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14 Insurance Commissioner of the State of California
15 in his Capacity as Conservator of
Majestic Insurance Company

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

16 SUPERIOR COURT OF THE STATE OF CALIFORNIA

17 CITY AND COUNTY OF SAN FRANCISCO

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

21 Applicant,

22 v.

23 MAJESTIC INSURANCE COMPANY, and
24 DOES 1-50, inclusive,

25 Respondents.

Case No. CPF-11-511261

**INSURANCE COMMISSIONER DAVE
JONES' REPLY TO NEW YORK
STATE WORKERS' COMPENSATION
BOARD'S OBJECTIONS TO
PROPOSED REHABILITATION PLAN
FOR MAJESTIC INSURANCE
COMPANY**

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

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I. INTRODUCTION

The objections of the New York State Workers' Compensation Board ("NYWCB")¹ to the proposed plan of rehabilitation ("Rehabilitation Plan") for Majestic Insurance Company ("Majestic") attempt to portray Majestic's conservation as a conspiracy between California Insurance Commissioner Dave Jones, as the statutory conservator of Majestic ("Conservator"), Majestic, and AmTrust North America, Inc. ("AmTrust") to deprive NYWCB of its rights. In reality, NYWCB's policyholder rights are 100 percent protected by the Rehabilitation Plan and its objections are a transparent attempt to leverage a favorable settlement of its civil litigation in the Supreme Court of New York against Majestic's bankrupt parent (the "New York Litigation") by threatening to derail the Rehabilitation Plan.

The strategic advantage that NYWCB attempts to gain through its meritless objections could indeed impair the Rehabilitation Plan, to the detriment of NYWCB as well as all other Majestic policyholders and the thousands of injured worker claimants who are relying on the benefits afforded under the Rehabilitation Plan. As the Court is aware, Majestic is a property and casualty insurer that, unlike a life insurer, writes policies of very short duration. The viability of the Rehabilitation Plan relies entirely on the Commissioner's ability to maintain, as Conservator, the enterprise value of Majestic. If final approval of the Rehabilitation Plan is postponed as NYWCB requests, Majestic's enterprise value will quickly evaporate, along with any hope for a successful rehabilitation. Unless the Rehabilitation Plan transactions close by July 31, 2011, AmTrust has the right to withdraw from the Rehabilitation Plan, because after that date there may well be little or no realizable value in the operating assets that AmTrust seeks to preserve and acquire, and that support AmTrust's willingness to assume all of Majestic's workers' compensation insurance liabilities without limit.

Exposing the Rehabilitation Plan to this risk of failure is particularly unwarranted given the patent weakness of the assertions in NYWCB's opposition. Notably, NYWCB disingenuously maintains that it is objecting to the Rehabilitation Plan in its capacity as a

¹ NYWCB has voluntarily appeared in the case and has thereby consented to the jurisdiction of this Court over all matters relating to Majestic and its assets, including with respect to the disposition of Majestic's statutory deposits in New York.

1 Majestic policyholder. The Rehabilitation Plan, however, provides full policy benefits, stability,
2 and continuity for Majestic's policyholders and injured worker claimants. Thus, NYWCB has
3 not, nor could it, identify any damages it would suffer as a Majestic policyholder on account of
4 the Rehabilitation Plan. NYWCB's true purpose in objecting to the Rehabilitation Plan is to
5 improve its bargaining position as a civil claimant against Majestic and Majestic's bankrupt
6 parents in its New York Litigation. Ironically, the New York Litigation, in which NYWCB
7 claimed damages of more than \$472 million against Majestic and its affiliates, marked the
8 beginning of the deterioration that ultimately resulted in Majestic's conservation.

