agreements.

Unlike a solvent insurance company, the liquidator overseeing the run-off of an insolvent insurance company has incentives to allow claims that should not be paid under the insurance policies, either because the claims are not covered at all or because the claims are inflated. For example, reinsurance recoveries for allowed claims, when covered by reinsurance, are to be paid into the estate at one hundred cents on the dollar, even though the policyholder may ultimately receive a small fraction of the allowed amount of the claim in a subsequent distribution from the estate. As a result, a liquidator seeking to maximize the estate's assets has an incentive to settle or allow claims of dubious value without performing a thorough claims investigation and coverage analysis and then seek to cram down the full value of the allowed claims upon Midland's reinsurers under the "follow the fortunes" doctrine. Under this model, the liquidator obtains a windfall from the reinsurers because the policyholder receives only pennies on the

dollar for the allowed claims. The remaining amount recovered from the reinsurers remains within the estate.

Although Midland's policyholders began submitting claims in 1986 that could potentially impact Everest's reinsurance agreements, the various liquidators overseeing the Midland estate made no attempt to notify Everest of these claims until nearly twenty years later. In 2004, the current liquidator, Howard Mills, Superintendent of Insurance of the State of New York, as Liquidator of Midland Insurance Company (the "Liquidator"), retained a consulting company and a new law firm to conduct the Midland estate's claim handling and also pursue reinsurance recoveries. As detailed below, after years of silence, the Liquidator and its agents have begun a process of freely allowing claims without conducting a proper and reasonable claims investigation while, at the same time, denying Everest its contractual right to participate in the claims investigation process.

Everest's reinsurance contracts provide Everest with certain explicit rights designed to protect Everest against the Liquidator's current course of conduct. For instance, in addition to requiring the Liquidator to provide prompt notice of claims that may impact Everest's reinsurance agreements, the reinsurance contracts require the Liquidator to grant Everest the right to participate in the claims investigation, review and settlement process and to provide Everest access to Midland's and/or the Liquidator's books and records relating to the submitted claims. As discussed below and detailed in the attached complaint, the Liquidator has refused to comply with these provisions, with the result that Everest has suffered irreparable harm and will continue to do so.

Were Midland not in liquidation, Everest could simply bring suit against Midland to protect its interests through a declaration of its rights and an injunction requiring Midland to

comply with its contractual obligations. However, the order of liquidation enjoins any action against Midland or the Liquidator. As a result, Everest faces the prospect of the Liquidator settling large numbers of claims, without any incentive to challenge the merits or legitimacy of such claims with respect to coverage, and later seeking to bind Everest with its settlements.

New York law is clear that the Liquidator should not be in a better position as a result of Midland's liquidation than Midland would have been in if it were solvent. Everest therefore respectfully requests that this Court modify the injunction to permit Everest to seek declaratory and injunctive relief concerning its rights under the reinsurance contracts with respect to the Liquidator's conduct. Otherwise, if shielded by the injunction, the Liquidator simply will continue to exclude Everest from the claims review and settlement process and thus continue to irreparably harm Everest to the extent that it later is requested to reimburse the Midland estate for its questionable settlements with Midland's policyholders.

Besides protecting its contractual rights, the participation that Everest seeks in the claims review and settlement process is intended to also protect the estate and all of Midland's policyholders. Through its separate involvement as an insurer in coverage litigation with several of the MPHs that are now making claims under policies issued by Midland, Everest has identified several defenses to coverage under the Midland policies for a number of these claims that the Liquidator apparently is unwilling or unable to assert. To the extent the Liquidator and its agents fail to properly investigate and deny illegitimate claims, they fail to not only uphold Midland's bargained for rights under its policies, but cause further harm to those Midland policyholders with legitimate claims whose ability to recover is put in doubt as the Liquidator wastes the reinsurance assets on illegitimate claims. Thus, it would be best for all interested

parties to be aware of those coverage limitations before claims are settled and recommended for allowance by the Liquidator.

For all of these reasons, Everest requests that the Court modify the injunction in this matter to permit Everest to file the complaint attached as Exhibit A to the accompanying Affirmation of Vincent J. Proto.

FACTUAL BACKGROUND¹

In 1986, Midland was adjudged insolvent by this Court and a Liquidator was appointed to administer the Midland estate, which included reviewing claims submitted by Midland's policyholders for payment. Some of these claims have been "allowed" by the Liquidator – that is, it appears that the Liquidator has concluded that the policyholder's claims otherwise would be covered under the Midland insurance policies – and other claims have been "disallowed." To date, the Liquidator has not rendered his decision on the vast majority of the claims that have been submitted to the Midland estate and constitute the bulk of Midland's potential liability. Everest believes, however, that the Liquidator will recommend for allowance hundreds of claims worth millions of dollars for which he, on behalf of the estate, will seek reinsurance coverage from Everest.

