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Insurance Commissioner of the State of California
13 in his Capacity as Conservator of CastlePoint
National Insurance Company

**EXEMPT from filing fees per Govt.
Code § 6103**

14
15 SUPERIOR COURT OF THE STATE OF CALIFORNIA
16 CITY AND COUNTY OF SAN FRANCISCO
17

18 DAVE JONES, INSURANCE
19 COMMISSIONER OF THE STATE OF
CALIFORNIA,

20 Applicant,

21 v.

22 CASTLEPOINT NATIONAL INSURANCE
23 COMPANY, and DOES 1-50, inclusive,

24 Respondents.
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27
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Case No.CPF-16-515183

**CONSERVATOR'S REPLY BRIEF IN
SUPPORT OF MOTION FOR ORDER
APPROVING CONSERVATION AND
LIQUIDATION PLAN FOR
CASTLEPOINT NATIONAL
INSURANCE COMPANY**

**Date: September 13, 2016
Time: 9:30 a.m.
Dept: 302
Judge: Hon. Harold E. Kahn**

**ELECTRONICALLY
FILED**
*Superior Court of California,
County of San Francisco*
09/06/2016
Clerk of the Court
BY:DAVID YUEN
Deputy Clerk

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I.
INTRODUCTION

In response to his Motion For Order Approving Conservation & Liquidation Plan For CastlePoint National Insurance Company (“Motion”), the Conservator received a number of formal and informal responses, objections and commentary from individual creditors and claimants.¹ Several of these creditors ask for either more time or more money – commodities that are in extremely short supply and will remain so absent approval and implementation of the Plan.² Other creditors or interested parties ask for more information or clarification of their status, which the Conservator has provided either separately or in this Reply. Notably, none of the objecting creditors or commentators have countered the Conservator’s showing in the Motion that the Plan provides significant and immediate value to the CastlePoint estate for the collective benefit of all policyholders, claimants and creditors. The value of the Plan includes:

- The preservation of at least \$500 million in tax attributes,
- An infusion of \$200 million in cash,
- The elimination of certain liabilities, contingencies, and credit risks related to existing policy liabilities and reinsurance agreements, and
- The provision of free policy and claims administration services for up to two years.

Moreover, none of the objecting parties have proffered any better alternative to generate that considerable value for the estate or otherwise to deal with the distressed financial condition

¹ The Conservator received and is responding to (1) filed opposition of claimant Northern Star Management, Inc., (2) a letter from counsel for Karen Wilkie, a severely injured plaintiff with a claim against a CastlePoint insured, (3) a letter from counsel for Hildene Capital Management and Hildene Opportunities Master Fund II, Ltd. (collectively “Hildene”), which are investment funds that own debt instruments issued not by CastlePoint, but by non-insurance company affiliates of the Tower Group that are not parties in this proceeding, (4) an affidavit in opposition to the Plan from counsel for Lorraine and Donald Turchiarelli, who also hold claims against a CastlePoint insured, (5) a response from Wellington Insurance Company, a third party insurer with a reinsurance relationship with CastlePoint, (6) a comment from 1436-1438 Williamsbridge Road LLC and Seneca Insurance Company (collectively “Williamsbridge”), a “cut-through” policyholder of CastlePoint, and (7) a claim for indemnity from Walaal Corporation d/b/a Ambassador Cab, a claimant who recently reached a settlement on an insured claim. This Reply responds to all of this commentary, even if not formally filed with the Court, and courtesy copies are provide to the Court by way of an Appendix of Support, Comment, or Opposition to Conservation and Liquidation. The Conservator has also served this Reply on all of these commentators, although the Conservator is not treating such persons as parties to the proceeding absent a formal appearance and motion for leave to intervene.

² Except where otherwise indicated, capitalized terms have the same meaning as in the Conservator’s Motion and its accompanying Memorandum.

