In the Matter of:

THE LIQUIDATION OF INTEGRITY INSURANCE COMPANY

SUPERIOR COURT OF NEW JERSEY

CHANCERY DIVISION: BERGEN

DOCKET No. C – 7022 -86

CIVIL ACTION

OPINION

Argued: November 20th, 2003

Decided: July 21st, 2004
Honorable William C. Meehan, P.J.S.C.

Joseph J. Schiavone Esq., Christine Franckk Esq. of Budd Larner P.C., Jeffrey S. Leonard Esq., and Debra Hall Pro Hace Vice appearing on behalf of the Reinsurance Association of America.

Thomas Novak Esq. of Sills, Cummis, Epstein and Gross appearing on behalf of the Commissioner of Banking and Insurance of the State of New jersey, in Her Capacity as Liquidator of Integrity Insurance Company.

Rodney T. Richards, Esq. of Bressler, Amery & Ross, attorneys for the New Jersey Property/Liability Insurance Guaranty Association.

Introduction

Before the court is an application brought on behalf of the New Jersey Commissioner of Banking and Insurance in her capacity as Liquidator (hereinafter "Liquidator") of the Estate of Integrity Insurance Company (hereinafter "Integrity" or "Estate"), seeking this Court's approval of the Fourth Amended Final Dividend Plan (hereinafter the "FAFDP" or "Plan"). The matter is opposed by the Reinsurance Association of America (hereinafter "RAA"). A three-day hearing on the matter was commenced on November 18, 2003 and ended on November 20, 2003. The application is granted for the reasons set forth herein.

Integrity Insurance Company was a New Jersey stock insurance company that issued various types of insurance policies as well as surety bonds. From 1977 to 1986, Integrity issued, amongst other types of policies, over 25,000 excess and umbrella insurance policies. By order of this Court, on March 24, 1987 Integrity was declared insolvent and the New Jersey Commissioner of Insurance was appointed liquidator. Pursuant to procedures established in NJSA 17:30C-20 and implemented by an order of this Court dated July 8, 1987, approximately 26,000 claims were filed against the Estate by March 25, 1988, the claim bar date. Pursuant to the Liquidation act, the Liquidator was directed to liquidate Integrity's liabilities, marshal its assets, and wind up its business and affairs. This Court appointed Special Masters to facilitate the claims against the Estate by policyholders and creditors who objected to notice of determinations (hereinafter "NOD") by the Estate.

Many of Integrity's policies covered large manufacturing companies who were the subject of massive environmental, asbestos and other product liability claims, which claims although incurred may not be reported for as long as fifty years. The Liquidator devised a plan seeking to resolve the Estate expeditiously while not cutting off those claims that have been incurred but not reported (hereinafter "IBNR"). In June 1996, the Liquidator filed a motion to establish procedures for court approval of the first "Final Dividend Plan" (hereinafter "FDP"). The FDP provided that an actuary would estimate Integrity's potential obligation on all pending and future claims and then allocate such claims to reinsurers. Following such allocations, reinsurance on the claims would come due, and the Liquidator would resolve all claims of and against the Estate in the FDP, which would expectantly close the Estate in three to five years. In a written opinion dated November 15, 1996, this Court held that the liquidator has legal authority to estimate net present value of incurred, but not yet known or reported losses and insurer's pending case reserves on behalf of future claimants and allow such contingent claims to participate in final distribution of assets. See In Re Liquidation of Integrity Ins. Co., 299 N.J. Super. 677 (Ch. Div. 1996).

At that time, numerous reinsurers opposed the approval of the FDP and asserted their purported right to litigate and challenge each claim as it arose demanding that they should not be obligated to pay into a fund for claims that have not materialized. Essentially, the reinsurers argued for a runoff scheme. After the opinion of November 1996, for the most part, the reinsurers decided to commute their reinsurance obligations, pay a set amount on those obligations, and waive their right to participate further in the

matter. Now, the RAA, an organization comprised of seventeen reinsurers some of which reinsure Integrity, remains and continues to oppose the approval of the FAFDP on several different grounds.

