Exhibit 10

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

PRESENT: HON. EILEEN BRANSTEN PART 3

Justice

In Re: Union Indemnity Insurance Co. of NY

INDEX NO. 41292/85

MOTION DATE 6/5/08

MOTION SEQ. NO. 133

MOTION CAL. NO.

The following papers, numbered 1 to 4 were read on this motion to/for

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	1
Answering Affidavits — Exhibits	2,3
Replying Affidavits	4

Cross-Motion: ☐ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DECIDED IN ACCORDANCE WITH THE ACCOMPANYING MEMORANDUM DECISION.

C

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: 2-6-09

Eileen Bransten

HON. EILEEN BRANSTEN J.S.C.

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE MDAT

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 3

----------X

In the Matter of the Liquidation of

Index No. 41292/85
Motion Date: 6/5/08
Motion Seq. No.: 133

UNION INDEMNITY INSURANCE COMPANY OF NEW YORK

----------X

EILEEN BRANSTEN, J.:

The Superintendent of Insurance of the State of New York as Liquidator ("Liquidator") of Union Indemnity Insurance Company of New York ("Union") seeks an order, among other things, approving: (1) the Liquidator's Initial Report on the Status of the Liquidation of Union ("Initial Report") and the financial transactions delineated therein; (2) establishing November 15, 2007 as the bar date for presentation of all claims other than administrative costs and expenses; (3) payment of all administrative costs and expenses; and (4) a distribution to the extent that assets are available after payment of all administrative costs and expenses, in accordance with the priorities set forth in the current version of Insurance Law § 7434, to those creditors of Union possessing claims allowed by the Liquidator.

133

Several creditors filed written objections to the Initial Report.[1] Three reinsurers, The Mutual Fire, Marine and Inland Insurance Company ("Mutual Fire"), British Insurance of Company of Cayman Islands ("BICC"), as successor in interest to the rights and obligations of American Centennial Insurance Company, and Invotex, Inc., formerly known as Maryland First Financial Corp., having agreed to serve as collection agent for the Property and Casualty Insurance Guaranty Corporation, who in turn acquired all of the interest in obligations of Union to Eastern Indemnity Company of Maryland ("EICOM"),[2] submitted written objections to the Initial Report.

Their written objections raise three constitutional issues. They challenge the retroactive application of Insurance Law § 7434 to set the priorities for payment of claims as a violation of due process, equal protection and/or the Contract Clause of the United States Constitution. BICC objects to the amounts claimed as administrative expenses, given that at the time that the Initial Report was issued, the audit of Union's financials had not been completed, and that the Liquidator admits that there was significant mismanagement of the

---

[1] Initially, Pfizer Inc. and Quigley Company Inc. submitted written objections to the Initial Report. They were joined by the Combustion Engineering 524 (g) Asbestos PI Trust. Subsequently, however, they withdrew their objections.

[2] The objections of EICOM were not timely filed and will not be considered on this application. Had they been timely filed, they assert essentially the same claims as the other reinsurer objectors and would have been decided in the same manner. While both BICC and Mutual Fire (collectively the "Objectors") submitted timely written objections, only BICC appeared for oral argument.

Union estate. BICC raises various other objections related to the procedures followed for notice and the policies employed as to the handling of reinsurance and commutation, citing many of the issues discussed in *Matter of Midland Insurance Company*, 2008 NY Slip Op 50110[u] (Sup Ct, NY County 2008).[3] The Objectors seek denial of the Liquidator's application and the imposition of a committee of creditors or a management audit.

Background

Union was incorporated in 1975 as a stock casualty insurance company and was domiciled in the State of New York. Union's business was concentrated in personal and commercial lines, in particular automobile, general liability, commercial multi-peril, fire, allied lines, ocean marine and surety policies. In addition, Union provided some medical malpractice and workers' compensation coverage and was a reinsurer of other insurance companies.

In addition to the State of New York, Union was authorized to transact business in Canada, the District of Columbia, Puerto Rico and all states except California, Maryland, North Carolina, South Dakota and Wyoming. It was approved as a non-admitted insurer in California, Maryland, North Carolina and South Dakota.

---

[3] The objection to the bar date chosen by the Liquidator has been withdrawn (*see* July 3, 2008 Transcript at 8).