9 NYWCB readily reveals that its true purpose is settlement leverage by plainly stating in
10 its objections that the Commissioner, instead of seeking approval of a Rehabilitation Plan that
11 protects all policyholders and creditors equally, should pursue the "better solution" of approving a
12 favorable settlement for NYWCB of the New York Litigation, in the blind hope that the
13 settlement will allow Majestic to "move on...improve its AM Best rating, and rebuild its revenues
14 and book of business." NYWCB Memo., 13:6-12. Needless to say, the Commissioner (acting
15 either as regulator or as statutory conservator) may not lawfully award the NYWCB the type of
16 preferential treatment that it seeks to leverage by opposing the Rehabilitation Plan. As a fellow
17 regulator and public agency of the State of New York, the NYWCB should know better than to
18 ask.

19 As the Commissioner explains below, the interests of the NYWCB, both as a policyholder
20 and as a general creditor, are treated exactly the same under the Rehabilitation Plan as all other
21 policyholders and creditors of Majestic. Neither the Court nor the Commissioner should
22 countenance these self-serving efforts to gain an advantage, particularly when the gambit places
23 all of Majestic's policyholders and creditors at grave risk. In sum, the Rehabilitation Plan is
24 neither arbitrary nor discriminatory, it is not a *de facto* liquidation, and it provides full coverage
25 for NYWCB's policyholder claims and at least the liquidation value of NYWCB's general
26 creditor claims. NYWCB's continuing references to actions taken by the Commissioner in
27 connection with Executive Life Insurance Company ("ELIC") are unavailing given the significant
28 and obvious differences between rehabilitating a life insurance company and a more volatile

1 property and casualty company. NYWCB has failed to present any cognizable objection to the
2 Rehabilitation Plan and its objections should be overruled.²

3 **II. FACTUAL BACKGROUND**

4 **A. The California Department of Insurance's Review of Majestic's Financial Condition.**

5 NYWCB asserts that Majestic already has assets sufficient to satisfy policyholder
6 liabilities. NYWCB Memo., 8:21-25. As outlined in the Commissioner's opening brief, the
7 California Department of Insurance ("CDI") initiated a periodic review of Majestic's financial
8 condition in 2008. That investigation revealed serious systemic problems in Majestic's finances
9 and management of a magnitude requiring conservation of Majestic. Wilson Decl., ¶¶ 5, 8;
10 Dahlquist Decl., ¶¶ 6-8, 11; Bottalico Decl., Ex. A.

11 **B. NYWCB's Claims**

12 Notwithstanding its statement that its objections to the Rehabilitation Plan "are in its
13 capacity as a Majestic policyholder," NYWCB has described both policyholder and general
14 creditor claims against Majestic in this proceeding. See NYWCB Memo., 1:18-2:14. NYWCB
15 has asserted policyholder claims as the successor to certain insolvent self-insurance trusts in New
16 York that were policyholders under a number of aggregate excess of loss policies issued by
17 Majestic ("Excess Policies"). NYWCB has also asserted damages claims based on its New York
18 Litigation in amounts that NYWCB estimated as exceeding \$475 million. Bottalico Decl., Ex. A,
19 8-9. These latter claims fall within the "general creditor" class under the California priority
20 statute. See Cal. Ins. Code § 1033(a)(7).

21 All of the Excess Policies written by Majestic are included in and covered without limit by
22 the Loss Portfolio Transfer and Quota Share Reinsurance Agreement ("Reinsurance Agreement")
23 entered into between Majestic and AmTrust under the Rehabilitation Plan. See Wilson Decl.,
24 Ex. 2, Ex. B, art. II. Thus, NYWCB will receive 100% payment on any claims under its Excess
25 Policies, as will all of Majestic's policyholders. *Id.* As to the general creditor claims asserted in

26 _____
27 ² Linda J. Clark, counsel to former members of group self-insurance workers' compensation trusts administered by an
28 affiliate of Majestic, submitted an untimely affidavit in support of NYWCB's objections that did not present any new
evidence or arguments. Clark's affidavit, which similarly fails to provide a basis for overruling the Rehabilitation
Plan, should be disregarded.