As it has already been decided in a prior opinion by this Court that the Liquidator has the legal authority to estimate the Estate's contingent IBNR and reported liabilities as a method to conclude the Estate, the central issue before this Court is limited to whether the proposed Fourth Amended Final Dividend Plan achieves that objective (1) using generally accepted estimation techniques; (2) in a commercially reasonable manner; and (3) while protecting the policyholders, insureds, and the public.

Accepted Estimation Techniques

As a prefatory matter, the Court will address the RAA's assertion that the FAFDP is flawed because contingent claims and IBNR are purportedly incapable of being made "absolute" and cannot be estimated in a reasonable manner. On this point, the Court notes that it is disingenuous for the RAA an organization whose members themselves employ these techniques to assert that the Plan is somehow unfair because the actuarial estimates may not represent what would actually occur if the Estate were to run-off. As the RAA well knows, it is axiomatic that an actuarial estimate is not a 100% guarantee. Rather it is an evaluation generated by an actuary using the most up-to-date technology available. Indeed, it is a process that is employed and relied upon by major insurance and reinsurance companies including the RAA and its members on a regular basis for such transactions as commutations, takeovers, and mergers. In fact, at trial and again in their post-trial brief the RAA has recognized that these techniques are a part of

their business and necessary to prepare for IBNR claims stemming from such claims as asbestos, which claims may have a latency period of up to fifty years. The RAA also acknowledges that reinsurers post IBNR reserves to make conservative provisions against future losses based on estimates of actuaries.

Therefore it is this Court's opinion, that if the actuarial estimation of claims is an accepted technique in the normal course of the RAA's members' business then it may be inferred that it should be acceptable in the context of the FAFDP.

Turning now to the actuarial techniques themselves, the Court, before approving the Plan, must be convinced that the proposed plan will require that generally accepted estimation techniques are employed in arriving at the liability figures for the parties involved.

After hearing the testimony elicited at trial and upon reviewing both the FDP and the post-trial briefs submitted by both parties, the Court is satisfied that the Fourth Amended Final Dividend Plan successfully addresses the foregoing issue.

Although the Plan does not specify the exact types of actuarial techniques[1] to be employed, it does however provide for a process that the Court is persuaded will ensure that such techniques will be employed. For instance, Part 4 of the FAFDP is entitled, "Adjustment and Allowance of Claims." That part sets forth the procedure for approval

[1] An example of the actuarial techniques, which would be used in estimating contingent and IBNR claims, is known in the industry as "bottom up" estimation. An expert, Christopher Diamontoukos, a Senior Consulting Actuary at Ernst & Young, explained this technique at trial. Mr. Diamontoukos represented to the Court that "bottom up" estimation is the most up-to-date and accurate method of estimating extraordinary hazard losses; typically environmental, asbestos, and other toxic tort claims. He further represented that although no technique is 100% accurate the development of bottom up based estimation has allowed actuaries to estimate contingent and IBNR liabilities with much greater accuracy. Essentially, the method traces the loss from its inception or source of exposure to the ultimate cost.

of an IBNR claim; these are the claims that the RAA most strongly objects to being liquidated. Specifically, Part 4 requires that a policyholder Claimant must submit information to value its claim for IBNR and comply fully with the requirements in the "proof of claim." The proof of claim requires that the policyholder must establish their IBNR claim by qualified personnel employing standard reserving practices and claim adjustment procedures. In order that this standard is met, the procedure also provides for the allowance of an objection on the part of a reinsurer after they receive a notice of determination on a particular claim. If an objection is timely filed the parties will have a chance to settle the matter. If the parties fail to settle the matter, a Special Master appointed by this Court will hear it. This Court must then approve the Special Master's decision in order for it to be final. The failure on the part of a reinsurer to avail itself of this process will be deemed a waiver of such rights.

In light of the safeguards provided by Part 4 of the Plan, the Court is satisfied that the Plan insists that only the most up-to-date actuarial techniques will be employed.

Commercially Reasonable

Consistent with this Court's prior rulings, it is critical the FAFDP is proven to be commercially sound. That is to say, that the estimation techniques can be applied in a commercially reasonable manner and will attain commercially reasonable results. For many of the same reasons mentioned above, the Court is satisfied that the FAFDP ensures that these goals will be achieved.