Union filed an annual statement for the year ending December 31, 1983, in which it reported a surplus of $9,275,076. The New York State Department of Insurance ("Insurance Department") conducted an examination of Union, and reported on January 3, 1985 that it was insolvent as of December 31, 1983 in the amount of $27,916,683, and that its capital was impaired by $30,416,683. As a result of these findings, the Insurance Department monitored Union's financial condition. On February 5, 1985, the Insurance Department directed Union to eliminate its capital impairment and to cease issuing policies while its capital remained impaired.

On March 15, 1985, Union filed its annual statement for the year ending December 31, 1984 with the Insurance Department. This statement reflected an insolvency in the amount of $14,580, 959. The Insurance Department meanwhile conducted further examinations of Union's financial affairs. It issued a report, dated March 25, 1985, which found that Union was insolvent in the amount of $138,501,581 and that its capital was impaired by $141,001,581.

Since Union was unable to eliminate its capital impairment and had suffered a substantial increase in its insolvency as found in the March 25, 1985 report, the Superintendent, as regulator, petitioned the court to liquidate Union. By order entered July 16, 1985 ("Liquidation Order"), the court granted liquidation and appointed then-Superintendent, James P. Corcoran, and his successors as Liquidator of Union (*Matter of*

Union Indem. Ins. Co. of New York, Sup Ct, NY County, July 1, 1985, Gammerman, J., Index No. 41292/1985).

The Liquidation Order charged the Liquidator with responsibility for 1) identifying Union's policyholders, claimants and creditors; 2) notifying Union's policyholders, claimants and creditors to present their claims; 3) marshaling Union's assets; 4) adjudicating the claims presented by Union's policyholders, claimants and creditors and determining the total liabilities of Union; 5) distributing Union's assets to creditors with allowed claims; and 6) otherwise liquidating Union's business, pursuant to Article 74 of the New York Insurance Law (*id.*) The Liquidator, as authorized by Insurance Law § 7422 (a), in turn, appointed the Special Deputy Superintendent in Charge as Agent of the Liquidator (the "Special Deputy") to carry out through the New York Liquidation Bureau ("NYLB") the responsibilities of the Liquidator.

Since then, this liquidation proceeding has generated a vast amount of litigation spanning over 20 years. Prior to this application, over 130 motions have been made. Many of the decisions have been appealed to the Appellate Division, and then the Court of Appeals, with one going all the way to the United States Supreme Court.[4] Much of this litigation involved the collectability of reinsurance proceeds, so that defining the size of the liquidation estate has been problematic. Specifically, the reinsurers obtained a declaration that the

---

[4] *See Curiale v United States*, 509 US 901 (1993).

reinsurance contracts were unenforceable because of fraud.[5] The last reported decision was handed down by the Appellate Division in 2005.[6]

During the course of the liquidation, the NYLB received 31,299 claims, 23,545 of which have been adjudicated. Of the remaining claims, 3,540 were filed for policyholder protection, 2,027 were voided as duplicates, 465 were withdrawn, and 1,722 remain open. Three New York State Security Funds--Property and Casualty Insurance Security Fund, the Public Motor Vehicle Liability Security Fund and the Workers' Compensation Security Fund ("WC Fund")--and 42 Guaranty Funds from other states have filed proofs of claim and these will remain open until all allowed claims handled by the funds have been resolved. As of March 31, 2007, the funds collectively have paid $73,946,372. There have been 1,692 general creditor policyholder proofs of claim that have been allowed in the amount of $20,738,729, leaving open 317 proofs of claim, of which 39 are Security Fund covered.

While Union was placed in liquidation in 1985, the Liquidator has not filed an Initial Report with the court until now, and as a consequence, no distributions have been made. The Liquidator acknowledges that "[t]he delays in issuing an initial report for Union are the result

---

[5] *See Curiale v AIG Multiline Syndicate*, 204 AD2d 237 (1st Dept 1994); *Matter of the Liquidation of Union Indem. Ins. Co. of New York,* 200 AD2d 99 (1st Dept 1994), *affd* 89 NY2d 94 (1996).

[6] *See Matter of the Liquidation of Union Indem. Ins. Co. of New York*, 21 AD3d 802 (1st Dept 2005).

of poor management," and cites the "troubled history of NYLB," including "the indictment of the immediate former Special Deputy Superintendent, the failure of the NYLB to have its financials audited and years of poor management" (Initial Report at 1).

The current administration of the NYLB was appointed in April 2007 with "a mandate to engage in sweeping reforms" (*id.*) To this end, the new administration is attempting to wrap up Union and other longstanding liquidations as quickly as possible.