1 of CastlePoint. To be blunt – if the Plan is not approved and implemented, the Conservator will
2 have no option but to immediately move the Court for an order of liquidation for CastlePoint.
3 This will result in the loss of the valuable consideration available under the Plan and will result in
4 significant disruption and harm to the policyholders, creditors, and injured workers whose
5 insurance claims will need to be abruptly transitioned to the state Insurance Guaranty Funds
6 without the benefit of adequate planning and preparation. That harm can and will be avoided
7 under the Plan.

8 In responding to the opposition and commentary to the Plan, the Conservator stresses that
9 the fundamental goal of the Plan is to protect and advance the interests of *all* policyholders and
10 creditors adversely affected by the failure of the Tower Group and CastlePoint. The Conservator
11 does not for a moment discount the harm being suffered by CastlePoint policyholders, claimants
12 and creditors – that harm is real. While the Plan cannot eliminate that harm, it can and does
13 reduce the harm and prevents the worse result that would emerge in the absence of the Plan.

14 The Plan was developed through close collaboration among the six domiciliary regulators
15 responsible for the resolution of the ten companies that were part of the Tower Group.
16 Collectively these regulators agreed that the solutions proposed in the Plan are in the best interests
17 of policyholders and creditors, as evidenced by their issuance of administrative orders approving
18 the mergers of the Tower Insurance Companies into CastlePoint (which were performed in
19 anticipation of the conservation and Plan). The Plan materially benefits policyholders and
20 creditors by providing a notably superior alternative to an immediate liquidation.

21 None of the submitted responses or oppositions undercut the basic premises of the Plan or
22 the Conservator’s authority to enter into the Plan and its accompanying transactions. As
23 established in the Conservator’s Memorandum in support of the Plan, the Conservator has broad
24 discretion to administer the CastlePoint estate, and the Conservation Plan should be approved
25 unless it is either unsupported by a rational basis or is arbitrary or improperly discriminatory. The
26 minimal objections raised to the Plan, however heartfelt, do not come close to making the
27 necessary showing to defeat the Motion. The Plan should therefore be approved for immediate
28 implementation.

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II.

**LEGAL STANDARD APPLICABLE TO
THE CONSERVATION AND LIQUIDATION PLAN PROCEEDINGS**

As noted in the Motion, the Conservator is vested with broad discretion in his administration of the CastlePoint estate, including his adoption of a plan of conservation and liquidation. The Conservator’s Plan must be approved unless it is shown that its terms constitute an abuse of discretion, either because they are unsupported by a rational basis or are arbitrary and improperly discriminatory. (*See In re Executive Life Ins. Co. v. Aurora Nat’l Life Assurance Co.* (1995) 32 Cal.App.4th 344, 358 [the conservator’s actions are reviewed for abuse of discretion]; *Commercial Nat. Bank v. Superior Court* (1993) 14 Cal.App.4th 393, 398 [same]. *See also Carpenter v. Pac. Mut. Life Ins. Co. of Cal.* (1937) 10 Ca.2d 307, 329 [“The only restriction on the exercise of this...power is that the state’s action shall be reasonably related to the public interest and shall not be arbitrary or improperly discriminatory.”]). A plan that provides benefits equal to or greater than a liquidation is per se reasonable, as interested parties are only entitled to “the equivalent of what [they] would receive on liquidation.” (*Carpenter v. Pac. Mut., supra*, 10 Cal.2d at p. 335-36.)

The Plan meets this standard. The Plan’s value inures to every policyholder, claimant, creditor, and shareholder of CastlePoint, and improves on the result of an abrupt liquidation.

III.

REPLY

A. The Conservator’s Plan And Motion Provide Adequate Information For the Court and Interested Parties to Evaluate and Approve the Plan

The most formal and vociferous opposition to the Motion came from Northern Star Management, Inc. (“Northern Star”), a judgment creditor of CastlePoint that is clearly irritated by the fact that CastlePoint’s conservation has impeded its ability to execute on its judgment. Without proposing alternative solutions or challenging the value of the Plan, Northern Star’s opposition simply raises a series of illusory objections based on the purported vagueness of the Conservator’s Motion and Plan, and proffers an inaccurate standard of review. Northern Star also

1 demands additional, unnecessary information beyond the scope of the Plan proceedings, and lobs
2 baseless suggestions that certain aspects of the Plan were the result of “pressure” upon the
3 Conservator. Notably, Northern Star does not identify a single, specific aspect of the Plan as
4 lacking a rational basis or being unfairly discriminatory. Nor does it offer any reason for needing
5 additional information. Northern Star’s objection appears to be little more than an unavailing
6 attempt to delay the implementation of the Plan, presumably to leverage preferential treatment.