Since it first gave notice in 2004, the Liquidator has essentially shut Everest out of every aspect of the settlement and claims review process, in violation of Everest's contractual rights. The Liquidator has also unnecessarily delayed in providing information to Everest – more than 15 years in some cases. When the Liquidator has provided information, it has been of a general nature, rather than the specific information to which Everest is entitled pursuant to the

¹ These facts are alleged in the Complaint that Everest seeks to file.

reinsurance contracts. Indeed, follow-up requests by Everest for additional documentation have been ignored, again in violation of Everest's contractual rights. Most importantly, as alleged in the Complaint, the underlying claims review and settlement process being conducted by the Liquidator and his agents is inadequate, at best.

A. Midland's Insolvency and Liquidation

On April 3, 1986, this Court found Midland to be insolvent and placed the company into statutory liquidation pursuant to Article 74 of the New York Insurance Law. At this time, the court appointed the then Superintendent of Insurance and his successors in office as Liquidator for the Midland estate. Pursuant to the Liquidation Order, creditors of the Midland estate (including Midland's policyholders) were required to file proofs of claim with the Liquidator within one year; *i.e.*, by April 3, 1987. (Liquidation Order at 4).² The Liquidation Order further enjoined any person from pursuing legal action against Midland or the Liquidator:

[T]he officers, directors, trustees, policyholders, agents and employees of MIDLAND, and all other persons, including but not limited to claimants, plaintiffs, and petitioners who have claims against MIDLAND, are permanently enjoined and restrained from bringing or further prosecuting any action at law, suit in equity, special or other proceeding against the said corporation or its estate, or the Superintendent and his successors in office, as Liquidator thereof, or from making or executing any levy upon the property or estate of said corporation, or from in any way interfering with the Superintendent, or any successor in office, in his possession or discharge of his duties as Liquidator thereof, or in the liquidation of the business of said corporation....

(Liquidation Order at 7-8). Thus, pursuant to the Liquidation Order, no proceeding arguably may be brought against the Liquidator unless the Court first modifies or lifts the injunction.

According to the Liquidator's October 13, 2005 report on the status of the liquidation, Midland received, as of that date, over 22,000 proofs of claim for environmental, products, and

² A copy of the Liquidation Order is attached as Exhibit B to the Affirmation of Vincent J. Proto.

asbestos liability coverage, including claims from Midland's "major policyholders" ("MPHs"), which the Liquidator has defined as "Fortune 500 companies and other corporate entities." (Complaint ¶¶ 20-21). The Liquidator reported that "for many of these MPHs ... [t]here may be thousands of individual claims for each policy ... (e.g. asbestos claimants of an asbestos manufacturer)." (*Id.* ¶ 23). At this time, Everest believes that the Liquidator has received what it considers timely proofs of claim from approximately 170 MPHs. (*Id.* ¶ 24).

B. The Requirements of the Midland Reinsurance Contracts

Everest entered into various excess-of-loss reinsurance treaties and facultative reinsurance certificates with Midland for certain periods in the 1970s and 1980s (collectively, the "Midland Contracts"). (Complaint ¶¶ 26-27). The Midland Contracts expressly provide that Everest has a right to participate in the review, investigation and settlement of underlying claims against Midland that may implicate the reinsurance provided by Everest. For example, the reinsurance contracts provide that in the event of Midland's insolvency Everest has the right to assert defenses to coverage under the Midland policies:

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

(*Id.* ¶ 33). Other contractual provisions give Everest the right to associate in the defense and control of any claim, suit or proceeding, at any time, which may involve Everest's reinsurance obligations:

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

(*Id.* ¶ 34).

The Midland Contracts further require Midland (or its Liquidator) to provide Everest with adequate proofs of loss and other information in support of Midland's claim under the reinsurance agreements. (*Id.* ¶¶ 35-37). In addition, the Midland Contracts give Everest the express contractual right to access Midland's books and records to obtain any information concerning the subject matter of the Midland Contracts. In particular, Midland (or its Liquidator) is required to provide Everest with:

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

(*Id.* ¶ 38).³

As a result of these provisions, Midland (or its Liquidator) is required to provide Everest with specific information concerning any claims that might impact the Everest reinsurance as soon as practicable and, in any event, before settlement negotiations with Midland's policyholders are commenced with respect to such claims. (*Id.* ¶ 32).⁴

³ Under the Midland Contracts, Midland (or the Liquidator standing in Midland's shoes) has the obligation to provide Everest with timely notice of every insurance claim that may result in a loss large enough to trigger Everest's reinsurance obligations. (Complaint ¶¶ 28-32). In many instances, the Liquidator, without justification and in violation of the reinsurance contracts, waited more than 15 years before providing notice to Everest of claims that could give rise to liability by Everest. (*Id.* ¶ 41-45). It appears that for most of the time since 1986, the Liquidator did not have in place a system for ensuring that the reinsurers received notice of claims. (*Id.* ¶ 46).