The Initial Report states that an audit of Union's financial condition was undertaken, and that at the time of issuance of the report, the audit was not completed but that it should be done by the end of the year.[7] The Initial Report indicates that should the audit results require it, the Liquidator would submit an amended Initial Report to reflect any significant changes revealed by the audit. In addition, the Initial Report sets forth that there are still open policyholder and Security or Guaranty Fund claims that have not as yet been processed by NYLB.[8] Consequently, the figures stated in the Initial Report undoubtedly will have to be adjusted.

The Initial Report provides that under Union's comparative balance sheet and statement of cash receipts and disbursements for the period ending March 31, 2007, Union

---

[7] Other submissions seem to indicate that the audit was not completed at year end and that it was thought that the audit would be finished by August 2008.

[8] The Initial Report states that 317 proofs of claim are unresolved and that 39 of them involve Security or Guaranty Fund coverage.

has total assets of $106,419,398 and total liabilities of $515,650,555, which leaves Union insolvent in the amount of $409,231,157.

Under the current version of Insurance Law § 7434, which establishes a priority scheme for payment of different types of claims and orders them by class, there will only be enough money to pay class one claims ("necessary costs and expenses of administration"), the administrative expenses of $83,704,661, and then the class two claims ("all claims under policies . . . except claims arising under reinsurance contracts"), totaling $273,928,000, will be subject to pro rata distribution to the class two creditors. Since there are insufficient funds to pay off all the class two creditors in full, no creditors from classes three through nine will recover monies from the liquidation estate.

Prior to the liquidation, the Objectors had agreements with Union for Union to provide reinsurance on policies the Objectors wrote for their insureds. Both Objectors had claims by their insureds presented to them, and the Objectors have paid on those claims. The Objectors have submitted claims in this proceeding to recover on the reinsurance issued by Union for the monies paid out to the Objectors' insureds.

However, under the current version of Insurance Law § 7434, their claims fall within class six, and will not be reached because there are insufficient funds in the Union estate. The Objectors are challenging the retroactive application of the priority scheme, because pursuant to the law existing at the time that Union went into liquidation, the Objectors would

have participated in pari passu with the other creditors in a pro rata distribution, and recovered some of the claimed reinsurance.

The History of Priority of Payment under New York Law

When this liquidation was commenced in 1985, all creditors (for example, policyholders, Security and Guaranty Funds, suppliers and holders of reinsurance claims), took ratably from the liquidation estate after administrative expenses had been paid. Previously, under New York law, there were no classes of creditors and the reinsurers shared equally in the estate with the policyholders and Security and Guaranty Funds. All creditor claims had to be reviewed and decided before any ratable distribution could be determined and made. Reinsurance claims were larger and their resolution would take longer. As a result, they often held up the closing of liquidation estates and the concomitant distribution of liquidation funds.

In 1999, Insurance Law § 7434 was amended to create a system of priorities for the payment of claims in liquidation. It set up a structure of nine classes. Under the structure, the claims from a class with the first priority must be paid in full before the claims of a subsequent class are to be considered. The statutory change finally put New York in conformity with other states around the country in giving special place to the needs of policyholders and the security funds/guaranty funds. It also took into account federal law as

enunciated in *U.S. Department of Treasury v Fabe* (508 US 481 [1993]), and the priority system contained in the National Association of Insurance Commissioners Model Act (*see* Mem of Assembly Rules Comm, Bill Jacket, L 1999, ch 134). Under the revised structure, if the liquidation estate has insufficient funds to pay a class in full, it will no longer be necessary to review all claims in later, less prioritized classes, thereby accelerating the winding up of the liquidation estate.

The 1999 enactment was to take effect immediately and would apply to any liquidation proceeding instituted after its effective date of July 1, 1999. Thus, the 1999 amendment did not apply to existing liquidation proceedings, like the instant Union liquidation.

However, in 2005, the Legislature revisited Insurance Law § 7434 (*see* L 2005, ch 33). Subsection (e) was added to the statute and provides:

> "The provisions of this section shall apply to distributions made after the effective date of this subsection in any proceeding under this article, regardless of the date such proceeding was commenced under this article, provided that the foregoing provisions of this subsection shall not apply to distributions made pursuant to a final court order of distribution entered on or before the effective date of this subsection."