It is a forgone conclusion, as evidenced by the industry's pervasive use of them, that actuarial estimates can be applied in a commercially reasonable manner and will

achieve commercially reasonable results. Mr. Diamaontoukos, an expert in actuarial estimation, testified at trial that based upon his training and experience, IBNR on extraordinary and non-extraordinary hazards can be allocated to reinsurers in a commercially reasonable manner. This Court does not agree with the RAA's assertion that the non-consensual nature of the Plan alone renders it commercially unreasonable. The Court recognizes that generally such techniques are voluntarily employed and not involuntarily as with the FAFDP. However, any risks that may exist in allowing insureds, claimants, and policyholders to provide their own acturial estimates for their own claims are nullified by way of Part 4 of the FDP, which as discussed above, provides safeguards to ensure that insureds, claimants, and policyholders employ only those techniques that will achieve a commercially reasonable result.

Specifically, Part 4 of the FAFDP in referencing Appendix A, textually requires that a claim will be deemed absolute and thereby ripe for disbursement only when the claim is established by qualified personnel employing standard reserving techniques and claim adjustment procedures, consistently applied in a ***commercially reasonable manner*** and approved by this Court and any appellate court(s) which may review the matter. Further, as already explained above, Part 4 provides for an objection process whereby a reinsurer may voice an objection for, inter alia, commercial unreasonableness that will then be considered before a Special Master and then reviewed by this Court thereby protecting a reinsurer from an unreasonable estimate.

Thus, the Court is satisfied that the FAFDP will achieve commercially reasonable results.

Protection of Policyholders, Insureds, and the Public

Finally, and a paramount issue to this Court, is that the Plan affords insureds, claimants, policyholders, and the public protection against the risks they would otherwise be exposed to absent such Plan.

It is the Court's Opinion that the Fourth Amended Final Dividend Plan is the best available option to close the Estate in a fashion that will significantly reduce, if not, eliminate the perils that currently exist and will continue to exist absent such plan.

The RAA on the other hand essentially argues for a run-off scheme whereby the Estate would be kept open until such time as all the claims were matured or liquidated, at which time the Liquidator would apply for a winding up order. Although the Court recognizes the success of such schemes under the right circumstances, in this case it is not as fair or commercially reasonable as the FAFDP.

The Integrity Estate has been in existence for over seventeen years at a cost to the Estate of over $130 million dollars through December 31, 2002, approximately $8.5 million per year. Although that figure has been reduced in recent years as a result of minimizing the staff and use of consultants, it is enormous nonetheless. At a current annual cost of $5.4 million, to allow the Estate to run-off as suggested by the RAA would be an unjustifiable depletion and waste of Estate assets. A run-off scheme could take approximately 25 years until all claims on Integrity's excess and umbrella policies matured. Therefore, in espousing a run-off scheme the RAA is in essence requesting this Court to forgo the approval of the FAFDP that would in all probability close the Estate in three to five years, and instead endorse additional Estate expenditures of more than $100

million dollars for operating costs so that the reinsurers may take the "wait and see" approach and litigate each individual claim. This Court disagrees with such an approach as it flies in the face of practicality and public policy. Unlike the FAFDP,a run-off scheme would significantly reduce the Estate's assets thereby diminishing the available proceeds for insureds, claimants, and policyholders.

Moreover, a run-off scheme would leave the Estate open to reinsurer insolvency. To date, the Estate has already been unable to collect on many claims ceded to reinsurers due to reinsurer insolvency; 49 of Integrity's reinsurers have become insolvent. The Estate simply cannot agree to a scheme that would increase the risk of further reinsurer insolvency. The best way to guard against such risk is to close the Estate as quickly as possible contradictory to a run-off scheme that allows the Estate to continue, as a practical matter, into perpetuity. The FAFDP, however, intends to close the estate within three to five years thereby significantly diminishing the risk of additional reinsurer insolvency.

The Court is convinced that the FAFDP provides the necessary safeguards to protect insureds, policyholders, and the public from the above-mentioned perils while at the same time fashioning a commercially reasonable outcome for reinsurers.

Conclusion

For the foregoing reasons the Liquidator's application is granted and the Fourth Amended Final Dividend Plan is hereby approved.