1 the New York Litigation, the Rehabilitation Plan also calls for equal, ratable treatment of all
2 allowed general creditor claims. *See* Wilson Decl., Ex. 2, art. VIII.

3 **C. Bayside's Termination of Merger Agreement**

4 Throughout its opposition to the Rehabilitation Plan, NYWCB asserts that a merger
5 agreement between Bayside Capital Partners LLC ("Bayside") and Majestic Capital, Ltd., which
6 allegedly would have rendered this Conservation proceeding unnecessary, failed because the
7 Commissioner delayed in considering the merger. The pertinent facts concerning that allegation
8 are set out in detail in the Supplemental Declaration of David E. Wilson in Support of Insurance
9 Commissioner David Jones' Motion for Order Approving Rehabilitation Plan for Majestic
10 Insurance Company ("Supplemental Wilson Decl."), ¶¶ 4-5. In short, Bayside withdrew from the
11 merger agreement for its own reasons and not because of delay by the Commissioner.

12 **D. Majestic's Current Financial Condition**

13 The financial stress and uncertainty surrounding Majestic has led to further decline in its
14 financial strength during the first quarter of 2011, emphasizing the need for the speedy
15 implementation of the Rehabilitation Plan. Majestic's Quarterly Statement as of March 31, 2011
16 of the Condition and Affairs of the Majestic Insurance Company demonstrates that even without
17 booking the Commissioner's examination reserve adjustments, Majestic's "Surplus as Regards
18 Policyholders" fell from \$57,941,604 as of December 31, 2010 to \$43,399,773 as of March 31,
19 2011, a decline of approximately \$14.6 million. If the reserve deficiency were to be booked (an
20 action that will be avoided by the prompt implementation of the Rehabilitation Plan), Majestic's
21 Surplus as Regards Policyholders would be at negative \$3,060,227 at March 31, 2011.
22 Supplemental Wilson Decl., Ex. A, Note 1.

23 **III. ARGUMENT**

24 **A. The Rehabilitation Plan is Neither Arbitrary Nor Discriminatory and Treats**
25 **NYWCB's Claims the Same as Claims of Other Policyholders and Creditors.**

26 NYWCB asserts that the Rehabilitation Plan improperly discriminates against its interests
27 as a policyholder, and the interests of New York policyholders in general, by transferring most of
28 Majestic's assets to AmTrust while omitting Majestic's liability in NYWCB's ongoing lawsuit

1 from the transaction. NYWCB Memo., 6-8. NYWCB argues that this action is arbitrary and
2 discriminatory and that this discrimination is not “founded on a rational basis related to effecting
3 a successful rehabilitation,” as required by *Carpenter v. Pacific Mutual Life Insurance Co. of*
4 *California*, 10 Cal. 2d 307, 336-37 (1937). NYWCB Memo., 6. This argument fundamentally
5 misconstrues both the rationale for the structure of the Rehabilitation Plan and the treatment of
6 NYWCB’s claims thereunder.

7 As described above, NYWCB asserts two distinct types of claims in this proceeding:
8 policyholder claims and general creditor/damages claims. According to the terms of the
9 Rehabilitation Agreement, NYWCB is treated, with respect to each type of claim, the same as all
10 other holders of claims of that type. NYWCB’s policyholder claims will receive the same
11 treatment as all other policyholder claims (100% coverage, without delay or diminution), and
12 NYWCB’s general creditor claims are treated *pari passu* with all other general creditor claims.
13 The Rehabilitation Plan provides for the payment of claims as set out in Insurance Code
14 section 1033.

15 NYWCB’s argument improperly conflates its separate claims as a policyholder and
16 creditor. NYWCB asserts that the Rehabilitation Plan discriminates against NYWCB as a
17 policyholder because it excludes its liability claims (as a general creditor) against Majestic.
18 NYWCB Memo., 8. This argument erroneously portrays the differing treatment of non-identical
19 claims as discrimination when, as NYWCB acknowledges, what is barred is discrimination
20 between holders of the *same* type of policy. NYWCB Memo., 6. The differences in the
21 Rehabilitation Plan’s treatment of policyholders and general creditors is not only founded on a
22 rational basis (maintaining coverage for policyholders), but is mandatory under the absolute
23 priority rule set forth in Insurance Code section 1033(a). Accordingly, the Rehabilitation Plan is
24 neither arbitrary nor improperly discriminatory.