⁴ The type of information to be provided includes: information concerning the date of loss and location of loss; a narrative factual summary of the loss/claim details, including date of claim; a description of Midland's insurance coverage at issue, including limits, participation, and attachment points; alleged and/or potential damages; a narrative exposure analysis, including an assessment of coverage defenses; a narrative allocation analysis where the loss/claim may trigger more than one year of coverage; underlying and other-insurance exhaustion analysis where appropriate; a description of inuring reinsurances; copies of reservation of rights letters and policyholder responses; and updates regarding changes in any of the foregoing. (*Id.*).

C. Everest's and Midland's Relationship

Prior to Midland's insolvency, the interests of Midland and Everest to ensure proper and efficient claim-handling were aligned (*i.e.*, neither company would want to pay inflated or meritless claims). However, once Midland was adjudged insolvent and the Liquidator was appointed, the traditional protections of Everest's interests arising from the ceding insurer and reinsurer being similarly situated with respect to claims under the Midland policies no longer existed.

Now that Midland is insolvent, the primary objective of Midland's statutory successor -- *i.e.*, the Liquidator -- is to maximize the assets of the Midland estate for the benefit of Midland's policyholders. (Complaint ¶ 66). The New York Liquidation Bureau's mission, as set forth in the mission statement on its website, is to "maximize assets and resolve liabilities." (*Id.* ¶ 67). The Liquidator has admitted that the largest potential asset of the Midland estate is its recoverable reinsurance. (*Id.* ¶ 68). In furtherance of that objective, the Liquidator has put in place a plan to maximize reinsurance recoveries for the Midland estate by indiscriminately allowing claims submitted by Midland's policyholders without due regard to the terms, conditions and warranties contained in the Midland policies. (*Id.* ¶ 70).

Beginning in or about 2004, the Liquidator retained the services of Navigant Consulting, Inc. ("Navigant") purportedly to conduct the Midland estate's day-to-day claim handling operation. Ostensibly, Navigant's role is to review claims and recommend settlements, for which the Liquidator subsequently seeks allowance by the Court. According to the Liquidator's stated intentions (and as demonstrated by its past conduct), after a Midland policyholder's claim is allowed by the Court, the Liquidator bills Everest for the entire allowed amount that the Liquidator contends impacts the respective reinsurance contracts. (*Id.* ¶ 69). The reinsurance

proceeds, when applicable, are then paid into the Midland estate for the full amount of the allowed claim even though the Midland estate, in all likelihood, will pay the particular policyholder only a small percentage of the settled or allowed amount in subsequent distributions. (*Id.*). Under this method, the Liquidator has the potential to access Everest's full limits under the reinsurance contracts even though a particular claim may not even reach the reinsurance layer. Thus, the larger the values of the claims allowed by the Liquidator and Navigant, the larger the reinsurance recovery from Everest. (*Id.*).

In addition, a direct conflict exists in connection with the Liquidator's retention of the law firm of McCarthy, Leonard, Kaemmerer, Owen, McGovern Striler & Menghini, L.C. (the "McCarthy Firm"). (*Id.* ¶ 71). The McCarthy Firm was hired to carry out the Liquidator's duties to, *inter alia*, evaluate and, when appropriate, defend against the claims of the MPHs for coverage under the Midland policies. (*Id.* ¶ 72). However, the McCarthy Firm has simultaneously been retained to pursue reinsurance recoveries for the Midland estate. As reinsurance recovery counsel for the Liquidator, the McCarthy Firm has a duty to maximize reinsurance recoveries in connection with the very same underlying claims against which the McCarthy Firm must vigorously defend. Therefore, a direct conflict is presented by the McCarthy Firm's representation of the Liquidator for the dual purposes of defending against claims while seeking to maximize reinsurance recoveries for those same claims. (*Id.* ¶ 73).

D. The Liquidator's Improper Claim Handling and Exclusion of Everest from the Entire Process

The Liquidator and/or his agent, Navigant, have repeatedly and consistently failed to conduct reasonable claim investigations and have failed to assert coverage defenses available to Midland. (Complaint ¶ 80). Despite its repeated requests, Midland has denied Everest the opportunity to conduct these investigations and/or assert those defenses on Midland's behalf.

The Liquidator's improper and inadequate claims handling procedure demonstrates either an inability to investigate and defend against claims with adequate vigor and/or the Liquidator's unreasonable objective to maximize reinsurance recoveries at all costs. (*Id.* ¶ 110). Such blatant disregard for the contractual protections bargained for by Midland when it issued its policies, coupled with the Liquidator's unjustified refusal to allow Everest to participate in the claims investigation, review and settlement process in contravention of the express rights granted under the reinsurance agreements, clearly justifies permitting Everest to file its Complaint against the Liquidator.