The 2005 amendment was adopted as part of a plan to rescue the near-bankrupt WC Fund, so that it would have sufficient funds to continue to pay injured workers whose insurers were insolvent (*see* Memorandum of Assemblyman Grannis, 2005 NY Legis Ann

at 23). The bill was designed to speed up the processing of longstanding liquidation proceedings, and to make additional monies readily available to the WC Fund. As a result of the enactment, estates that had insufficient funds to reach reinsurance claims did not have to review such claims, and distributions could be made sooner, once the earlier classes were resolved. In furtherance of the rescue plan, the provision also permitted loans from the liquidation estates to the WC Fund against the monies to which the WC Fund would be entitled under the new priority rules.[9]

The language of the 2005 amendment unequivocally expresses the Legislature's intention to apply the amended priority scheme to all existing liquidations, which would include the Union liquidation. It changes the previously existing ratable distribution to a priority scheme that places reinsurance claims in class six.

The Constitutional Objections

The court must now examine whether the application of the priority scheme to a pending liquidation proceeding is a retroactive change that runs afoul of the constitutional provisions cited by the Objectors. The Objectors argue that generally contracts, such as the reinsurance agreements, incorporate the applicable statutory law existing at the time of

[9] Such a loan of $410,000 was made from the Union estate to the WC Fund, and the loan has almost been repaid.

formation. In this case, that would include the existing statutory distribution scheme that would have permitted them to participate pro rata in the distribution. The Objectors contend that under the order of liquidation, their rights have been set as of that date, so that application of the current version of § 7434 acts retroactively to impair their vested rights in violation of the Due Process, Equal Protection and Contracts Clauses of the United States Constitution. The Objectors assert that the retroactive changes must be examined by employing a balancing test, and that using such analysis, the court should find it would be inequitable to uphold the application of the statute as amended because it would vitiate their claims in violation of their Constitutional rights.

The Liquidator contends that the current version of § 7434 is economic regulatory legislation that is remedial, and that it should be applied to distributions to be made in pending liquidations. The Liquidator maintains that the appropriate analysis centers on application of the rational-basis test because the legislation is prospective since it only applies to future distributions and does not require the return of any distributions already made. The Liquidator claims that the legislative history of § 7434 demonstrates that it was enacted for legitimate governmental purposes and that courts in other jurisdictions have considered the same issues and upheld the constitutionality of retroactive application of similar provisions, concluding that there is no vested right in any particular distribution scheme (*see Maryland Ins. Guar. Assn. v Muhl*, 66 Md App 359, 504 A2d 637 [Ct of Spec

App Md 1986]; *In Matter of the Rehabilitation of Mut. Benefit Life Ins. Co.*, 1993 NJ Super Lexis 940 [Super Ct, Chancery Div, Mercer County 1993] *affd* 297 NJ Super 179, 687 A2d 1035 [App Div 1997], *cert denied* 149 NJ 408 [1997]; *Matter of the Liquidation of American Mut. Liability Ins. Co.*, 434 Mass 272, 747 NE2d 1215 [2001]).

Analysis

Legislative enactments are afforded a strong presumption of constitutionality, and the Objectors, who challenge the liquidation statute, bear the heavy burden of establishing unconstitutionality beyond a reasonable doubt (*41 Kew Gardens Rd. Assocs. v Tyburski*, 70 NY2d 325, 333 [1987]).

Due Process

The Objectors urge that application of the current form of Insurance Law § 7434 works a deprivation of their property without due process. They claim that, under the old law, they would have received funds as part of the pro rata distribution and that the new statute results in their claims being reduced to zero. The Liquidator counters that there is no due process violation because there is no vested right to any particular distribution and that the Legislature had a public purpose for amending the statute; thus, there is a rational basis for its application.

Generally, when economic legislation is challenged, due process jurisprudence requires great deference to the legislature (*Exxon Corp. v Governor of Maryland,* 437 US 117, 124 [1978]; *Montgomery v Daniels*, 38 NY2d 41, 67 [1975]). Applying the rational-basis test, courts are not to consider the wisdom of the legislature's policy choices, but must determine only whether the legislation has any reasonable relation to a legitimate governmental purpose or interests (*Exxon Corp. v Governor of Maryland*, 437 US at 124).

Courts have concluded that "[a] legitimate governmental purpose is, of course, one which furthers the public health, safety, morals or general welfare" (*Fred F. French Investing Co., Inc. v City of New York,* 39 NY2d 587, 596, *cert denied* 429 US 990 [1976]). Thus, even if a statute treats groups differently, the legislation will be upheld unless "'varying treatment of different groups or persons is so unrelated to the achievement of any combination of legitimate purposes that we can only conclude that the legislature's actions were irrational" (*Pennell v City of San Jose*, 485 US 1, 14 [1988] [citations omitted]; *see also Elmwood-Utica Houses v Buffalo Sewer Auth.,* 65 NY2d 489, 492 [1985]).