25 Finally, NYWCB maintains that the Commissioner acted arbitrarily in not approving the
26 merger with Bayside instead of proposing the Rehabilitation Plan. As discussed above, Bayside
27 withdrew from the contemplated merger for its own reasons. The Commissioner can hardly be
28 acting arbitrarily by failing to pursue an alternative that does not exist.

1 **B. The Commissioner's Decision to Forego a Redundant Bidding Process Was Not an**
2 **Abuse of Discretion.**

3 NYWCB asserts that the Commissioner abused his discretion by failing to put the
4 Transaction Agreements between Majestic and AmTrust out for competitive bids and that this
5 failure constituted a breach of the Commissioner's duty to protect the interests of Majestic's
6 shareholder and creditors. NYWCB Memo., 4. There is no statutory requirement, however, that
7 a Rehabilitation Plan be competitively bid. Rather, the Commissioner has discretion to take such
8 actions as he "may deem necessary or expedient for the accomplishment or in aid of the purpose"
9 of the rehabilitation. Cal. Ins. Code § 1037. Moreover, Majestic's corporate parent *had* been
10 seeking to sell Majestic for a significant period of time. Wilson Decl., ¶ 6. The proposed
11 Rehabilitation Plan for Majestic has been widely publicized and no bidder has stepped forward to
12 compete with AmTrust's proposal, which reinsures Majestic's policyholder liabilities without
13 limit. *See* Declaration of Stephen Ungar in Support of Insurance Commissioner's Motion for
14 Order Approving Rehabilitation Plan for Majestic Insurance Company (describing involvement
15 of AmTrust and benefits of Rehabilitation Plan); *see generally* Declaration of Joseph Holloway in
16 Support of Insurance Commissioner's Motion for Order Approving Rehabilitation Plan for
17 Majestic Insurance Company.

18 Further, were the Commissioner to engage in a protracted competitive bidding process at
19 this stage, it would likely result in the evaporation of Majestic's enterprise value by the end of the
20 process, leading to liquidation and avoidable injuries to Majestic's policyholders, creditors,
21 shareholder, and employees. *See* Wilson Decl., ¶¶ 7-8. Indeed, the first quarter 2011 decline of
22 \$14.6 million in Majestic's surplus serves to illustrate and emphasize this concern. Supplemental
23 Wilson Decl., ¶ 3.

24 Without the AmTrust transactions contemplated by the Rehabilitation Plan, Majestic
25 would unquestionably be headed into liquidation. The most recent deterioration is further
26 compelling evidence that the Commissioner simply does not have the luxury of another few
27 months for a low priority general creditor to attempt to draw the Commissioner into a battle of the
28 lawyers and actuaries in order to leverage a favorable settlement. NYWCB repeatedly claims that

1 the Commissioner should pattern his approach to Majestic on the slower-paced ELIC
2 rehabilitation. Setting aside the unfortunate fact that the ELIC rehabilitation process, which
3 NYWCB holds up as a preferred approach, has been embroiled in continuous litigation for more
4 than 20 years since ELIC's original conservation in April 1991 (hardly a process that this
5 Commissioner is prepared to emulate), NYWCB fails to acknowledge that ELIC presented vastly
6 different circumstances from Majestic. In fact, the rehabilitation of a life insurer generally does
7 not necessitate the type of immediate response required to preserve the franchise value of a
8 property and casualty carrier. The enterprise or franchise value of a property and casualty
9 company derives from its ability to maintain long-term renewal relationships. Supplemental
10 Wilson Decl., ¶ 3. Unlike a life insurer in conservation, which can maintain its book of business
11 for years through a moratorium on policy surrenders, the book of business of a property and
12 casualty company like Majestic can evaporate in a matter of weeks if insureds perceive financial
13 instability. *Id.*