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

For example, in 2004, the Liquidator advised Everest that the decision in *In re Liquidation of Midland Insurance Company*, 709 N.Y.S.2d 24 (2000) (“*LAQ*”), was the controlling law in the Midland estate and that the Liquidator would enforce the *LAQ* decision to the fullest extent possible as a defense to coverage. (*Id.* ¶ 76). The Appellate Division in *LAQ* ruled, in connection with a claim for coverage under a Midland policy, that (i) the underlying claimant must prove contact with the injury-causing agent during the policy period and (ii) all other solvent insurance must be exhausted before the Midland policy could be accessed. (*Id.* ¶ 77). Despite admitted that the *LAQ* decision is “controlling” case law for the Midland estate, the Liquidator has now abandoned his former position regarding *LAQ* (again without informing

Everest), and has since negotiated settlements with MPHs without asserting *LAQ* as a defense to coverage. (*Id.* ¶¶ 76, 78-79). Everest has requested that the Liquidator allow Everest to participate in settlement negotiations with MPHs and to interpose numerous applicable coverage defenses, including the *LAQ* decision, which the Liquidator has refused, without justification, to assert. (*Id.* ¶ 95).

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

Sometimes the underlying claims paid by the MPH are audited, however, it appears that the purpose of the audits is merely to confirm that the MPH paid claims that were filed against it, rather than to evaluate the validity of those claims in the context of whether such claims are covered by the Midland policies. (*Id.* ¶ 82). While it appears that the Liquidator and/or Navigant have retained a third party to allocate the claims allegedly paid by the MPH to the relevant Midland policy period(s) and to opine whether the MPH's settlement demand is "reasonable," these opinions are prepared solely for the purpose of supporting allowance of the full amount of the MPH's claim. (*Id.* ¶¶ 83-84). As a result, for the claims allowed to date, the

amount recommended for allowance has always fallen within the amount demanded by the MPH. (*Id.* ¶¶ 85-86).

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

For example, the Liquidator has advised that it intends to recommend full payment of two MPH's claims without conducting a separate audit of those claims. (Complaint ¶ 88). Instead of conducting an independent audit, the Liquidator relied solely on an analysis conducted years ago in connection with the liquidation of a different insurance company, Transit Casualty Company ("Transit"), which has no connection to the Midland estate other than the fact that both Navigant and the McCarthy Firm were also involved in the Transit liquidation. (*Id.*).

More egregiously, the Liquidator has advised that it intends to recommend for allowance claims against the Midland estate based on the manner in which these claims were treated in the Transit liquidation without conducting an independent investigation and analysis of those claims under the Midland policies. (*Id.* ¶ 89). Such a position is wholly improper and is tantamount to a breach of the fiduciary obligations that the Liquidator has to the Midland estate and Midland's policyholders to preserve the estate's assets. (*Id.*). As a result, the Liquidator has approved (and has stated its intention to continue to approve) claims without: (1) asserting Midland's defenses to coverage; (2) conducting a proper and independent investigation as to the proper value of covered claims; or (3) requiring the MPHs to produce complete, adequate, or sufficient

documentation of the underlying claims. At the same time, despite Everest's repeated requests, the Liquidator has refused to allow Everest to participate in the claims review and settlement process in direct contravention of Everest's right under the Midland Contracts. (*Id.* ¶ 95).

E. The Recent Decision in *Suter v. General Accident Insurance Company* Further Highlights the Inadequacies of the Liquidator's Claims Handling Process and the Incompetence of the Liquidator's Agents

In a recent case of striking applicability, the United States District Court for the District of New Jersey reviewed the claims handling competence of another liquidator of another insolvent insurance company in *Suter v. General Accident Ins. Co.*, Civ. No. 01-2686 (WGB), 2006 U.S. Dist. LEXIS 48209 (D.N.J. July 14, 2006) ("*Suter*"). (Complaint ¶ 96). In *Suter*, the reinsurer argued that the liquidator of Integrity Insurance Company ("Integrity") improperly allowed coverage for certain heart valve claims against Pfizer under certain Integrity policies issued to Pfizer. The court heard evidence concerning the liquidator's claims review process over the course of a multi-week trial and found, inter alia, that the liquidator's allowance of those claims was "grossly incompetent." (*Id.* ¶ 97). *Suter* is particularly on point here because, by letter dated May 8, 2006, the Midland Liquidator advised Everest that it intended to allow millions of dollars of those same Pfizer heart valve claims against the Midland estate based in large part on the same inadequate analysis and the same incorrect and "misleading" legal advice at issue in *Suter*. (*Id.* ¶ 98). Indeed, the Midland Liquidator and its agents, Navigant and the McCarthy Firm, have made the same mistakes here that the *Suter* court found were tantamount to bad faith by the Integrity liquidator. (*Id.*).

In *Suter*, the Court detailed numerous errors that were made by the liquidator in his acceptance of the Pfizer heart valve claims, including:

- The liquidator failed to "make an independent assessment of whether all underlying coverage had been exhausted." *Id.* at 45.

