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POTENTIAL SALE OF MIDLAND ESTATE

By David B. Killalea and Rachel S. Kronowitz

On February 26, 2009, the Superintendent of the New York State Insurance Department (the “Liquidator”) announced that the New York Liquidation Bureau (“NYLB”) intends to seek court approval of a liquidation plan (the “Liquidation Plan” or “Plan”) for Midland Insurance Company in Liquidation (“Midland”). The Plan provides for the sale of substantially all of Midland’s assets to a private entity through a competitive bidding process. To facilitate the proposed sale, the Liquidator has petitioned the court overseeing Midland’s liquidation (the “Receivership Court”) to impose a deadline for submitting claims information of ninety (90) days from the date the Receivership Court grants the petition (the “Cutoff Date”). The NYLB has widely publicized the Plan, and the potential sale in particular, as an “industry template” that could be adopted by other liquidators and distressed insurers. Accordingly, Midland is significant not only to many policyholders in its own right – the Liquidator has stated that there are approximately \$2.9 billion in liabilities, and approximately \$1.0 billion in assets (including potential reinsurance recoveries) – but its significance is magnified by its potential for becoming a model for other insolvencies.

The deadline for filing objections to the proposed Cutoff Date in the Receivership Court is **April 9, 2009**. The deadline for submitting comments to the NYLB concerning the proposed Liquidation Plan before the NYLB files the plan with the Receivership Court is **April 20, 2009**.

Midland has been in liquidation since 1986. For 23 years, Midland’s liquidation has been noteworthy principally for its lack of claims allowances and payments. Absent a substantial change in the manner in which the estate is being liquidated, policyholder claims likely will remain largely undetermined and unpaid for an extended period. The Receivership Court has commented that it could take at least another decade to liquidate the estate. The Liquidator takes the position that the sale of the Midland estate to a private investor would result in a quicker and more efficient liquidation process that would yield larger distributions to policyholders.

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Based in Washington, DC, with an office in Austin, Gilbert LLP is a law firm representing a wide range of clients, including corporations, partnerships, non-profit organizations and individuals in complex disputes, including high-stakes litigation, bankruptcy matters, class actions and ADRs. Best known for representing policyholder interests in insurance coverage matters, Gilbert LLP also has an active public interest practice that specializes in complex multi-plaintiff actions involving cutting-edge issues.

The proposed Liquidation Plan and related documents are quite detailed, complex and vague in certain important respects. The process set forth in the Liquidation Plan generally is as follows. First, policyholders are required to provide supplemental claims information by the Cutoff Date to preserve their claims against Midland and so that Midland, through its retained experts, can value the estate's liabilities. Second, the NYLB will hold an open bidding process to select an entity to purchase the Midland assets (consisting of reinsurance and other assets). Third, the Liquidator will select the winning bidder; as explained below, each bid will set forth a payment percentage that the purchaser would pay for certain allowed claims.

Policyholders will be permitted to opt into or out of the Liquidation Plan (but not the Cutoff Date) within sixty (60) days of the date on which the Receivership Court approves a sale. For policyholders that opt in, there will be an expedited claims determination process. This includes a mandatory settlement offer by the purchaser; if the claim is not resolved through negotiation, it will be resolved through a binding fast-track arbitration. Opt-in policyholders whose claims are allowed consensually or through arbitration will be paid their allowed claim amount within ten (10) days based on the payment percentage established in the winning bid. In addition, opt-in policyholders with approved claims will receive a distribution from a portion of the purchaser's profits based on terms to be detailed in the bid proposals. The opt-in process, including payment, is designed to conclude in slightly more than one year from the date of the sale, and less than that if the claim is resolved without arbitration; it remains to be seen whether this timeframe is realistic.

Policyholders that opt out of the Liquidation Plan will have their claims resolved as though the sale had not taken place, *i.e.*, by the Liquidator with disputes resolved before the Receivership Court, pursuant to current claims handling procedures; the purchaser will not handle opt-out claims for the Midland estate. Policyholders that are successful through the opt out process will: (1) receive a percentage distribution on their allowed claims, as determined by the Liquidator and approved by the Receivership Court, equal to the percentage such policyholders would have received if there had been no sale (presumably determined by the liquidation value established by the Liquidator's analyst, Milliman Inc., which amount by definition is less than the amount the purchaser will pay on opt-in claims); (2) not participate in any profit-sharing distributions made to opt-in policyholders by the purchaser; and (3) have their claims paid only at one of two annual distributions.

A group of Midland policyholders represented by Gilbert Oshinsky LLP with approximately \$500 million in face-value policy limits, along with several other major Midland policyholders, has begun discussions with the NYLB to address issues raised by the Cutoff Date (including the lack of specificity as to the information required to be submitted by such date and the adequacy of the timeframe for submitting data) and the Liquidation Plan, including the potential sale of Midland.

The sale of Midland to a qualified purchaser, under appropriate conditions, has the potential for expediting the claims approval and payment process, and for allowing policyholders the opportunity to receive meaningful and (relatively) prompt distributions. The Liquidation Plan, however, raises significant issues that should be of concern to Midland policyholders. Among potentially many other issues, policyholders should be concerned that the ultimate Liquidation Plan: (1) includes sufficient safeguards to ensure that the purchaser has adequate financial wherewithal and the enforceable obligation to pay valid claims; (2) has fair and reasonable rules governing the timing and amount of distributions to policyholders; (3) clearly provides that the estate will pay

valid contingent claims and defense costs; (4) provides for the equitable and efficient resolution of both opt-in and opt-out claims; and (5) otherwise provides for the equitable treatment of similarly-situated policyholders.

The NYLB's proposal plainly deserves serious consideration by policyholders, but at the same time significant issues such as those outlined above must be addressed adequately to warrant policyholders' support. We believe that policyholders' interests likely will be best served in the first instance through negotiations with the NYLB to address policyholder concerns before the Liquidator files a petition seeking court approval of the Liquidation Plan. Experience has shown that policyholders are most effective in presenting their concerns and protecting their financial interests and rights if they collaborate, giving them maximum leverage with the NYLB and maximum impact to positively shape the Plan ultimately filed.