

1 MANATT, PHELPS & PHILLIPS, LLP
2 CRAIG S. BLOOMGARDEN (Bar No. CA 110241)
3 11355 West Olympic Boulevard
4 Los Angeles, CA 90064-1614
5 Telephone: (310) 312-4000
6 Facsimile: (310) 312-4224
7 Email: cbloomgarden@manatt.com

8 RUPP, BAASE, PFALZGRAF, CUNNINGHAM & COPPOLA LLC
9 David R. Pfalzgraf, Jr., *pro hac vice pending*
10 Daniel E. Sarzynski, *pro hac vice pending*
11 Charles D.J. Case, *pro hac vice pending*
12 1600 Liberty Building
13 Buffalo, New York 14202
14 Telephone: (716) 854-3400
15 Facsimile: (716) 332-0336

16 Attorneys for
17 NEW YORK STATE WORKERS' COMPENSATION BOARD

18 SUPERIOR COURT OF THE STATE OF CALIFORNIA

19 CITY AND COUNTY OF SAN FRANCISCO

20 INSURANCE COMMISSIONER OF THE
21 STATE OF CALIFORNIA,

22 Applicant,

23 vs.

24 MAJESTIC INSURANCE COMPANY,

25 Respondent.

Case No. CPF-11-511261

**MEMORANDUM OF POINTS AND
AUTHORITIES IN SUPPORT OF
NEW YORK STATE WORKERS'
COMPENSATION BOARD'S
OBJECTIONS TO THE PROPOSED
REHABILITATION PLAN FOR
MAJESTIC INSURANCE COMPANY**

Date: June 2, 2011
Time: 9:30 a.m.
Dept: 301
Judge: Hon. Peter J. Busch

26
27
28
300256097.1

TABLE OF CONTENTS

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

TABLE OF AUTHORITIES ii

FACTUAL BACKGROUND 1

ARGUMENT 3

I 3

THE POLICE POWERS EXERCISED BY THE
CALIFORNIA COMMISSIONER OF INSURANCE
IN CONSERVATION ARE NOT WITHOUT LIMITS

II 3

THE REHABILITATION PLAN FOR MAJESTIC IS
ARBITRARY AND IMPROPERLY DISCRIMINATES
AGAINST THE NYWCB

III 9

THE COMMISSIONER OF INSURANCE HAS
BREACHED HIS DUTY AS TRUSTEE TO ACT
FOR THE BENEFIT AND IN THE BEST INTEREST
OF ALL POLICYHOLDERS AND CREDITORS

IV 10

THE COURT SHOULD REJECT THE PLAN BECAUSE
THE CONSERVATOR HAS FAILED TO SHOW THAT
IT PROVIDES THE NYWCB WITH THE LIQUIDATION
VALUE OF ITS CLAIMS

V 11

IN A CONSERVATION PROCEEDING, LIQUIDATION IS
A LAST RESORT AND SHOULD ONLY BE UNDERTAKEN
WHEN ALL EFFORTS AT REHABILITATING THE
INSOLVENT INSURANCE COMPANY HAVE FAILED

CONCLUSION 14

TABLE OF AUTHORITIES

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

CASES

Carpenter v. Pacific Mut. Life Ins. Co.,
10 Cal. 2d 307, 329 - 331 (1937).....3, 6, 10, 11

Commercial Nat. Bank v. Superior Court,
14 Cal. App. 4th 393 (2d Dist. 1993)..... 3, 6, 7, 9

In re Executive Life Ins. Co. v. Aurora National Life Assurance Co.,
32 Cal. App. 4th 344, 358 (2d Dist. 1995).....3, 4, 10

Foster v. Mut. Fire, Marine & Inland Ins. Co.,
614 A.2d 1086, 1093-94 (Pa. 1992).....10

Grode v. Mut. Fire, Marine & Inland Ins Co.,
572 A.2d 798, 804 (Pa. Commw. Ct. 1990).....10