- The liquidator improperly relied on an “opinion letter” from the McCarthy Firm that was “misleading” and contained errors, including, the McCarthy Firm’s statements concerning a California coverage case concerning the Pfizer heart valve claims. (The same McCarthy Firm that is counsel to the Midland estate was counsel to another insolvent carrier, Transit, that had also issued coverage to Pfizer.)⁵ *Id.* at *57; *see also id.* at *63 (It was not the “custom and practice in the industry” for the Integrity liquidator to have relied on the claims investigation performed by the Transit estate.).
- The liquidator failed to follow-up on his request to Pfizer for medical documentation concerning the heart valve claims. *Id.* at *56-59.
- The liquidator “should have retained medical advice as to when bodily injury actually occurred.” *Id.* at *60.
- The liquidator erred in failing to account for Pfizer’s self-insured retentions or SIRs in calculating Integrity’s attachment point. *Id.* at *65-66.
- Actions taken by the deputy liquidator were not “a substitute for [the liquidator’s] failure to properly investigate Pfizer’s claims. *Id.* at *67-68.

(Complaint ¶ 99).

Indeed, the *Suter* court concluded that the liquidator “was grossly incompetent under the circumstances of this case not to retain competent coverage counsel and to have made an allowance on a claim of this type without obtaining medical information to support it.” (*Id.* ¶ 100). In particular, the *Suter* court noted:

It doesn’t take an insurance expert to conclude, as [reinsurer’s expert] did, that industry practices would have required a claims handler to make an effort to get a copy of the [California Pfizer heart valve] decision, read it, and understand what was at stake and retain the assistance of outside coverage counsel. [The liquidator] never bothered to explore the insurers’ [c]overage defenses when it was apparent that carriers settled for less than their policy limits. When [the liquidator] examined Transit’s files he did not determine whether there was any bodily injury claims that occurred during any policy period that validly exhausted

⁵ As explained above, the Liquidator in this matter has retained the McCarthy Firm to provide the Midland estate with insurance coverage advice concerning the MPH claims, on the one hand, and reinsurance coverage advice, on the other.

all of the underlying carriers below the attachment point of Integrity's policy. [The liquidator] repeated the error of the McCarthy [Firm] opinion on the outcome of the [California coverage decision].

(*Id.*). In addition, the court noted that the liquidator had permitted Pfizer to lead him "down the proverbial prim rose path," and that the liquidator should have "retained insurance coverage counsel before cavalierly dismissing" the significance of the California coverage decision. (*Id.*).

A simple review of Midland's May 8, 2006 Supplemental Report to reinsurers, including Everest, concerning Midland's proposed settlement and allowance of the Pfizer heart valve claims demonstrates that the Midland liquidator is making the same exact mistakes made by the Integrity liquidator. For example:

- there is no evidence that the Midland liquidator conducted "an independent assessment of whether all underlying coverage had been exhausted."
- although the McCarthy Firm "opinion letter" is not specifically referenced in the Midland liquidator's May 8, 2006 Supplemental Report on the Pfizer claims, the McCarthy Firm is Midland's counsel and Midland's misinterpretation of the California coverage case concerning the Pfizer heart valve claims mirrors the McCarthy Firm advice criticized by the Court in *Suter*.
- there is no evidence that the Midland liquidator retained medical advice as to when bodily injury actually occurred.
- the Midland liquidator relied upon the claims investigation performed by the Transit estate.

(*Id.* ¶ 101). Despite the foregoing failures, the Midland Liquidator intends to recommend many of the Pfizer heart valve claims for allowance. (*Id.* ¶ 102).

F. The Liquidator Has Refused to Provide Everest with Claims Information

Notwithstanding Everest's unconditional right to access information concerning claims that the Liquidator alleges should be indemnified by Everest, the Liquidator has placed unreasonable and unwarranted restrictions on Everest's access to Midland's books and records in clear violation of the terms and conditions of the Midland Contracts. (Complaint ¶ 54).

For example, in response to Everest's request to conduct a claim review in 2004, the Liquidator conditioned Everest's access to Midland's claims documents on obtaining a guarantee from Everest that it would pay all outstanding billings on the claims subject to the review immediately after the audit. (Complaint ¶ 55). More recently, after numerous requests by Everest, in June 2006, the Liquidator agreed to make available for Everest's review a small selection of claim files pertaining to 34 of the 170 MPHs. (*Id.* ¶ 56). However, the Liquidator then withdrew Everest's access to these records – even after Everest, at a substantial cost, arranged for a third-party contractor to travel to New York, set up equipment at the offices of the New York Liquidation Bureau and copy the files the Liquidator made available. (*Id.* ¶ 57). After copying only six files, Everest's contractor was told to pack up and leave.⁶ As a result, other than the six files copied by Everest (two of which are files for claims that have already been allowed), Everest currently does not have any access to any of the files relating to current or potential claims against Everest under the Midland Contracts, despite the fact that it is contractually entitled to these materials. (*Id.* ¶ 60).

⁶ The Liquidator has not provided Everest with a consistent or coherent reason for its decision to change course and deny Everest access to the claim files in violation of Everest's contractual rights. The excuse stated by the Liquidator and/or its agents for denying Everest's access to claim files has alternated from the purported need to reshelve the subject files for review by another reinsurer to the assertion that Everest's review was taking up space needed for other purposes (in the otherwise vacant offices of the New York Liquidation Bureau) to the claim that the presence of Everest's agent was disturbing the relationship between the Liquidator's consultant and the New York Liquidation Bureau. (*Id.* ¶ 58). Everest proposed to move its contractor to another vacant space in the building and to coordinate its activities with those of any other reinsurer reviewing files by arranging to image and review file materials on a rolling basis. The Liquidator rejected these simple solutions without explanation and without making any attempt to accommodate Everest. (*Id.* ¶ 59).

