No. GV 204523

THE STATE OF TEXAS,

Plaintiff,

v.

AMCARE HEALTH PLANS OF TEXAS, INC. and AMCARE MANAGEMENT, INC.

Defendants.

IN THE DISTRICT COURT
IN TRAVIS COUNTY, TEXAS
200TH JUDICIAL DISTRICT

SPECIAL DEPUTY RECEIVER'S RESPONSE TO MOTION FOR ADVANCEMENT OF CERTAIN LEGAL EXPENSES UNDER INSURANCE POLICY

Jean Johnson, as Special Deputy Receiver of AmCare Health Plans of Texas, Inc. and AmCare Management, Inc. (the *SDR*) submits this response to the Motion for Advancement of Certain Legal Expenses Under Insurance Policy as follows:

1. The SDR is duly qualified to act on behalf of the Receiver of AmCare Health Plans of Texas, Inc. and AmCare Management, Inc.

2. The companies in receivership are affiliates of two other health maintenance organizations, each of which is also in receivership in Oklahoma and Louisiana, respectively.

3. The parent company of these three health maintenance organization affiliates is not in receivership or bankruptcy, though the SDR is not aware that it conducts any business. Presently, the SDR has pending in the District Court in Travis County, an application to have a receiver appointed for the parent company.

4. The three health maintenance organizations have a substantial number of claims made against them by participants and health care providers, and inadequate assets to satisfy those claims in whole. To the end of recovering assets to pay claims, the SDR commenced a lawsuit in the District Court in Travis County against former officers and directors of the companies under her control, as well as against the accounting firm that performed audits of the

companies prior to receivership. The SDR was joined in her litigation by the Oklahoma receiver for the affiliate of the Texas companies. The Louisiana receiver has commenced his own litigation in Louisiana against former officers, directors and the accounting firm.

5. The officers and director defendants, as well as the parent company have properly recognized the permanent injunction of this Court that prevents them from utilizing property of the estate, including applicable insurance policies, without the approval of this Court. The insurance policies in question are indeed property of the receivership estate, the proceeds of which represent valuable assets for the payment of claims upon a finding that the officer and director defendants violated their obligations to the companies now in receivership. In re The Minoco Group of Companies, Ltd., 799 F.2d 517 (9th Cir. 1986); In re Sacred Heart Hospital of Norristown, 182 B.R. 413 B. E.D. Pa. 1995)

6. The movants tell the Court that they "have retained, or may in the future retain, professionals, including counsel or others, to defend the interests" in the litigation brought by the SDR and the Louisiana Receiver. [*See* ¶3 of Motion]. The movants also tell the Court that the insurer, Executive Risk Indemnity, Inc., "is and may in the future be willing to advance certain payments to the Professionals in defense of the Actions, subject to reservations of rights. . . ." [*See* ¶4 of the Motion]

7. Assuming that the assets of the receivership estate should be depleted by payment of Defendants' legal fees and costs, which proposition the Receiver rejects, the request as submitted by the movants should be denied by the Court. The movants put the Court in the position of giving an advisory opinion, which the Court does not have jurisdiction to render.

   a. The movants do not identify all the persons, or even the types of persons who would be engaged, receiving distributions under the insurance policy. Without knowing who will be engaged, the Court does not have a sufficient basis to determine that such work would be appropriate.

   b. The movants do not tell the Court that the claims on which they seek advancement of costs are even covered claims under the policy in question. Indeed, movants tell the Court that any money received from the insurer would be under a reservation of rights. Again, the movants are asking the Court to render an advisory opinion and to authorize the expenditure of funds, on matters that may not even be within the scope of the policy.

   c. This Court does not have jurisdiction to authorize the use of proceeds to defend claims brought by the Oklahoma and Louisiana receivers. The

movants would have to approach each receivership court to obtain authority to use policy proceeds for the purposes they seek, as such funds are the property of those estates. Bryant v. United Shortline Inc., Assurance Services, N.A., 972 S.W.2d 26 (Tex. 1998).

8. Assuming that any amount is advanced to Defendants, it should be only for proper claims. An insurer providing directors and officers liability insurance may allocate defense costs between covered and non-covered claims asserted against an insured in underlying litigation. *See* Gon v. First State Ins. Co., 871 F.2d 863, 868-69 (9th Cir. 1989); Okada v. MGIC Indem. Corp., 823 F.2d 276, 282 (9th Cir. 1987).

9. While no funds should be advanced, as the policy is a valuable asset of the estate, certainly until there is a determination by the insurer of the claims that are, and are not covered under the policy, costs should not be advanced. *See e.g.* In re Kenai Corp., 136 B.R. 59, 63-64 (S.D. N.Y. 1992); In re Ambassador Group, Inc. Litig., 738 F. Supp. 57, 62 (E.D.N.Y. 1990) Using this approach, the Court minimizes the wasting of assets under the policy, maximizing the potential recovery by the Receiver. It makes no sense to authorize the payment of fees and costs on claims that the insurer has not even determined are covered by the policy. The insurer should be forced to take a position before wasting the assets available to the party to be benefited by the policy – the claimant.

10. In determining whether defense cost should be allocated (i) between covered and non-covered claims asserted against an insured, or (ii) between the insured directors and officers and the corporation or other uninsureds, most courts have adopted the "reasonably related" test. Under this approach, so long as an item of service or expense is reasonably related to the defense of a covered claim, it may be apportioned wholly to the covered claim. Continental Casualty Co. v. Board of Education for Charles County, 302 Md. 516, 533, 489 A.2d 536, 545 (1985); *see also* Safeway Stores, Inc. v. National Union Fire Ins. Co., 64 F.3d 1282, 1289 (9th Cir. 1995)(adopting reasonably related test and finding that the corporation's defenses costs are reasonably related to the defense of its officers and directors.)

11. It is axiomatic that the insurer should determine what is covered by the policy it issued. An insurer is not required to pay defense costs properly ascribable to the defense of a noninsured or an uncovered claim. Health-Chem Corp. v. National Union Fire Ins. Co., 148 Misc. 2d 187, 190-191, 559 N.Y.S.2d 435, 437-38 (Sup. Ct. New York County 1990); Sentex Sys. v. Hartford Accident & Indem. Co., 882 F.Supp. 930, 947 (C.D. Cal. 1995) aff'd 93 F.3d 578 (9th Cir. 1996)(although insurer wrongfully refused to defend, it was not liable for that portion of the defense costs incurred solely because of the non-covered claims); Transport Ins. CO. v. Lee Motor Freight, Inc., 487 F. Supp 1325,

1332 (ND Tex 1980)(recognizing that insurer is not liable for defense costs allocable solely to noncovered claim); EEOC v. Southern Publishing Co., 894 F.2d 785, 791 (5th Cir. 1990)(Mississippi law)

12. Before this Court can adjudicate the request of Movants as to property of the estate, they should provide the Court with meaningful information as to the claims that are covered and the professionals that are being engaged on such claims. The Court can then determine whether any amount should be authorized, and if so, how to monitor the payment to satisfy itself that the funds are being appropriate used under any authorization given. The SDR believes that an appropriate process would be for movants to submit fee proposals to the Master *in camera* who could then make a recommendation on compensation if any to be provided out of the applicable policy.

13. The SDR requests that until the movants provide specific information to the Court about the claims to be covered and the professionals to be engaged, the Motion be denied.

THEREFORE, the SDR requests that the Motion be denied, and that she have such other and further relief, at law and in equity, to which she is entitled.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this the 7th day of June, 2004, a true and correct copy of the foregoing Request for Production was served via facsimile on all counsel of record as follows:

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