Koken v. Fidelity Mut. Life Ins. Co.,
907 A.2d 1149 (Pa. Commw. Ct. 2006).....10

Neblett v. Carpenter,
305 U.S. 297 (1938).....10

STATUTES

Cal. Ins. Code § 1010 *et. seq.* (Deering 2011).....3

Cal. Ins. Code § 1011 (Deering 2011).....11

Cal. Ins. Code § 1012 (Deering 2011).....11

Cal. Ins. Code § 1016 (Deering 2011).....11

Cal. Ins. Code § 1023 (Deering 2011).....9

Cal. Ins. Code § 1025 (Deering 2011).....9

Cal. Ins. Code § 1033 (Deering 2011).....6, 9

Cal. Ins. Code § 1043 (Deering 2011).....12

Cal. Ins. Code § 1057 (Deering 2011).....4, 6, 9

12 NYCRR § 317.20 (McKinney 2011).....1

OTHER AUTHORITIES

1 COUCH ON INS. § 5:29.....10

NAIC, *Receivers Handbook for Insurance Company Insolvencies*, at 5, 448 (2009).....10

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

MEMORANDUM OF POINTS AND AUTHORITIES

The New York State Workers' Compensation Board ("NYWCB") submits this Memorandum in support of its objections to the proposed Rehabilitation Plan ("Plan") for Majestic Insurance Company ("Majestic"), submitted to this Court by the California Commissioner of Insurance ("Conservator"). NYWCB objects to the Plan on the grounds that it: (1) is discriminatory in that it specifically excludes the claims of the NYWCB prior to the NYWCB even submitting its claims for consideration; (2) is an abuse of discretion because the Conservator did not put the definitive agreements with AmTrust out for competitive bid; (3) is an abuse of discretion because the Conservator approved AmTrust as purchaser based upon AmTrust's commitment to keep jobs and resources in the State of California, instead of what is in the best interests of policyholders and creditors; (4) is an abuse of discretion because the Conservator in his role as trustee has failed to pursue less drastic remedies that were available to him, and remain available to him, in order to rehabilitate Majestic for the protection of its policyholders and creditors; (5) and is an unconstitutional taking because the Conservator has not shown that the Plan provides the NYWCB with at least the liquidation value of its claims.

FACTUAL BACKGROUND

By way of background, and as more fully set forth in the accompanying Declaration of Michael Papa (the "Papa Declaration"), the NYWCB is a governmental agency created pursuant to the New York State Workers' Compensation Law ("NYWCL"). Pursuant to regulations promulgated by the Commissioner of the NYWCB, attendant to NYWCL, including 12 NYCRR § 317.20, the NYWCB is the successor in interest to a number of group self-insured trusts ("GSITs"), through which employers provided workers' compensation coverage to their employees through self-funded insurance trusts, and through which excess coverage is in force through private carriers, among them Majestic. The NYWCB's objections to the Plan thus are in its capacity as a Majestic policyholder. Upon information and belief, the NYWCB is the largest claimant in these proceedings.

1 On December 9, 2009, the NYWCB filed suit in the State of New York Supreme
2 Court, Albany County, against Compensation Risk Managers, LLC (“CRM”) (the parent of
3 Majestic), Majestic, and numerous other related entities. See Papa Declaration at ¶ 59. In this
4 complaint and the NYWCB’s amended complaint, which was filed on March 26, 2010, the
5 NYWCB asserted claims against the defendants for, among other things, breach of contract,
6 breach of fiduciary duty, breach of duty of good faith and fair dealing, fraud in the inducement,
7 fraud, unjust enrichment, deceptive business practices, false advertising, and conversion. See
8 Papa Declaration at ¶ 66.

9 CRM’s actions of mismanagement included placing excess insurance coverage for
10 the GSITs with Majestic, which was owned by CRM, without obtaining excess insurance quotes
11 that would have cost less in premiums to the GSITs, and without notifying the NYWCB of the
12 relationship between CRM and Majestic. This was done in violation of the New York Workers’
13 Compensation Law (“WCL”), as well as in violation of CRM’s fiduciary duty to the GSITs and
14 for the purpose of financially benefiting CRM and Majestic. See Papa Declaration at ¶ 62-63.

15 In July 2010, subsequent to the reduction of Majestic’s AMBest rating, the
16 Conservator began talks with Majestic and the NYWCB aimed at settling the New York
17 litigation. See Papa Declaration at ¶ 75. Through these negotiations, a settlement plan was
18 reached whereby Bayside Capital Partners, LLC (“Bayside”) agreed to purchase Majestic. *Id.* at
19 ¶ 69. This plan required the approval of the California Department of Insurance (“CADOI”) in
20 order to be finalized. However, after eight months of inaction on the part of the CADOI, during
21 which Majestic continued to incur additional losses, Bayside withdrew from the settlement on
22 March 1, 2011. *Id.* at ¶ 83-84.