However, the Court of Appeals, in *Alliance of American Insurers v Chu*, 77 NY2d 573, 586 (1991), explained that "where legislation has retroactive effects, judicial review does not end with the inquiry generally applicable to economic regulation, i.e., whether the legislation has a rational basis []. Instead, the courts must balance a number of factors ... to determine whether the rights affected are subject to alteration by the Legislature." The

factors to be considered include "'fairness to the parties, reliance on pre-existing law, the extent of retroactivity and the nature of the public interest to be served by the law'" (*Matter of Hodes v Axelrod*, 70 NY2d 364, 370 [1987] [citations omitted]; *Matter of Chrysler Props. v Morris,* 23 NY2d 515, 518 [1969]).

Here, the parties disagree as to whether the new statute has retroactive effect. In urging that the provision operates retroactively, the Objectors point to the change in their status from equal participants in the distribution to a lower priority--class six--that will receive nothing upon liquidation. The Liquidator maintains that the statute is prospective because it only applies to distributions made after its effective date and anyone receiving monies prior to the enactment would retain them.

Even assuming that the enactment has retroactive effect, a balancing-test analysis warrants application of the priority scheme. Considerations relevant to the balancing test are: 1) the nature of the interest granted under a liquidation statutory priority scheme; 2) whether that scheme creates reasonable expectations among the claimants in the liquidation as to how payment would be made; and 3) the public interest to be served by the amendment to the statute.

The constitutionality of retroactive application of the current version of Insurance Law § 7434 has not yet been considered by a New York court. Courts in other states that enacted similar measures, however, have uniformly upheld the constitutionality of retroactive

application and concluded that the insurance insolvency laws' priority schemes are remedial, do not give rise to vested rights and are subject to change by legislative amendment.

In *Maryland Ins. Guar. Assoc. v Muhl*, 66 Md App 359, 504 A2d 637, the court analyzed a series of bankruptcy cases to determine whether retroactive changes would be applied to existing cases. The Maryland appellate court found that the "insolvency laws are remedial in nature" and that while "creditors may develop expectations of what they might receive under those laws, they do not acquire vested rights to particular modes of distribution that are beyond the power of Congress to alter" (*id.* at 372; *see also Matter of Ancillary Liquidation of Integrity Ins. Co.,* 217 Wis 2d 252, 580 NW2d 348 [1998]).

New York law likewise provides that a right is not vested unless it is something more than a mere expectation based on an anticipated continuation of the present general laws (*Ten Ten Lincoln Place v Consolidated Edison Co. of New York,* 190 Misc 174 [Sup Ct, Kings County 1947], *affd* 273 App Div 903 [2d Dept 1948]).

Additionally, since the priority and distribution scheme is a creature of statute, and the Legislature may amend it at anytime, a claimant "can establish no *contractual* right to recover any particular distribution in a liquidated estate" (*Matter of the Liquidation of American Mut. Liability Ins. Co.,* 434 Mass at 283).

The Objectors assert, in the first instance, that it is entry into the reinsurance agreements that brings into play the statutory priority scheme in force at that time. This

position has been rejected by other courts, which explained that merely "entering into contracts for insurance does not in itself implicate the priority scheme established by the Legislature; it is the subsequent insolvency of that insurer that triggers the statute" (*id.*, at 283 [citations omitted]). The Objectors' reliance on *Matter of Knickerbocker Agency (Holz)*, 4 NY2d 245, 251 (1958), is misplaced, for it actually supports insolvency as the intervening event that will bring the statute into play.

The Objectors next submit that the Liquidation Order fixed the rights of the parties. That order, however, was made pursuant to Insurance Law § 7405(b), which provides that:

> "The rights and liabilities of any such insurer and of its creditors, policyholders, shareholders, members and all other persons interested in its estate shall, *unless otherwise directed by the court*, be fixed as of the date the order is entered" (emphasis added).

The statute explicitly uses the qualifying language "unless otherwise directed by the court," which implies "'a power of retroactive adjustment,' and should have put the objectors on notice that future changes in the priority scheme were possible" (*Matter of Liquidation of American Mut. Liability Ins. Co.*, 434 Mass at 284, 747 NE2d at 1224 [citations omitted]). Indeed, if the court may "otherwise direct," then "the rights of creditors cannot be regarded as so irretrievably fixed as to be beyond alteration" (*Maryland Ins. Guar. Assn. v Muhl*, 66 Md App at 373, 504 A2d at 644).

