CAUSE NO. GV 204523

THE STATE OF TEXAS	§	**IN THE DISTRICT COURT OF**
	§	
	§	
VS.	§	**TRAVIS COUNTY, TEXAS**
	§	
AMCARE HEALTH PLANS	§	
OF TEXAS, INC. and	§	
AMCARE MANAGEMENT, INC.	§	**200TH JUDICIAL DISTRICT**

DEFENDANTS' REPLY TO PLAINTIFFS' RESPONSE TO THE FIRST AMENDED APPLICATION FOR ADVANCEMENT OF CERTAIN LEGAL EXPENSES UNDER INSURANCE POLICY (AMCARECO, INC., THOMAS J. LUCKSINGER, STEPHEN J. NAZARENUS AND MICHAEL D. NADLER)

TO THE HONORABLE JUDGE OF SAID COURT:

AmCareco, Inc. ("AmCareco"), Thomas S. Lucksinger ("Lucksinger"), Stephen J. Nazarenus ("Nazarenus"), and Michael D. Nadler ("Nadler"), defendants in litigation related to AmCareco file this reply in support of their first amended application for the advancement of certain legal expenses under an insurance policy, and for which would show unto this court the following:

1. In their response, plaintiffs make two points. The first point is that the insurance policies are property of the receivership estate and that they are not available to pay the claims of "general creditors" of the estate, including the defense of individual insureds under the policies. The second point is that even if it is determined that the policies can be used to defend the insureds against the claims brought by the plaintiffs, the fees must be segregated into those pertaining to covered and non-covered causes of action. This reply will address these two points.

Plaintiffs mischaracterize the insurance policies

2. Whether or not the insurance policies are property of the receivership estates of AmCare Texas and/or AmCare Management[1], plaintiffs have ignored the obligations that exist under the policies and are attempting to rewrite the terms of those policies. The policy for which defendants have filed the motion to approve the advancement of fees is a $5 million D&O policy that expressly includes for the payment of defense costs of an "insured" against that limit and thus is an "eroding" policy. Even if the policy is an asset of the receivership estate, it is an asset in its entirety with all of its terms and conditions and not just a portion of those terms and conditions, namely the $5 million limits. The receivership estates, as plaintiffs, are entitled, at most, to the amount of the policy remaining following the subtraction of defense costs if the plaintiffs prevail in this litigation. Any other interpretation impermissibly rewrites the policy, confers benefits that the receivership estate is not entitled to and deprives the individual insured defendants from a proper defense of this case.

3. The individual defendants are contractual beneficiaries of the policies and are not general creditors of the receivership estate as the plaintiffs contend. As such, the use of the policies consistent with their terms and *obligations* is not "wasting" or otherwise "dissipating" an asset in the context of what the injunction was seeking to prevent.[2]

---

[1] Defendants doubt the proceeds of the policy are property of the receivership estates. The named insured is AmCareco, Inc. and its officers and directors and the directors and officers of AmCareco's subsidiaries. *See* D&O Policy Sections II(C) and (I). As such, the proceeds to indemnify and to pay defense costs are not property of the receivership estates in this case. *See also In re Louisiana World Exposition, Inc.*, 832 F.2d 1391 (5th Cir. 1987).

[2] Because defendants contend the policy is not property of the receivership estates, or alternatively, that *at best* the asset of the estates is the policy limits *after* erosion, defendants contend that the injunction does not bar the expenditure of defense costs pursuant to the express terms of the policy. Nonetheless, defendants have filed the motion for approval of the advancement of defense costs out of an abundance of caution and so as to operate openly and without the risk of being accused of violating the injunction.

Segregation of fees is not required

4. Under Texas law, the insurer has a duty to defend its insureds in actions which assert claims that are covered by the insurance policy. *American States Insurance Co. v. Hanson Industries,* 873 F. Supp. 17 (S.D. Tex. 1995). In this case, the insurer and plaintiffs apparently don't contest that the fourth amended petition contains claims that are covered by the insurance policy from which defense costs are sought. Furthermore, if the petition contains both potentially covered and non-covered claims, the insurer must defend the entire suit. *LaFarge Corp. v. Hartford Casualty Insurance Co.,* 61 F.3d 389 (5th Cir. 1995).

5. The plaintiffs do not cite a single case under Texas law in which a receiver for a failed insured could bar, or even apportion, the payment of defense costs of individual insured defendants on the basis that its constitutes a waste of estate assets. Apportionment, to the extent it has been recognized as appropriate in the case law in jurisdictions other than Texas, such as the jurisdictions cited by plaintiffs, involves the right of the insurer to seek that relief and is not a right that may be enforced by a plaintiff. The cases cited by plaintiffs are either clearly distinguishable from the right of the plaintiff to require apportionment and even support the defendants' position. For example, in *Gon v. First State Insurance Co.,*871 F.2d 863 (9th Cir. 1989), the issue did not involve an attempt by a receiver to prohibit or apportion the payment of defense costs. Instead, the case involved a lawsuit by the individual insured defendants to compel the insurance company to pay their entire defense costs, which the insurer was resisting. The Court held that the policy language compelled the insurer to pay the legal expenses "as soon as the services were rendered". *Id.* at 868. With regard to the issue of the apportionment of fees for covered and non-covered claims, the Court held that the *insurer* was entitled (but not