23 ARGUMENT

24 I. THE POLICE POWERS EXERCISED BY THE CALIFORNIA 25 COMMISSIONER OF INSURANCE IN CONSERVATION ARE 26 NOT WITHOUT LIMITS

27 The California Insurance Code provides that the Commissioner of Insurance has
28 the power to seize the assets of an insurance company operating in such a deficient financial

1 condition that it is hazardous to its policyholders, creditors, and the general public. *See* Cal. Ins.
2 Code § 1010 *et. seq.* Although the Commissioner is authorized to exercise the state's police
3 powers in rehabilitating and/or liquidating the insurance company in conservation, these powers
4 are limited under the law. *See Carpenter v. Pacific Mut. Life Ins. Co.*, 10 Cal. 2d 307, 329 - 331
5 (1937); *Commercial Nat. Bank v. Superior Court*, 14 Cal. App. 4th 393 (2d Dist. 1993).

7 The plan to rehabilitate the insurance company in conservation must not be
8 arbitrary, nor may it improperly discriminate against policyholders within the same class. *See*
9 *Carpenter*, 10 Cal. 2d at 329. Further, the Commissioner must act as a trustee for the benefit of
10 all creditors and all interested persons while administering the insurance company in
11 conservation. *See* Cal. Ins. Code § 1057. Finally, the conservation proceedings must favor
12 rehabilitation over liquidation if at all possible, with liquidation being viable only as an absolute
13 last resort. *See Carpenter*, 10 Cal. 2d at 329. The court reviews the actions of the Commissioner
14 in administering a rehabilitation plan for abuse of discretion. *In re Executive Life Ins. Co. v.*
15 *Aurora National Life Assurance Co.*, 32 Cal. App. 4th 344, 358 (2d Dist. 1995).

17 **II. THE REHABILITATION PLAN FOR MAJESTIC IS ARBITRARY**
18 **AND IMPROPERLY DISCRIMINATES AGAINST THE NYWCB**

19 In reviewing a rehabilitation plan of an insurance company in conservation, the
20 court is vested with the authority to determine whether the plan is impermissibly arbitrary. *See*
21 *Executive Life Ins.*, 32 Cal. App. 4th at 358. A plan may be deemed arbitrary if it is unsupported
22 by a rational basis or is contrary to a specific statute. *Id.* In order for a plan to avoid a
23 determination that it is arbitrary, it must be formulated only after a diligent effort to ascertain the
24 best possible outcome for all potential creditors, and must follow the guidelines of the California
25 Insurance Code for the disposition of assets of an insurance company in conservation.
26

1 In *Executive Life Ins.*, a portion of the rehabilitation plan involved the sale of a
2 portfolio of high-yield securities with low or no credit rating, *i.e.*, junk bonds. The Commissioner
3 planned to sell this portfolio in order to begin issuing new life insurance policies through the new
4 owners of the portfolio of the junk bonds. Although the Commissioner was engaged in talks with
5 one proposed buyer of the portfolio, Altus, for a period of time, and entered into a publicized
6 “Definitive Agreement” with Altus concerning the buyer’s plans for reinvestment of the bonds
7 and issuance of new life insurance policies, the Commissioner permitted a rigorous bidding
8 process involving several proposed buyers.
9

10 After several months of reviewing bids from proposed buyers, including Altus, the
11 Commissioner, with the court’s approval, selected Altus as the winning bidder. Although another
12 proposed buyer had been selected as the potential winner, this alternate buyer was unable to
13 overcome certain concerns over its ability to advance funds to the new life insurance policies,
14 which would have made them less dependent on the performance of the junk bond portfolio. The
15 court found that this rigorous and diligent process, which involved several rounds of bidding and
16 continuous involvement from the trial court overseeing the conservation proceeding, was
17 sufficient to overcome a challenge of arbitrariness.
18

19 In this case, by contrast, the actions of the Conservator and the California
20 Department of Insurance (“CADOI”) in formulating the Majestic Rehabilitation Plan have been
21 arbitrary. As discussed more fully below, and in the accompanying Papa Declaration, for
22 approximately nine months prior to the Conservator commencing this proceeding, the
23 Conservator, through the CADOI, engaged in discussions with the NYWCB regarding a proposed
24 settlement of the NY Litigation, which would have upgraded Majestic’s AMBest ratings and
25 effectively restored it to a sound financial operating position. *See* Papa Declaration at ¶ 75-83.
26
27
28