G. The Liquidator's Exclusion of Everest from the Claim Allowance Process

Not only has the Liquidator deprived Everest of its right to participate in the underlying claim-handling process and, in particular, the settlement negotiations between the Liquidator and Midland's policyholders, but Everest has also been precluded from participating in the procedure established by the Liquidator to obtain Court approval of the settlements negotiated by the Liquidator, in further violation of Everest's participation rights under the Midland Contracts. (Complaint ¶ 111).

The "allowance procedure" established by the Liquidator provides that after proofs of claim against the Midland estate are filed, the Liquidator will evaluate each claim and recommend to the Court whether it should be "allowed" or "disallowed" from sharing in a distribution of assets of the Midland estate, which determinations are ultimately subject to Court approval – all without notice to Everest. (*Id.* ¶ 112).

The allowance procedure does not afford Everest advance notice of, or an opportunity to participate in, the process by which the Liquidator determines whether to allow a claim. (*Id.* ¶ 113). The allowance procedure contains several steps. (*Id.* ¶ 114). First, following its review of what it considers to be "timely-filed" proofs of claim, the Liquidator is required to serve each Midland claimant with a "Notice of Determination" advising the claimant that the claimant's claim has been recommended by the Liquidator to be either disallowed or allowed by the Liquidator in the amount set forth in the notice. (*Id.*).

The allowance procedure does not provide for notice to Everest of the Liquidator's Notices of Determination. (*Id.* ¶ 115). The allowance procedure provides that, if the claimant accepts the Liquidator's recommendation for allowance, the claimant need not take any further action and the Liquidator shall submit an *ex parte* application to the Supreme Court of New York

that “will be approved by the Court,” without exception. (*Id.* ¶ 116). Everest does not even receive notice that the Liquidator is seeking Court approval of a Notice of Determination, and, in fact, the Liquidator has not provided such notice to Everest with respect to the Midland Claims. (*Id.* ¶ 117).

The allowance procedure further provides that if the claimant disputes the amount recommended for allowance, the claimant may object by serving a written notice to the Liquidator and the Liquidator will refer each disputed claim to a referee appointed by the Court. Either party may move to confirm or set aside the referee’s determination of the dispute pursuant to CPLR 4403. (*Id.* ¶ 118). The allowance procedure does not afford Everest notice of a disputed Notice of Determination or an opportunity to participate in any way in the referee’s adjudication of a disputed Notice of Determination, and Everest has not been afforded any such opportunity. (*Id.* ¶ 119). Because the undisputed recommendations for allowance are submitted by the Liquidator to the Court *ex parte*, Everest is not afforded notice or an opportunity to review, comment on, or object to the Liquidator’s recommendations before they are approved by the Court. (*Id.* ¶ 120).

Because the Liquidator’s *ex parte* allowance procedure forms the basis of the Liquidator’s reinsurance billings to Everest, Everest has been, and continues to be, prejudiced by the *ex parte* approval of the Liquidator’s settlement recommendations that are based on inadequate information, inadequate investigation, and improper claims analysis by the Liquidator and/or Navigant. (*Id.* ¶ 121). The Liquidator has steadfastly ignored Everest’s requests to participate in settlement negotiations with Midland policyholders and the claims allowance process, despite Everest’s protests. (*Id.* ¶ 122). The Liquidator’s refusal to permit Everest to

participate in settlement negotiations and the claims allowance process continues to be a breach of the Liquidator's duties under the Midland Contracts.

ARGUMENT

The 1986 injunction should be modified to permit Everest to bring an action against the Liquidator so that Everest, pursuant to its rights under the Midland Contracts, can participate in the handling and settlement of the underlying claims, and to raise and resolve coverage defenses that may exist.

A. The Court Should Lift the Injunction to Permit Everest to File Suit

Courts typically issue injunctions in liquidation proceedings to protect the assets of the estate.⁷ A liquidator, however, should not be allowed to abuse the injunction – even if the liquidator's stated intent is to acquire assets for the estate. *See Mutual Fire, Marine & Inland Ins. Co. v. Adler*, 726 F. Supp. 478, 484 (S.D.N.Y. 1989) (court permitted intervenors' cross-claims, holding that "issuance of a stay ... would allow Mutual Fire to use the Rehabilitation Order as a shield to protect itself while it sued for assets to which [intervenors] clearly has some claim.").

As the New York Court of Appeals has repeatedly recognized, including in this matter, "liquidation cannot place the liquidator in a better position than the insolvent company he takes over, authorizing him to demand that which the company would not have been entitled to prior to liquidation." *Liquidation of Union Indem. Ins. Co. v. American Centennial Ins. Co.*, 89 N.Y.2d

⁷ [A] court or justice may at any time during a proceeding under this article issue such other injunctions or orders as it deems necessary to prevent interference with the superintendent or the proceeding, or waste of the assets of the insurer, or the commencement or prosecution of any actions, the obtaining of preferences, judgments, attachments or other liens, or the making of any levy against the insurer, its assets or any part thereof.