The new prioritization scheme does not deny the remedies afforded by the underlying reinsurance contracts, "it only affects the order of payment" (*Matter of Rehabilitation of Mut. Benefit Life Ins. Co.*, 1993 NJ Super Lexis 940 at 70). Any "contractual right to recover on these claims was impaired by the insolvency. . . and not by the application of the . . . amendments to pending proceedings. The priority accorded to the right has been affected, but not the underlying right itself" (*American Mutual,* 434 Mass at 284, 747 NE2d at 1224).

The Objectors do not have a vested right in any particular priority scheme. In addition, there was no reasonable expectation that the priorities set in the statute would remain forever static. Indeed, to the extent that the statute deals with insurance, an intensely regulated industry, the "element of reliance essential to a challenge against retroactive application of a statute is lacking" (*id.* at 283, 747 NE2d at 1223).

Next, the court must consider the nature of the public interest to be served by retroactive application.

The New York Senate Memorandum in support of the 1999 amendment provides:

> "In order to facilitate and expedite the closing of companies in liquidation, the present scheme must be amended to differentiate between and/or among claims to establish class priority for making distributions. Adoption of the proposed legislation will bring New York into conformity with most sister states and federal case law while hastening the process of closing companies and reversing inequities in the present pro-rata sharing by claimants in distribution."

The New York State Assembly further explained:

> "Under the existing law, the Superintendent, as liquidator, cannot make distribution until an estimate of the company's liabilities for all types of claims is made. This requires that every claim be reviewed before distribution begins. Otherwise, sufficient assets may not be available to pay claimants with late developing claims their pro rata shares. In particular, reinsurance claims are larger and take longer to develop than direct claims. The proposed legislation will eliminate the need for review of each claim before the distribution of assets begins and ensure policy holders and security funds/guaranty associations are paid more quickly."

The amendment prioritizes, above all else, the expenses of administration, as was previously the case (*Matter of Union Indem. Ins. Co. of New York*, 216 AD2d 48 [1st Dept 1995]). Second priority was given to policyholder claims and claims held by the various security and guaranty funds because:

> "Policyholder claims, due to the importance of insurance coverage to individuals and to society, are more important than other types of claims, such as claims for taxes and assessments, reinsurance claims, or for goods and services. The equal treatment afforded all such claims dissipates the assets available to pay policyholders. Furthermore, the assets available to pay New York's insurance security funds, out-of-state guaranty associations of their equivalence are also dissipated by the current statutory scheme. The security fund/guaranty association system is funded by assessments and by distributions from the assets of the insolvent companies in liquidation. Recognition of the preeminence of policyholder claims in liquidation will ease the burden on security funds and guaranty associations. This will reduce the need for assessments, and thus benefit the industry and the public."

The Assembly Memorandum further indicates that general creditor claims, including reinsurance claims, were placed in class six because:

> "Reinsurance claims are claims by insurance companies that ceded or assumed business from the company in liquidation. An insurance company which enters into a reinsurance contract with a company placed in liquidation is in a better position than direct policyholders to face the financial consequences of an insolvency. Furthermore, reinsurance claimants can offset amounts they owe to the company against their claims. Finally, insurance companies are required to write-off amounts due from insolvent companies on their statutory financial statements. Thus, the impact on their financial condition is immediate and cannot be rectified by the possibility of future distributions."

Thus, the nine-class priority scheme was designed to serve the public in several ways. It was intended to give greater protection to claimants deemed to need it more and streamline liquidation and asset distribution. Additionally, the amendment furthers uniformity in handling liquidation estates across state lines. Interstate consistency was yet another strong policy reason for the enactment.

The Memorandum of Assemblyman Grannis, 2005 New York Leg Ann, Chapter 33, p 23-24, outlines the events leading up to the enactment of the 2005 amendment. In January 2005, the Department of Insurance informed the Legislature that the WC Fund was about to become insolvent and that more than 7,500 workers receiving benefits from the fund, as a consequence of their employers' workers' compensation carriers' insolvency, were in danger of not receiving their payments in February. The WC Fund obtained an infusion of funds from an out-of-state liquidation estate that put off the shortfall for several weeks.

The Legislature held hearings on February 15, 2005, to investigate the crisis and arrive at a plan to protect the solvency of the WC Fund and the injured workers dependent upon it. One of the sources of funding for the WC Fund is payment of the fund's claims from the estates in liquidation. At the time, the Liquidation Bureau was managing the estates of 34 companies in liquidation, with estimated liquid assets of $783 million.