1 Specifically, the NYWCB believes the Conservator delayed settlement of the
2 NY Litigation (as defined in the Papa Declaration, ¶ 4) and used the delay to build a case to bring
3 Majestic into conversion, in order to give a preferential deal to AmTrust based on AmTrust’s
4 commitment to keep jobs and resources in California, all of which was to the detriment of the
5 policyholders and creditors of Majestic. *See* Papa Declaration at ¶ 70-71, 88. Based on the
6 Conservator and the CADOI’s conduct during the nine-month negotiation process, it appears that
7 there never was an intention of approving a settlement with the NYWCB, and that the nine
8 months of review was a pretext for the real goal of delaying and eventually denying the proposed
9 settlement with the company that initially considered acquiring Majestic -- Bayside Capital
10 Partners, LLC (“Bayside”). *Id.*

11
12 In July 2010, the NYWCB, Majestic, and Consolidated Risk Management, LLC,
13 (“CRM”) resolved (at least preliminarily) the NY Litigation via a Memorandum of Understanding
14 (“MOU”). Pursuant to the MOU, Majestic would have been sold to Bayside. *See* Papa
15 Declaration at ¶ 101 - 104. The settlement outlined in the MOU would have eliminated the
16 source of AMBest's downgrade of Majestic’s rating which, as explained further below, was the
17 primary reason for Majestic’s financial decline. *Id.* With Majestic’s rating improved, the
18 premium inflow to Majestic would have been restored. This would have eliminated the majority
19 of the basis for this conservation. *Id.* The settlement, however, was subject to the approval of the
20 CADOI. Instead, and as a result of CADOI's inaction for nine months, Bayside withdrew from
21 the transaction. *Id.* at ¶ 80 – 84. While NYWCB had been willing to accept alternative settlement
22 compensation, AmTrust and CADOI have excluded NYWCB’s claims from the Majestic
23 liabilities that AmTrust will assume under the Plan if approved by this Court. *Id.* at ¶ 85 – 91.

24
25 In contrast to the transparency and diligence with which the commissioner pursued
26 rehabilitation arrangements in *Executive Life Ins.*, in this case the Plan was negotiated in secret, to
27
28

1 the detriment of NYWCB. Furthermore, the Conservator has set forth no proof that the definitive
2 agreements with AmTrust have been put out to bid, as was done in *Executive Life Ins.* The result
3 is that AmTrust will assume all of Majestic's assets but none of its New York liabilities.

4 *See* Papa Declaration at ¶¶ 87 – 91. No legitimate effort was made by the Conservator or the
5 CADOI to investigate whether allowing the settlement involving NYWCB, Bayside, and Majestic
6 to go forward would have been equally beneficial to Majestic's policyholders and creditors, to
7 which the Conservator is legally bound as a fiduciary. *See* Cal. Ins. Code §1057, Papa
8 Declaration at ¶ 85. Thus, the Plan should be rejected as arbitrary.

9
10 A rehabilitation plan also must not improperly discriminate between holders of the
11 same type of policy. All policyholders are placed into the same priority level of claims in a
12 conservation proceeding, and all claimants (including policyholders) are entitled to share ratably
13 with other claimants within their class. *See* Cal. Ins. Code § 1033. A rehabilitation plan must
14 adhere to this requirement. Discrimination between different types of policies is justified only
15 "if it is founded on a rational basis related to effecting a successful rehabilitation," *i.e.*, if certain
16 types of policies were unprofitable to the insurance company and needed to be restructured in
17 order to return the insurance company to a favorable financial position. *Commercial National*
18 *Bank v. Superior Court*, 14 Cal. App. 4th 393, 404 (2d Dist. 1993), *citing* *Carpenter*, 10 Cal.2d at
19 336-337. A rehabilitation plan is, however, impermissibly discriminatory if it does not treat
20 policyholders of the same type of policy equally. *Id.*

21
22
23 In *Commercial National Bank*, the rehabilitation plan proposed by the
24 Commissioner of Insurance established a valuation system for the claims of policyholders of
25 certain guaranteed investment contracts involving municipal bonds, or muni-GICs.
26 *See Commercial National Bank*, 14 Cal. App. 4th at 404. This valuation system contained two
27 tiers that treated holders of muni-GICs differently from holders of other GICs, by valuing the
28