14 As noted in *In Re Executive Life*, cited by NYWCB, the Commissioner's "first duty [is] to
15 the grave and important public interest in not depriving . . . policyholders of the protection of
16 their policies." 32 Cal. App. 4th 344, 365 (1995). The clear and present risk of further
17 deterioration in Majestic's financial condition compels immediate action by the Commissioner
18 and the Court. Supplemental Wilson Decl., ¶ 3.

19 **C. The Transaction Agreements are an Appropriate Means of Protecting Majestic's**
20 **Policyholders, Shareholder, and Creditors.**

21 NYWCB contends that the Commissioner abused his discretion by approving Majestic's
22 transaction with AmTrust, rather than the Bayside merger, solely based on AmTrust's agreement
23 to preserve jobs and resources in California rather than the best interest of Majestic's
24 policyholders and creditors. NYWCB Memo., 9:20-25. The assertion that preservation of
25 California jobs was the Commissioner's sole, or even highest priority, is patently false. First, as
26 discussed above, the proposed Bayside merger was a stock transaction. Bayside would have
27 acquired Majestic with all of its California employees, leaseholds, and other operating assets
28 intact. The Rehabilitation Plan and the merger did not materially differ with respect to

1 preservation of California jobs as, under the Rehabilitation Plan, AmTrust will assume Majestic's
2 leases and a large share of its employees in California.

3 Further, as evidenced in the Commissioner's motion to approve the Rehabilitation Plan,
4 the Commissioner's overriding considerations in approving the Plan and associated Rehabilitation
5 Transaction Agreements were the preservation of policyholders' insurance coverage and the
6 maintenance of Majestic's operating assets in order to facilitate an orderly and seamless transition
7 of claims to ensure that no disruption would occur in the payment of injured workers. Neither of
8 these considerations is "extraneous to the entitlements of policy owners." *Commercial Nat'l*
9 *Bank*, 14 Cal. App. 4th 393, 409 (1993). The Rehabilitation Transaction Agreements allow the
10 Commissioner to achieve both of these goals.

11 In addition, NYWCB is incorrect that AmTrust's assumption of Majestic's operating
12 liabilities harms Majestic's creditors. Under the Rehabilitation Plan, AmTrust will assume
13 approximately 80 Majestic employees and Majestic's office leases. By avoiding the need to pay
14 for the termination of approximately 80 employees and the liability that would arise from the
15 rejection of several long term office leases, the Rehabilitation Plan preserves Majestic's assets for
16 Majestic's policyholders, creditors, and shareholder, ensuring a larger payout on their claims.
17 Thus, the Rehabilitation Plan is in line with the Commissioner's fiduciary duty to act "for the
18 benefit of all creditors and other persons interested in the estate." Cal. Ins. Code § 1057.

19 **D. The Rehabilitation Plan Provides NYWCB with the Liquidation Value of Its Claims.**

20 The Commissioner has concluded that the Rehabilitation Plan would likely provide
21 significantly greater benefits to policyholders and creditors than they would obtain in a
22 liquidation, under which there would be virtually nothing for creditors. *See* Wilson Decl., ¶ 13;
23 Dahlquist Decl., ¶¶ 10-11. Thus, NYWCB's assertion that the Conservator "has failed to
24 demonstrate that the Plan provides the NYWCB with at least the liquidation value of its claims"
25 is false. *See* NYWCB Memo., 11.