7 1. Northern Star Applies The Wrong Legal Standard.

8 Northern Star asserts that the Conservator “fails to make any showing about the basis of
9 the proposed [Plan, and] does not provide facts to justify why the proposed Plan is needed.”
10 Northern MPA³ at p. 1 (Appendix at Tab I(A)(2)). It then goes on to argue that the Conservator
11 neglects to explain “*why this Plan is necessary,*” and “*why the Conservation and Liquidation Plan*
12 *is needed over other [unspecified] alternatives.*” (*Id.*, at p. 3 [emphasis in original]). This
13 proffered legal standard of “necessity” does not exist under California law. The Conservator is
14 not required to show why it is “necessary” to adopt a specific Plan over a hypothetical alternative.
15 The Conservator need only show that the proposed Plan provides an equal or better recovery for
16 creditors and policyholders than they could expect in a straight liquidation. (*See* Section II,
17 *infra.*) This bar has been easily cleared – the Plan provides for an immediate injection of \$200
18 million into the estate, which will be used to pay policyholder claims, administrative services
19 worth up to \$40 million, and other items of value specified in the Motion. Moreover, the Plan
20 allows for a period of conservation prior to the placement of CastlePoint into liquidation. This
21 provides several benefits: it ensures the continuation of uninterrupted claim payments, grants time
22 for the preparation of files for transfer to the guaranty associations,⁴ and allows for a smoother
23 consolidation of the merged companies.

24 But even assuming the Court were to apply this “necessary” standard, the Conservator has
25

26 ³ Northern Star Management, Inc’s Opposition And Objections Memorandum Of Points And Authorities (hereinafter,
27 “Northern MPA”).

28 ⁴ CastlePoint is also responsible for a relatively small number of claims that are not subject to protection under
insurance guarantee laws, such as claims under surplus lines or excess liability policies. Although these claims may
be subject to treatment as policyholder claims, they will be separately administered during the conservation and
liquidation.

1 met that standard as well. Simply put, the Plan is “necessary” because CastlePoint has inadequate
2 liquidity to continue paying claims unless the Plan is implemented. (Wilson Supp. Decl., at
3 ¶ 23(a); Wilson Reply Decl., at ¶ 9). There are no alternatives. Either the Plan is approved and
4 implemented, or CastlePoint must enter into an abrupt and immediate liquidation. (*Ibid.*)

5 2. Approval of the Plan does not hinge on whether Northern Star understands the
6 rationale for the mergers of the Tower Companies into CastlePoint.

7 Northern Star next attempts to manufacture uncertainty regarding the legality and benefit
8 of the pre-conservation merger of the Tower Insurance Companies with and into CastlePoint.
9 (Northern MPA, at p. 5). As explained in the Conservator’s Memorandum, these mergers were
10 accomplished pre-conservation based on merger applications approved by all of the six affected
11 domiciliary state insurance regulators. Further, by merging the Tower Insurance Companies, the
12 Conservator and CastlePoint obviated the need for ten separate conservation proceedings across
13 six state forums, thereby greatly streamlining the conservation and eventual liquidation of these
14 companies and preserving estate assets for the payment of creditors and policyholders.
15 (Memorandum, at p. 2, 7; Wilson Supp. Decl., at ¶ 9(a).) By approving these mergers, state
16 regulators concluded that policyholders and creditors would be better protected, and would likely
17 receive better treatment, in a single, orderly conservation and liquidation process. Northern Star’s
18 request for additional information showing that the mergers “complied with all laws” and were
19 “in the interest of CastlePoint’s policyholders and creditors” is superfluous. Northern Star has no
20 basis or standing to challenge the mergers, which were carried out in accordance with state law,
21 were approved by state regulators, and are a matter of public record.