1 muni-GICs under a different formula than other GICs. The Court of Appeals stated that this
2 portion of the plan violated the requirement that holders of the same types of policies be treated
3 equitably, and thus was impermissibly discriminatory. *Id.*

4 In this case, the Plan impermissibly discriminates against New York policyholders,
5 and specifically against the NYWCB as a policyholder. *See* Papa Declaration at ¶¶ 88 – 93. This
6 impermissible discrimination is yet another example of the Plan’s arbitrariness, in contravention
7 to the *Carpenter* standard for rehabilitation plans. Majestic’s financial difficulties are a result of
8 its inability to settle the litigation involving NYWCB. The Conservator has stated in
9 conversations with NYWCB’s declarant, Michael Papa, that much of the problem with Majestic
10 is the “black cloud hanging over it as a result of the NY Litigation.” *Id.* at ¶ 78. The decline in
11 Majestic’s revenues was caused in large measure by the decline of its AM Best rating in 2009.
12 AM Best’s statement, effective December 16, 2009, which downgraded Majestic from A - to B++,
13 indicates that the basis for the downgrade was the NY Litigation. *Id.* at ¶ 96. This downgrade,
14 which occurred immediately prior to Majestic’s renewals, caused Majestic’s premium renewals to
15 decline. *Id.*

16 The Declaration of Ronald A. Dahlquist submitted in support of the proposed Plan
17 states that Majestic failed to properly administer its liabilities and assets and did nothing to stop
18 the company’s decline when it began in December 2009. *See* Dahlquist Declaration paragraph
19 8(e). However, as soon as AM Best downgraded Majestic because of the NY Litigation, Majestic
20 approached the NYWCB and the Office of the Attorney General of New York State about
21 settlement. Also, the NYWCB understands and believes that CRM engaged in discussions with
22 AMBest and convinced it to hold off a further downgrading of Majestic pending settlement
23 negotiations with the NYWCB. *See* Papa Declaration at ¶¶ 99 - 100.
24
25
26
27
28

1 Rather than take the appropriate action in response to this decline, which would
2 have been to approve the settlement of the NYWCB litigation, the Plan seeks to transfer
3 substantially all of Majestic's assets into AmTrust, but specifically excludes from the transaction
4 Majestic's liability in the NYWCB action. This is arbitrary and discriminatory against the
5 NYWCB as a policyholder. The New York policyholder trusts did not cause Majestic's financial
6 downturn, and effectively excising Majestic's liability to the NYWCB concerning these
7 policyholder trusts is an action that is unrelated to Majestic's quest to return to financial stability.
8 Instead, it is an action which arbitrarily discriminates against the NYWCB, along with other
9 New York policyholders.
10

11 Under the Plan, with the limited exception of the \$15 million that will remain in
12 the estate, all of the excessive premiums that were paid over to Majestic by the GSITs will be
13 turned over to AmTrust, and the Plan specifically carves out the transfer of any New York-based
14 liabilities. *See* Papa Declaration at ¶¶ 90 – 91, 104. This is impermissibly discriminatory against
15 New York policyholders. When coupled with the fact that, but for the Conservator and the
16 CADOI's failure to approve the settlement involving Majestic and NYWCB, there would be no
17 basis for the instant conservatorship, the Plan becomes especially discriminatory against New
18 York policyholders and the NYWCB.
19

20 Additionally, the Plan does not "materially improve the current security position of
21 Majestic's [New York] policyholders," as Majestic already has sufficient assets to meet all of the
22 obligations of the Majestic policyholders, and the Plan would result in the \$35 million statutory
23 deposit currently held by the New York State Department of Insurance being returned to
24 AmTrust. *See* Papa Declaration at ¶ 105. In reality, the Plan materially decreases the protection
25 for claimants in New York, with no rational basis for doing so. Thus, the Plan is arbitrarily
26 discriminatory.
27
28

1 **III. THE COMMISSIONER OF INSURANCE HAS BREACHED**
2 **HIS DUTY AS TRUSTEE TO ACT FOR THE BENEFIT AND**
3 **IN THE BEST INTEREST OF ALL POLICYHOLDERS AND**
4 **CREDITORS**

5 The Commissioner of Insurance, acting as the conservator of an insolvent
6 insurance company, is “deemed a trustee for the benefit of all creditors and other persons
7 interested in the estate of the person against whom the proceedings are pending.” Cal. Ins. Code
8 § 1057. When read together with Sections 1023 and 1025 of the California Insurance Code
9 (dictating the form of insolvency proceedings) and Section 1033 (requiring that claimants share
10 ratably with other claimants within the same class), it is understood that “the insolvency trustee
11 has a fiduciary duty to effect a pro rata distribution to all allowed policyholder claimants.”
12 *Commercial National Bank*, 14 Cal. App. 4th at 409.