26 **E. The Rehabilitation Plan is Not a De Facto Liquidation of Majestic.**

27 Contrary to NYWCB's assertion, the Rehabilitation Plan is not a de facto liquidation of
28 Majestic. Again, the Rehabilitation Plan preserves full policy benefits, provides stability and

1 continuity for Majestic's policyholders, and protects the interests of general creditors. This is a
2 true rehabilitation of Majestic that preserves the existence of the corporation and provides for the
3 possibility that all creditors will be paid in full and thereafter the company may be released from
4 conservation and control returned to the shareholder. *See* Wilson Decl., Ex. 2, arts. III, VIII; *see*
5 Declaration of Wayne Wilson in Support of Insurance Commissioner's Motion for Order
6 Approving Rehabilitation Plan for Majestic Insurance Company (Executive Director of California
7 Insurance Guarantee Association demonstrating rehabilitation is not a de facto liquidation and
8 discussing benefits of Rehabilitation Plan). The Commissioner has not sought, and assuming the
9 Rehabilitation Plan is approved and implemented, does not intend to apply for an order of
10 liquidation under Insurance Code section 1016. In addition, he has not requested that the Court
11 make a finding of insolvency.³

12 NYWCB also baldly claims that "no increase in Majestic's reserves is necessary."⁴
13 NYWCB Memo., 13. The fact that Majestic had a loss and loss adjustment expense reserve
14 deficiency and unearned premium reserve deficiency of approximately \$46 million as of
15 December 31, 2010 was determined by the CDI and detailed in the declaration of the CDI's Chief
16 Actuary Ronald Dahlquist. Dahlquist Decl., ¶ 7; Bottalico Decl., ¶ 5; Wilson Decl., ¶ 8.
17 NYWCB cannot contest the legitimate findings of the examination report. Additionally, Majestic
18 did not oppose the conservation. *See* Cal. Ins. Code § 1012 (providing no standing for a creditor
19 to challenge a conservation).

20 **F. NYWCB's Objections Constitute a Motion to Stay Approval of the Rehabilitation**
21 **Plan That Lacks Factual and Legal Support.**

22 Finally, NYWCB's request for an evidentiary hearing constitutes a motion to stay
23 approval of the Rehabilitation Plan. NYWCB is effectively asking this Court to stay the approval

24 _____
25 ³ Regardless, there is no requirement that the Conservator demonstrate he pursued the least drastic remedy. While
26 case law establishes that "[l]iquidation is the last resort," "[t]he only restriction on the exercise of [the conservator's]
power is that the state's action shall be reasonably related to the public interest and shall not be arbitrary or
improperly discriminatory." *Carpenter*, 10 Cal. 2d at 329.

27 ⁴ NYWCB's assertion that the Commissioner's finding that Majestic has a \$46.4 million reserve deficiency lacks a
28 basis (and thus requires further investigation) is completely at odds with its request that the Court strike section 7.1(c)
of the Rehabilitation Plan and increase New York's statutory deposit by a portion of the \$46.4 million reserve
deficiency

1 of the Rehabilitation Plan until it can carry out some unspecified inquiry into the CDI's analyses
2 of Majestic's financial condition. Such a request is neither justified by the facts nor supported
3 with proper authorities. It is within the Commissioner's discretion to seek conservation under
4 section 1011, and as a creditor, NYWCB lacks standing to attempt to engage the Commissioner in
5 a battle as to the appropriateness of the Conservation Order in an effort to delay the proceedings.

6 Further, in order to obtain a stay, NYWCB would be required to demonstrate a likelihood
7 of success on the merits or that the delay could result in a better result for policyholders.

8 NYWCB fails to offer any evidence that an actuarial inquiry would benefit policyholders when,
9 as discussed above, any significant delay will only result in the failure of the Rehabilitation Plan
10 and harm to Majestic's policyholders, creditors, and shareholder.

11 IV. CONCLUSION

12 For all the foregoing reasons, the Conservator respectfully requests that the Court approve
13 the Rehabilitation Plan for Majestic, and enter the order lodged by the Conservator authorizing
14 the Conservator to enter into the Rehabilitation Agreement and Rehabilitation Transaction
15 Agreements, and take such other action as necessary to carry out the Rehabilitation Plan.

16 Dated: May 26, 2011.

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