22 3. The Plan is not vague and requires no further explanation.

23 Finally, as an afterthought, Northern Star purports to identify three items in the Plan that it
24 dubs “vague”: the identity of the “historical shareholders” or “creditors,” how the trust
25 established by the Plan will be administered, and the “basis and factual support” for the estimate
26 that the administration services to be provided by AmTrust and National General are worth up to
27 \$40 million. (Northern MPA, at 6.) These are obvious red herrings.

28 The “historical” creditors and shareholder referred to by the Plan are simply the existing

1 creditors and shareholder who will have claims under Insurance Code section 1033(a). They will
2 be formally identified based on the standard liquidation proof of claim process that will
3 commence with the entry of a liquidation order by this court. The trust established under the Plan
4 will be administered in accordance with the terms of the Trust Agreement that is incorporated into
5 the Plan, subject to the continuing jurisdiction and oversight of this Court. Finally, the
6 Conservator's estimate as to the value of administration services is based on the Conservator's
7 review of historical claim cost and information obtained from the counter-parties. (*See* Wilson
8 Supp. Decl., at ¶9(c).) The exact calculation of the value of these services is hardly necessary to
9 conclude that the provision of administration services under the Plan is better for creditors and
10 policyholders than forcing the estate to absorb those costs – in short, “free” services offered by
11 the same competent and qualified administrators that are currently handling the claims is per se
12 valuable to the estate and will not be available absent approval of the Plan.

13 **B. Recently Settled Claims Seeking Full Recovery and Claims With Pending Litigation**
14 **Will Be Treated In Accordance With The Applicable Law**

15 Counsel for Karen Wilkie and Ambassador Cab submitted letters to the Court and/or the
16 Conservator asserting the existence of settlements of claims against CastlePoint insureds and
17 demanding immediate payment of the settlement amounts. In short, these claimants are seeking
18 preferential treatment, superior to other policyholders and claimants based on their perceived
19 good fortune that their claims were settled pre-conservation. Neither the Plan nor California law
20 permits such windfalls. And more important, the self-interests of several individual claimants is
21 not a basis to reject a Plan that adds value for the benefit of all creditors.

22 During the initial conservation phase, the Conservator is overseeing the administration
23 and payment of policy claims as they are submitted, but is implementing controls to avoid
24 unequal treatment between pre-liquidation and post-liquidation claims. The Conservator is
25 causing the company to pay claims up to the applicable cap established under the laws that
26 govern the state guaranty funds (that is, the amount that such claims would be paid post-

1 liquidation).⁵ This is well within the Conservator’s discretion. Both Insurance Code section 1011
2 and this Court’s July 28 Conservation Order grants the Conservator authority to “conduct...the
3 business of [CastlePoint], or so much thereof as to the commissioner may deem appropriate.”
4 The Insurance Code goes on to give the Conservator authority to “compound, compromise or in
5 any other manner negotiate settlements of claims...upon such conditions as the commissioner
6 shall deem to be most advantageous to the estate.” (Cal. Ins. Code § 1037(c).) Finally, in every
7 insolvency, the Commissioner is directed to take actions to avoid the payment of preferences of
8 the type sought by these claimants. (See Cal. Ins. Code § 1034 [authorizing the “clawback” of
9 liabilities paid during the four months prior to liquidation].) Because the Conservator expects that
10 CastlePoint’s conservation will be converted to liquidation within a few months’ time, any
11 payment above the guaranty fund cap would risk creating an improper voidable preference under
12 Insurance Code section 1034, as it would favor claimants that happened to strike a deal before the
13 conservation proceedings became public knowledge. Claim administration is part of the
14 Conservator’s function, and he is granted broad discretion to conduct this function equitably and
15 fairly. More importantly, the handling of individual claims has no bearing on whether the Plan
16 should be approved for the benefit of all creditors.