13 This fiduciary duty is embodied in the requirement that rehabilitation plans be
14 neither arbitrary nor impermissibly discriminatory. Further, this precludes the Commissioner
15 from “reducing the value of [insurance policy contracts] in order to achieve objectives extraneous
16 to the entitlements of policy owners.” *Id.* The Commissioner’s primary duty in a conservation
17 proceeding is to protect the interests of **all** policyholders and creditors and to ensure that the
18 rehabilitation plan treats them equitably.

19 As discussed more fully herein, the Conservator’s actions in this case are designed
20 to “achieve objectives extraneous to the entitlements of the policy owners.” The real goal of the
21 Conservator and the CADOI appears to have been to allow AmTrust to obtain all of the assets and
22 simultaneously escape NYWCB’s action in exchange for keeping California employees employed
23 and maintaining California-based obligations, conditions to which Bayside would not commit.
24 *See* Papa Declaration at ¶ 93. It appears that the Conservator and the CADOI delayed approval of
25 the NYWCB settlement for nine months in order to allow Majestic to decline such that an
26
27
28

1 argument for conservation could better be made. *Id.* at 84. This was an improper basis for
2 placing Majestic into conservation, and violates the Conservator's duties as a fiduciary to
3 Majestic's policyholders and creditors.

4 **IV. THE COURT SHOULD REJECT THE PLAN BECAUSE THE**
5 **CONSERVATOR HAS FAILED TO SHOW THAT IT PROVIDES**
6 **THE NYWCB WITH THE LIQUIDATION VALUE OF ITS CLAIMS**

7 Policyholders must receive at least the liquidation value of their claims from a plan
8 of rehabilitation. *Carpenter v. Pac. Mut. Life Ins. Co. of Cal.*, 10 Cal. 2d 307, 335-336, 74 P. 2d
9 761, 777-778 (Cal. 1938), *aff'd sub nom Neblett v. Carpenter*, 305 U.S. 297 (1938). This
10 requirement is rooted in the constitutional prohibition against governmental takings, *Neblett v.*
11 *Carpenter*, 305 U.S. 297 (1938), and has been applied by courts in rehabilitation proceedings
12 throughout the country. *See, e.g., In re Executive Life Ins. Co.*, 38 Cal. Rptr. 2d 453, 480 (Cal.
13 Ct. App. 1995) (applying *Carpenter*); *Foster v. Mut. Fire, Marine & Inland Ins. Co.*, 614 A.2d
14 1086, 1093-94 (Pa. 1992) ("Under [*Carpenter*], creditors must fare at least as well under a
15 rehabilitation plan as they would under a liquidation[.]"); *Koken v. Fidelity Mut. Life Ins. Co.*, 907
16 A.2d 1149 (Pa. Commw. Ct. 2006) (court approved rehabilitation plan after finding plan gave
17 policyholders at least what they would have received under a forced liquidation); *Grode v. Mut.*
18 *Fire, Marine & Inland Ins Co.*, 572 A.2d 798, 804 (Pa. Commw. Ct. 1990) (a rehabilitation plan
19 must be viewed in light of the *Carpenter* rule that it may not give parties worse treatment than
20 they would receive in liquidation); NAIC, *Receivers Handbook for Insurance Company*
21 *Insolvencies*, at 5, 448 (2009) (a rehabilitation plan should not give policyholders and creditors
22 worse treatment than they would receive in liquidation); 1 COUCH ON INS. § 5:29 (rehabilitation
23 plan objector must receive "the liquidated value of his contract rights without any unreasonable
24 delay").
25
26
27
28

1 Here, the Conservator has failed to demonstrate that the Plan provides the
2 NYWCB with at least the liquidation value of its claims. Instead, the Conservator has improperly
3 predetermined the NYWCB claims prior to their even being submitted. *See* Papa Declaration
4 at ¶ 117. For this reason, before ruling on the Plan the Court should order the Conservator to
5 demonstrate that the NYWCB and all other policyholders will receive under the Plan, at a
6 minimum, the liquidation value of their claims.
7