required) to apportion legal expenses between these claims, but "cannot do so at the expense of the insured". *Id.* The Court further held that where the nature of the claims made in the complaint do not indicate whether they would be covered or uncovered, the apportionment issue is more difficult. As the Court said: "where, for example, the defense of a claim based on an alleged act would be covered if the act were committed negligently, but would not be covered if it were committed intentionally, apportionment *in advance* would be very difficult, *if not impossible". Id. (emphasis added).* In *Gon,* the apportionment of fees was not feasible and the court said two important policy reasons supported its determination that apportionment was not required and that all legal expenses should be paid as incurred. Those two policy reasons are: that the plaintiff should not be the arbiter of the policy's coverage and apportioning legal expenses where coverage is not yet clear may deny the insureds the benefits of the protection they purchased. *Id.* at 869. *Accord, Okada v. MGIC Indemnity Corp.,* 823 F.2d 276 (9th Cir. 1986) also cited by plaintiffs. Just as in these cases, the apportionment of fees for work on claims that would be clearly not covered, if any, is impossible to separate from the work on claims that are covered, and apportionment should not be required, particularly since the insurer is not seeking an apportionment remedy.

6. In *Safeway Stores, Inc. v. National Union,* 64 F.3d 1282 (9th Cir. 1995) cited by the plaintiffs, Safeway filed suit against its D&O insurer seeking reimbursement for the settlement paid, the plaintiff's attorney's fees and the defense legal fees. The District Court apportioned one-quarter of the defense costs to Safeway, and ordered the insurer to pay three-quarters of the defense costs. On appeal, the Court of Appeals reversed and ordered the insurer to pay all of the defense costs, effectively overruling any apportionment. The Court held that: "Defense costs are thus covered by the D&O policy if they are reasonably related to the defense

of the insured directors and officers, even though they may have been useful in defense of the uninsured corporation". *Id.* at 1289. As the plaintiffs say in their response, "it is axiomatic that the insurer should determine what is covered by the policy it has issued". *See plaintiffs' opposition, paragraph 12.* In the instant case, the D&O insurer has not requested an apportionment of the fees and therefore it has apparently made the determination that apportionment is not appropriate and/or feasible at this stage of the litigation. *Accord, EEOC v. Southern Publishing Co.,* 894 F.2d 785 (5th Cir. 1990); *Insurance Company of North America v. Forty-Eight Insulations,* 633 F.2d 1212 (6th Cir. 1980), *clarified,* 657 F.2d 814 (6th Cir.) *cert. denied,* 454 U.S. 1109 (1981); *LaFarge Corp. v. Hartford Casualty Insurance Co.,* 61 F.3d 389. The insurers's decision is reasonable and supported by the cited case law.

7. For the reasons cited, the Special Master should recommend approval of the payment of the costs of defense as either not prohibited by the permanent injunction or as permitted by the circumstances of this case. Due process to the insured defendants requires that they be given the opportunity to conduct a full and vigorous defense against the substantial claims made against them in this lawsuit, to be paid for as provided by the insurance policies in place, without interference from the plaintiffs who are asserting those claims.

WHEREFORE, PREMISES CONSIDERED, the AmCareco Defendants pray that their application is granted and that the Court award such other and further relief as necessary.

Respectfully submitted,

Adams and Reese LLP

By: Mark Elvig by permission MSJ

Daryl G. Dursum
State Bar No. 06287900
Mark F. Elvig
State Bar No. 06594200
Erin H. Patterson
State Bar No. 10297500
4400 One Houston Center
1221 McKinney Street
Houston, Texas 77010
Telephone: (713) 652-5151
Telecopier: (713) 652-5152

ATTORNEYS FOR DEFENDANTS
THOMAS S. LUCKSINGER, an Individual,
MICHAEL D. NADLER, an Individual
STEPHEN J. NAZARENUS, an Individual
AMCARECO, INC., a Delaware Corporation

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing motion with proposed consent order has been served on all counsel of record in accordance with Rules 21 and 21a, Texas Rules of Civil Procedure, on this 9th day of August 2004.

R. James George, Jr.
George & Brothers, L.L.P.
114 W. Seventh Street
Suite 1100
Austin, Texas 78701

Guy M. Hohmann
T. Wade Jefferies
Hohmann, Taube & Summers, L.L.P.
100 Congress Avenue
Suite 1600
Austin, Texas 78701-2746

Harold B. Gold
Robert H. Nunnally, Jr.
Wisener Nunnally, L.L.P.
625 W. Centerville Road
Suite 110
Garland, Texas 75041

Attorneys for Plaintiff

H. Robert Powell
John Garda
Renee Hughes
Hughes & Luce, LLP
111 Congress Avenue
Suite 900
Austin, Texas 78701

Attorneys for Defendant PricewaterhouseCoopers, LLP