New York Ins. Law § 7419(b).

94, 102 (1996) (*quoting Midland and Bohlinger infra*); *Matter of Midland Ins. Co.*, 79 N.Y.2d 253, 264-65 (1992); *Bohlinger v. Zanger*, 306 N.Y. 228, 234 (1954).

The New York Court of Appeals has held that a company does not have “special” extra-contractual rights just because it is in liquidation. For example, in *Bohlinger, supra*, the liquidator demanded that a broker turn over the entire premium collected, even though brokers are only required to return the earned portion of premiums as of the date of the policy’s termination. Notwithstanding this general rule, the liquidator in *Bohlinger* argued that “as soon as the liquidation order becomes effective the broker is without power or authority to do other than turn over in toto all premium moneys in his possession.” *Bohlinger*, 306 N.Y. at 233. The liquidator further argued that “to permit [the broker] to do otherwise would lead to a substitution of his judgment for that of the liquidator ... and would amount to an avoidance of the restraining order enjoining him ...” *Id.* at 233-34.

The *Bohlinger* court ruled for the broker, holding that “[l]iquidation does not change the situation and the liquidator should not and may not be placed in a better position than the company he takes over and demand that which is not owed.” *Id.* at 234. *See also National Bank of Warren v. Stoddard*, 207 A.D. 276, 280 (4th Dep’t 1923), *aff’d*, 238 N.Y. 618 (1924) (“[w]e recognize the fact that if the property of petitioner was taken illegally or by mistake and commingled with the assets of the company, neither the Superintendent nor the creditors have any right to retain it.”).

As set forth above, Everest is being directly harmed by the Liquidator’s refusal to allow Everest to participate in the claims-handling and settlement process, in violation of Everest’s contractual rights. Absent this Court modifying the injunction, the Liquidator will continue to

breach its contracts with Everest and the other reinsurers.⁸ As a result of these ongoing breaches, claims will be submitted to this Court for approval that should not be paid because they are not covered under the terms of Midland's policies with the MPHs or because the allowed settlement amounts are inflated. If allowed by the Court, the estate may be able to collect the full amount of the allowed claims from Everest, notwithstanding the fact that the estate will likely only pay a fraction of the allowed amount of the claims as a result of the "insolvency clauses" in the Midland Contracts. *See Matter of Midland Ins. Co.*, 79 N.Y.2d at 258 ("insolvency clauses ... permit a liquidator to collect from the reinsurer the amount of reinsurance proceeds that would have become due if the ceding company had not become insolvent."); New York Ins. Law § 1308(a)(2) (providing negative financial ramifications for reinsurers that do not include insolvency clauses in their contracts). In attempting to recover these amounts under the Midland Contract, the Liquidator will argue that the "follow the fortunes" doctrine bars Everest from disputing its settlements. *See Travelers Cas. & Sur. Co. v. Certain Underwriters at Lloyd's, London*, 96 N.Y.2d 583, 596 (2001) (the "follow the fortunes" clause in most reinsurance agreements, when it is appropriate to apply, leaves reinsurers little room to dispute the reinsured's conduct of the case).

If Everest is permitted to exercise its contractual rights to participate in the settlement and claims allowance process at this stage, it can avoid the harm of potentially being forced to pay settlements that are not covered under the Midland policy. Given its financial interest, Everest has every incentive to ensure that only valid covered claims are paid. In contrast, the Liquidator

⁸ "The general rule is that a liquidator 'stands in the shoes' of the insolvent, gaining no greater rights than the insolvent had." *Liquidation of Union Indem. Ins. Co.*, 89 N.Y.2d at 109 (citation and quotation omitted).

does not share this incentive, but rather has incentives to over-pay claims and/or inadequate resources to handle claims properly.

Permitting Everest to bring an action at this time poses no direct threat to the assets of the Midland estate. Everest is not a creditor and is not seeking a “preference” to get ahead of anyone who may be owed money to the estate. Rather, Everest is seeking declaratory and injunctive relief to determine and enforce its and the estate’s respective rights and obligations under the Midland Contracts. While there is a possibility that this Court will determine that Everest does not owe money to the Midland estate or may owe less than any sum demanded by the Liquidator, under no circumstances will a money judgment be entered in Everest’s favor against the Liquidator or the estate. *See Mutual Fire, Marine & Inland Ins. Co.*, 726 F. Supp. at 483-84 (court permitted intervenors’ cross-claims, in part, because there would be no threat to the insolvent company’s assets).