8 V. **IN A CONSERVATION PROCEEDING, LIQUIDATION IS**
9 **A LAST RESORT AND SHOULD ONLY BE UNDERTAKEN**
10 **WHEN ALL EFFORTS AT REHABILITATING THE**
11 **INSOLVENT INSURANCE COMPANY HAVE FAILED**

12 In a conservation proceeding, the Commissioner not only has fiduciary duties to
13 policyholders and creditors of the insolvent insurance company, but also has a duty to the general
14 public to preserve the insurance company as a going concern if at all possible. *See Carpenter*, 10
15 Cal.2d at 329. In *Carpenter*, the Supreme Court of California stated that “insurance is a public
16 asset, a basis of credit, and a vital factor in business activity . . . [and] the public has a grave and
17 important interest in preserving the business if that is possible. *Liquidation is a last resort.*” *Id.*
18 (emphasis added). If an insurance company is liquidated, it would “immeasurably [injure] many
19 of its policyholders.” *Id.* For these reasons, rehabilitation plans that do not include liquidation of
20 the insolvent insurance company’s assets are vital.

21 The structure of the California Insurance Code reflects this obvious preference for
22 rehabilitation over liquidation. Specifically, Section 1011 requires that the Commissioner of
23 Insurance be appointed as conservator of an insolvent insurance company, and be vested with the
24 control of the insurance company necessary to return it to a profitable status. *See* Cal. Ins. Code
25 § 1011. Section 1012 provides for a phase of state control which must last until the insolvent
26 insurance company evinces an ability to conduct its own business affairs in a profitable manner.
27 *See* Cal. Ins. Code § 1012. This phase of state control allows the Commissioner time to
28

1 rehabilitate the insurance company and instill procedures designed to maintain its profitability.
2 Section 1016 allows the Commissioner to seek leave from the court to liquidate an insurance
3 company in conservation only if further efforts of rehabilitation under state control “would be
4 futile.” Cal. Ins. Code § 1016. Section 1043 embodies the Commissioner with the duty to
5 rehabilitate the insolvent insurance company through mutualization, reinsurance, or other
6 “rehabilitation agreements.” Cal. Ins. Code § 1043.
7

8 When read together, these sections create a strong presumption toward
9 rehabilitation over liquidation, if at all possible, and impose on the Commissioner a duty to avoid
10 liquidation at nearly all cost. *See Carpenter*, 10 Cal.2d at 331. If a viable avenue for
11 rehabilitation exists that can avoid extinguishing the insurance company as a going concern, it
12 must be pursued before liquidation can be considered. *Id.*
13

14 Here, while the Plan is styled as a rehabilitation, it is in effect a *de facto*
15 liquidation of Majestic, as its policies will be rewritten by AmTrust and a scant \$15 million will
16 be left in Majestic as assets for distribution to general creditors. *See Papa Affidavit* at ¶ 122.
17 This is unnecessary in light of Majestic’s current financial condition, especially considering
18 California’s clear preference for rehabilitation plans which allow the insolvent insurance
19 company to continue its business as a going concern.
20

21 The Plan is premised upon the results of the examination of Majestic as set forth in
22 the Dahlquist declaration. Dahlquist relies upon an alleged \$46.4 million underfunding of
23 reserves and a drop in premiums from \$150 million in December 2009 to \$84 million in
24 December 2010. As a result of the premium decline, Dahlquist alleges Majestic’s expense ratio is
25 above 50%, with its surplus declining at a rate of \$1.5 million per month. *See Papa Declaration*
26 at ¶ 107.
27
28

1 However, the NYWCB believes that no increase in Majestic's reserves is
2 necessary. The fact that AmTrust is willing to accept only \$26 million above current reserve
3 levels indicates that Majestic's reserve deficiency is not \$46.4 million. See Papa Declaration
4 at ¶ 108 - 113.
5

6 A better solution than the Plan – a solution that would avoid the *de facto*
7 liquidation of Majestic – would be for the Conservator to approve a settlement of the NY
8 Litigation. Settlement would allow for Majestic to move on from the NY Litigation, improve its
9 AM Best rating, and rebuild its revenues and book of business without the drastic step of
10 liquidating its business. *Id.* While the Plan is styled as a rehabilitation, it is, in fact a liquidation
11 of Majestic's business. Majestic will no longer exist and millions of dollars in claims against
12 Majestic will go unpaid, prejudicing the NYWCB. *Id.*