A series of measures were adopted to facilitate an infusion of money to stabilize the WC Fund. Loans from the liquidation estates were authorized under Insurance Law § 7433-a, to be paid back by an increase in assessments on the workers' compensation carriers. In conjunction with these measures, the Legislature determined to apply the prioritization scheme to distributions in existing liquidations. This would free up additional funding for the WC Fund by facilitating delayed distributions, because reinsurance claims would not have to be addressed if the assets of the estate were insufficient to pay in full classes of claims that have priority.

Rescue of the WC Fund so that it could provide its intended safety net for over 7,500 injured workers is clearly a legitimate public purpose that is in line with those discussed in the legislative history created when the priority scheme was adopted in 1999.

The Initial Report impacts almost 5,600 claimants, all of whom were notified. Only three have objected to the Liquidator's plan to distribute the assets of the estate in accordance with the current version of Insurance Law § 7434, evidencing that, all things considered,

there would be very minor impact using the revised distribution scheme. The vast majority of the claimants will benefit from the remedial application of the amended statute.

Based on balancing the relevant factors, the priority scheme must be applied here. Insurance Law § 7434 is a remedial statute that does not impair a vested right; there is no expectation that the priority scheme in force at any given time will not be subject to change at the discretion of the Legislature; and the Legislature was acting in the public interest when it elected to apply the new priority scheme to existing liquidations in order to provide a more equitable and consistent scheme for the distribution of the insolvent's assets that better protects the public-at-large and helped to ensure the continued solvency of the WC Fund as a safety net for injured workers.

The amendments to Insurance Law § 7434, moreover, are undoubtedly rational and further the public interest. The Objectors have not met their burden of establishing a due process violation.

Equal Protection

The Objectors claim that the current version of Insurance Law § 7434 unconstitutionally gives a preference to certain claimants over others in violation of the Equal Protection Clause. The Liquidator contends that the distinction is based on furthering legitimate public purposes and that the Legislature's actions were rational.

In *McGowan v Maryland*, 366 US 420, 425-426 (1961), the Supreme Court emphasized that equal protection "is offended only if the classification rests on grounds wholly irrelevant to the achievement of the State's objective" and that "a statutory discrimination will not be set aside if any state of facts reasonably may be conceived to justify it."

The State's reasons for the disparate treatment and the prioritization of claims by policyholders, security funds and guaranty funds over those of general creditors, such as reinsurers, was laid out in depth in the legislative history set forth above. The Legislature explained the public purposes that would be served through the amendment. There is a rational basis for the distinctions in the legislation; namely, more efficient and equitable resolution fo claims. Indeed, the priority scheme "is the same as most other states, it is neither arbitrary nor discriminatory in preferring policyholders to the general unsecured creditors" (*Matter of Rehabilitation of Mut. Benefit Life Ins. Co.*, 1993 NJ Super. Lexis 940 at 84). There has been no violation of equal protection.

Impairment of Contract Rights

The Objectors argue that their contract rights under the reinsurance agreements have been constitutionally impaired by application of the priority scheme. Once again, the Liquidator responds that the contract rights were impaired by the insolvency of Union, and

that there is no vested contractual right to a particular distribution method because the statute itself contemplates its alteration.

The cases in other states that have reviewed priority-scheme legislation have all determined that contract rights are unimpaired by application of comparable statutes. The Objectors have failed to establish that a vested contractual right has been impaired.

BICC's Other Objections

BICC argues that the plan of the Initial Report to pay classes one and two is premature. It cites the Liquidator's admission that an audit of the estate is incomplete and that there may be need for further amendment of the report on completion of the audit. BICC also points to the Liquidator's admission of poor management of the estate to challenge the priority for administrative expenses, urging that expenses must be "reasonably necessary to further the goal of protecting policyholders" (*United States Department of the Treasury v Fabe*, 508 US 491). In addition, BICC alleges that the report fails to provide sufficient facts related to the handling of reinsurance claims and commutation agreements for its evaluation, and that these issues have been questioned in *Matter of Midland Ins. Co.*, 18 Misc 3d 1117(A), 2008 Slip Op 50110[u]. BICC seeks appointment of a creditors committee or a management audit.

The Liquidator responds that the priority given administrative claims is lawful and appropriate. The Liquidator argues that BICC is not entitled to the affirmative relief it seeks, because such relief would abrogate his exclusive discretionary decision-making authority to act on behalf of the creditors as a whole under Article 74 of the Insurance Law, and that the application was not made in good faith in that it seeks to ferret out information relating to the Liquidator's positions and strategies concerning claims against BICC as a debtor of Union.