17 Counsel for Lorraine and Donald Turchiarelli submitted an “Affidavit in Opposition” to
18 the Conservator’s Plan Motion (“Vinal Affidavit”) based on the Turchiarellis’ pending litigation
19 in New York State Supreme Court against a CastlePoint insured. Nothing in the Plan or the
20 Motion impacts the ordinary process for adjudicating the Turchiarellis’ claim. The Vinal
21 Affidavit, though meandering, raises one additional argument worth addressing: Vinal demands
22 that CastlePoint, as successor by merger with Tower Insurance Company of New York, be
23 liquidated in a New York proceeding under New York law.⁶ As noted in the Commissioner’s
24 Verified Petition for Conservation of CastlePoint, CastlePoint is a California domiciled insurer
25 that is subject to conservation solely in the California Superior Court. This Court’s jurisdiction

26 _____
27 ⁵ The Conservator is applying the same “cap” to claims without guaranty coverage, in order to avoid applying
different treatment to similarly situated policyholders.

28 ⁶ Vinal also raises non-specific objections to the information contained in the Conservator’s Plan and Motion. Such
objections essentially mirror those raised by Northern Star, and the Conservator’s response to such objections is the
same.

1 over the CastlePoint estate, its assets, and all claims against the estate is well established and is
2 governed by California law. This is the case regardless of where a particular claim arises, or the
3 domicile of a company that lawfully merged into this California insurer.

4 **C. The Anti-Suit Injunctions in the Proposed Order Are Authorized by California Law**

5 In a letter to the Court, counsel for Hildene seeks confirmation that the Order approving
6 the Plan does not enjoin claims against the entities enumerated in section 8.1.2(vii) of the
7 Conservation Agreement, so long as such actions do not involve the assets of CastlePoint or
8 interfere with the Plan or the administration of this proceeding. The Conservator believes that the
9 Conservation Agreement and proposed Final Conservation Order are unambiguous on this point.
10 By its terms, the injunction in section 8.1.2(vii) of the Conservation Agreement applies only to
11 claims that “(A) arise[] out of any acts or omissions of [the enumerated parties] occurring after
12 the consummation of the Acquisition Transactions and (B) may adversely affect the assets or
13 operations of [CastlePoint] or the Constituent Companies or the Conservation Plan.” (See
14 Conservation Plan, § 8.1.2(vii).) The proposed Order thus enjoins claims against the enumerated
15 entities that arise out of “(1) Retained Liabilities, (2) the management or operations of CastlePoint
16 or its affiliates prior to the closing of the transactions contemplated by the Conservation
17 Agreement and the Conservation Transaction Agreements, or (3) the Plan, Conservation
18 Agreement, or Conservation Transaction Agreements.” (See Proposed Order, ¶ 22.) The
19 proposed Order separately enjoins claims that “(1) arise[] out of any acts or omissions of such
20 persons occurring after the consummation of the series of transactions by which ACP Re, Ltd.
21 acquired TGI and its affiliated insurance companies, and (2) may adversely affect the assets or
22 operations of CastlePoint, the companies merged with and into CastlePoint, or the Plan.” (*Id.* ¶
23 23.)

24 The powers granted under Insurance Code section 1020 extend to enjoining only actions
25 that have an impact upon the estate. (See *Webster v. Superior Court* (1988) 46 Cal. 3d 338, 350-
26 51 [allowing claimant to proceed where claim “will neither deplete [insolvent company’s] assets
27 nor disrupt an orderly distribution.”]). The Conservator carefully drafted section 8.1.2(vii) of the
28

1 Conservation Agreement to comply with applicable law.⁷

2 **D. Treatment of Policies With Cut-through Endorsements**

3 Williamsbridge submitted a comment on the Plan in which it seeks to clarify the treatment
4 of policies issued between January 1, 2014 and September 15, 2014 containing “cut-through”
5 reinsurance endorsements. Any policy that has a cut-through endorsement pursuant to either the
6 Personal Lines Cut-through Quota Share Reinsurance Agreement or the Commercial Lines Cut-
7 Through Quota Share Reinsurance Agreement⁸ (or any other part of the Conservation Agreement
8 and its exhibits) is entitled to the same treatment as the “fronted policies” referenced in the
9 Motion.⁹ (See Conservation Agreement § 9.1.11.) Policies with cut-through endorsements are
10 being assigned under the Plan to the relevant reinsurer – Integon National Insurance Company
11 (“Integon”) for personal lines policies, and Technology Insurance Company (“Technology”) for
12 commercial lines policies) – and claimants may seek the administration and payment of claims
13 from said reinsurer, subject to the coverage limitations of the policy. This treatment is the same
14 for all policies with cut-through endorsements, regardless of the date of issuance of the policy.