13 ///

14 ///

15 ///

16 ///

17 ///

18 ///

19 ///

20 ///

21 ///

22 ///

23 ///

24 ///

25 ///

26 ///

27 ///

28 ///

300256097.1

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

CONCLUSION

Based on the foregoing, the NYWCB respectfully requests that this Court enter an order rejecting the Plan. In the alternative, the NYWCB respectfully requests that this Court (a) permit limited discovery and set an evidentiary hearing with respect to the issues raised in the NYWCB's Objections, (b) defer ruling on the Conservator's Motion pending that hearing and the Conservator's both putting the definitive agreements with AmTrust out for competitive bid, and demonstrating that policyholders will receive at least the liquidation value of their claims under the Plan, and (c) strike Section 7.1(c) of the Plan and order that New York's statutory deposit (rather than being turned over to a subsidiary of AmTrust) be increased by that portion of the claimed \$46.4 million reserve deficiency that is attributable to the New York claims.

Dated: May 18, 2011

MANATT, PHELPS & PHILLIPS, LLP

By: 
Craig S. Bloomgarden

RUPP, BAASE, PFALZGRAF, CUNNINGHAM &
COPPOLA LLC

David R. Pfalzgraf, Jr., *pro hac vice pending*

Daniel E. Sarzynski, *pro hac vice pending*

Charles D.J. Case, *pro hac vice pending*

Attorneys for
NEW YORK STATE WORKERS' COMPENSATION
BOARD

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

PROOF OF SERVICE

I, Luana R. Washington, declare as follows:

I am employed in Los Angeles County, Los Angeles, California. I am over the age of eighteen years and not a party to this action. My business address is MANATT, PHELPS & PHILLIPS, LLP, 11355 West Olympic Boulevard, Los Angeles, California 90064-1614.

On May 20, 2011, I served the within:

**MEMORANDUM OF POINTS AND AUTHORITIES IN
SUPPORT OF NEW YORK STATE WORKERS'
COMPENSATION BOARD'S OBJECTIONS TO THE
PROPOSED REHABILITATION PLAN FOR MAJESTIC
INSURANCE COMPANY**

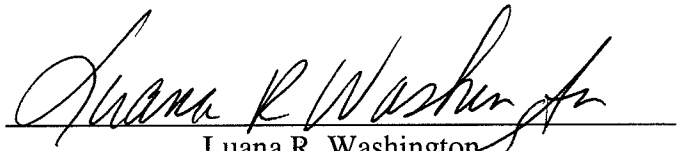
on the interested parties in this action addressed as follows:

SEE ATTACHED SERVICE LIST

(BY OVERNIGHT MAIL) By placing such document(s) in a sealed envelope, for collection and overnight mailing at Manatt, Phelps & Phillips, LLP, Los Angeles, California following ordinary business practice. I am readily familiar with the practice at Manatt, Phelps & Phillips, LLP for collection and processing of overnight service mailing, said practice being that in the ordinary course of business, correspondence is deposited with the overnight messenger service, Federal Express, for delivery as addressed.

(BY ELECTRONIC MAIL) By transmitting such document(s) electronically from my e-mail address, LWashington@manatt.com at Manatt, Phelps & Phillips, LLP, Los Angeles, California, to the person(s) at the electronic mail addresses listed above. The transmission was reported as complete and without error.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on May 20, 2011, at Los Angeles, California.


Luana R. Washington

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

SERVICE LIST

Thomas J. Welsh, Esq.
Orrick, Herrington & Sutcliffe LLP
400 Capitol Mall, Suite 3000
Sacramento, CA 95814
Telephone: 916-447-9200
Fax: 916-329-4900
Email: tomwelsh@orrick.com

Kristian D. Whitten, Esq.
Deputy Attorney General
455 Golden Gate, Suite 11000
San Francisco, CA 94102
Telephone: 415-703-5589
Fax: 415-703-5480
Email: Kris.Whitten@doj.ca.gov

Jon Holloway
Conservation Manager
Majestic Insurance Company in Conservation
101 California Street, 22nd Floor
San Francisco, CA 94111
Telephone: 415-362-7000
Email: hollowayj@caclo.org