Modifying the injunction to allow Everest to bring a complaint against the Liquidator now will allow Everest and the Liquidator to resolve all of their contractual issues at one time and in one place. There will be finality concerning the amount of reinsurance that will be available to pay allowed claims. In contrast, if this Court declines to modify the injunction, the Liquidator will continue to adjudicate and possibly allow hundreds of claims worth millions of dollars. If Everest cannot participate at this stage, final resolution of the availability of reinsurance claims may be years away. In short, there is every reason to permit Everest and the Liquidator to resolve their disputes now, and there is no good reason to delay.

Indeed, the recent *Suter* decision illustrates the Midland estate’s ongoing (and inevitable continuation of its) inadequate claim review process. If Everest is permitted to intervene in that process now, however, many of these same issues may be avoided. The Liquidator here has

hired the same lawyers chastised in *Suter*, which the *Suter* court noted provided incorrect and “misleading” coverage information to its client, the Transit estate and liquidator, that were later relied upon by the Integrity liquidator. Permitting Everest access to information and the claims-handling process, to which it is contractually entitled, will avoid the coverage determination errors that were made in *Suter* as a result of the McCarthy Firm’s involvement.

B. This Court Should Modify the Injunction in the Interests of Judicial Economy

Midland has now been in liquidation for twenty years, and Everest should not have to wait for additional years to pass before it can have its rights adjudicated. *See Reinsurance Co. of N. Am. v. Superintendent of Ins.*, 183 A.D.2d 626, 627 (N.Y. App. Div. 1992) (modifying injunction to allow creditor to bring its “long asserted substantive claim”); *Mutual Fire, Marine & Inland Ins. Co.*, 726 F. Supp. at 484 (court permitted intervenors’ cross-claims, noting that “it would be manifestly unjust to allow Mutual Fire to take advantage of its being the subject of three year old delinquency proceedings to prevent [intervenors] from establishing that its claim is superior.”); *Stoddard*, 207 A.D. at 280 (“The petitioner is entitled to a speedy adjudication of his claim without waiting for the Superintendent to ascertain liabilities and marshal and distribute assets, ordinarily a protracted process.”). The Liquidator has demonstrated that he is not going to honor Midland’s current and ongoing contractual obligations to Everest. Fundamental fairness dictates that Everest should be allowed to file an action against the Liquidator in order to resolve the parties’ dispute now.

CONCLUSION

For the reasons set forth above, Everest requests that this Court modify the injunction to permit Everest to file the complaint attached hereto.

Dated: New York, New York
August 10, 2006

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Vincent J. Proto", is written over a horizontal line.

Joseph J. Schiavone

Vincent J. Proto

BUDD LARNER, P.C.

11 Penn Plaza, 5th Floor

New York, New York 10001

(212) 946-2798

Attorneys for Plaintiff Everest Reinsurance
Company

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

-----X
In the Matter of the Liquidation of
MIDLAND INSURANCE COMPANY

Index No. 41294/86

Assigned to:
Hon. Michael Stallman

AFFIDAVIT OF SERVICE

-----X
STATE OF NEW YORK :
:SS:
COUNTY OF NEW YORK :

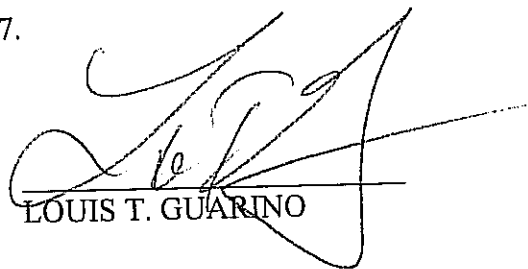
I, LOUIS T. GUARINO, being duly sworn, depose and say:

1. I am over 18 years of age and am a paralegal with the law firm of Budd Lerner, P.C., attorneys for Everest Reinsurance Company.
2. On August 10, 2006, I caused to be served the foregoing Memorandum in Support of Everest Reinsurance Company's Motion to Modify the Injunction to Permit Suit against the Liquidator to be served by hand delivery upon the following:

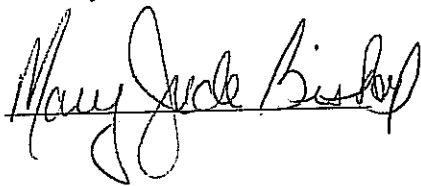
Office of the General Counsel
New York State Insurance Department
25 Beaver Street
New York, New York 10004

Liquidation Bureau
New York State Insurance Department
123 William Street
New York, New York 10004
3. On August 10, 2006, I caused to be served the foregoing Memorandum in Support of Everest Reinsurance Company's Motion to Modify the Injunction to Permit Suit against the Liquidator to be served by overnight, Fed Ex courier, addressed to James C. Owen, Esq.,

McCarthy, Leonard, Kaemmerer, Owen, McGovern, Striler & Menghini, L.C., 400 South Woods
Mill Road, Suite 250, Chesterfield, Missouri 63017.


LOUIS T. GUARINO

Sworn to before me this
10th day of August, 2006.



MARY JUDE BISHOP
NOTARY PUBLIC, STATE OF NEW YORK
NO. 01B1609805
QUALIFIED IN PUTNAM COUNTY
COMMISSION EXPIRES 8/27/2007

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