15 **E. Other Reinsurers Such as Wellington Insurance Company Are Not Impacted By The**
16 **Plan**

17 The “Notification and Response” submitted by Wellington Insurance Company
18 (“Wellington”), a reinsurer that agreed to provide 100% quota share reinsurance on certain
19 CastlePoint homeowners insurance policies, sets forth this reinsurer’s desire to be treated in the
20 same manner as the 100% quota share reinsurers under the Plan (Integon and Technology, each of
21 whom are providing value to CastlePoint in exchange for their rights under the Plan).

22 Wellington’s response is not an opposition to approval of the Plan, only an expression of its
23

24 ⁷ Any specific issues relating to this section can be addressed upon the filing of a specific action, as the Conservator
25 cannot speak to whether a hypothetical action would fall within the injunction or not.

26 ⁸ The Commercial Lines Cut-through QSA (with Technology), and the Personal Lines Cut-through QSA (with
27 Integon), are both dated January 3, 2014. The intent of these agreements was to ensure that all liabilities under
28 policies issued after January 3, 2014 would not add to the obligations of the Tower Companies and that policyholders
could expect that the reinsurers would be responsible for obligations under those policies. The Plan stays true to that
original intent and policyholders’ expectations.

⁹ The Conservator has confirmed that the Hermitage Insurance Company policy issued to Williamsbridge contained
an in-force cut-through endorsement. (Wilson Reply Decl., at ¶ 11.) Counsel for the Conservator forwarded a copy of
that cut-through endorsement to counsel for Williamsbridge on August 31, 2016. (*Ibid.*)

1 desired treatment of the claims it is currently reinsuring and administering. While nothing in the
2 Plan precludes the Conservator from subsequently working with Wellington and other similarly-
3 situated parties to enter into similar agreements, neither this Motion nor the Plan are the right
4 context in which to address those proposals. Nothing in the Plan results in any immediate change
5 to the status quo for Wellington, and any proposed changes can and must be arranged separately
6 between the Conservator and Wellington.

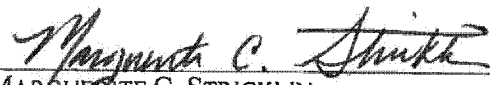
7 **IV.**

8 **CONCLUSION**

9 Based on the foregoing, the Conservator respectfully requests that the Court grant the
10 Motion and approve the Conservator's Conservation and Liquidation Plan for CastlePoint, enter
11 the Conservator's proposed Order Approving Conservation and Liquidation Plan for CastlePoint
12 National, and thereby authorize the Commissioner to implement the Plan forthwith.¹⁰

13 Dated: September 6, 2016

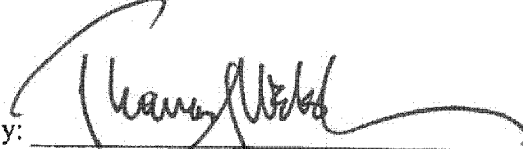
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16 By: 
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18 Attorneys for Applicant Dave Jones,
19 Insurance Commissioner of the
State of California

20 Dated: September 6, 2016

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21
22
23 By: 
24 THOMAS J. WELSH

25 Attorneys for Applicant Dave Jones,
26 Insurance Commissioner of the
27 State of California

28 ¹⁰ The Conservator has lodged a revised proposed Final Conservation Order which incorporates additional factual findings related to CastlePoint's deconsolidation from its tax group, all of which are supported.
OHSUSA:765724366.3