Insurance Law § 7434 (a) (1) states that

> upon "the recommendation of the superintendent, and under the direction of the court, distribution payments shall be made in a manner that will assure the proper recognition of priorities and a reasonable balance between the expeditious completion of the liquidation and the protection of unliquidated and undetermined claims" (emphasis added).

Thus, a court's oversight of the liquidation requires a careful examination of the Liquidator's proposal to assure a proper recognition of priorities and a reasonable balance between expeditiousness and protection.

Here, the Initial Report is deficient in certain respects.

While the Liquidator is correct that administrative expenses are entitled to first priority under *Matter of Liquidation of Union Indem. Ins. Co. of New York*, 216 AD2d at 49, whether the amount claimed is justified as "reasonably necessary to further the goal of protecting policyholders" under *Fabe*, 508 US at 492, is a different issue. The Liquidator has admitted

on the very first page of his report that there have been "years of poor management," and he cites a "troubled history of NYLB" that includes criminal conduct and the failure to undertake financial audits (*see also* Affidavit of Jack A. Franceschetti, Memorandum of Assemblyman Grannis supporting the 2005 amendment to Insurance Law § 7434 [pointing out that the "insurance department's administration of insurer rehabilitations and insolvencies and the state's insurance security funds has been widely criticized by insurers, those owed money from companies being liquidated in New York and three state comptrollers as inefficient, costly, lacking in oversight and secretive"]).

Union's assets total $106,419,398, and the administrative expenses are $83,704,661. The Initial Report calls for an unusually high proportion of the assets--approximately 80% of the estate--going toward satisfaction of administrative expenses, which leaves the policyholders, security funds and guaranty funds with a very small proportionate share. The administration has taken over 23 years and is not as yet completed. There are still outstanding claims to be adjudicated, so that the class two creditors cannot partake of distribution until these open matters are resolved. Further, the Initial Report is based upon an incomplete audit. This is hardly the expeditious resolution contemplated by the statute.

The Liquidator supports his figure for administrative expenses by listing various expenses and giving totals, the derivation of which is nowhere explained or supported by documentation beyond vague generalities. While this liquidation proceeding has been

lengthy and may have given rise to higher expenses, the numbers here require justification. In light of the admissions by the Liquidator regarding the history of poor management, criminality and lack of oversight in the form of audits, it would be unreasonable for the court, which is duty-bound to oversee the distribution, to accept the administrative expenses figure at face value.

The Liquidator must demonstrate the administrative expenses are not attributable to the poor management, criminality or audit failure. To this end, the Liquidator shall submit a more detailed report concerning calculation of the administrative expenses, including the formulas applied to each category of expense and any appropriate documentation. The Liquidator should review the expenses to determine which, if any, were attributable to problems with NYLB management of the estate and account for those costs. In addition, the affidavit should include an update on the results of the audit, as well as a report on which claims, if any, remain to be considered. Should the affidavit with further documentation not be satisfactory to the court, then the matter of validity of the claimed administrative expenses will be submitted to a referee for a hearing. Until the matter of administrative expenses is resolved, there can be no approval of the report and distribution from the estate.

The NYLB is now under new administration with a mandate for reform. The court will not interfere with the Liquidator's discretion to manage the estate by requiring a creditor's committee or directing a management audit at this time. Reinsurance claims and

commutation matters will be handled consistent with the procedures announced in *Matter of the Liquidation of Midland Ins. Co.*, 18 Misc 3d 1117(A), 856 NYS2d 498 (New York County 2008), so as to provide consistency in the management and handling of the estates in liquidation. To this end, the Liquidator shall report to the court on how the rulings in *Midland* impact this matter, and delineate the steps that are to be implemented to conform with *Midland*.

Accordingly, it is

ORDERED that the application to approve the Initial Report is granted to the extent that the Liquidator's plan to apply the priority scheme for distribution in accordance with the current version of Insurance Law § 7434 is approved, but final approval of the complete Initial Report and its planned distribution is stayed pending further submissions by the Liquidator consistent with this Decision and Order, and it is further

ORDERED that the Liquidator provide said submissions within 30 days of service of a copy of this order with notice of entry.

This constitutes the Decision and Judgment of the Court.

Dated: New York, New York
February 6, 2009

ENTER:

Hon. Eileen Bransten