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IN THE SUPREME COURT OF THE STATE OF MISSISSIPPI
No. 2010-CC-00076

MISSISSIPPI WINDSTORM UNDERWRITING ASSOCIATION	**APPELLANT**
v.	
UNION NATIONAL FIRE INSURANCE COMPANY, et al.	**APPELLEES**

ON APPEAL FROM THE CHANCERY COURT OF HINDS COUNTY, MISSISSIPPI FIRST JUDICIAL DISTRICT

BRIEF OF APPELLEE/CROSS-APPELLANT, AEGIS SECURITY INSURANCE COMPANY

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v.

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CERTIFICATE OF INTERESTED PARTIES

The undersigned counsel of record certifies that the following listed persons and entities have an interest in the outcome of this case. These representations are made in order that the Justices of the Supreme Court and/or Judges of the Court of Appeal may evaluate possible disqualification or recusal.

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STATEMENT OF ISSUES

1. Did the Chancery Court err in upholding the Mississippi Windstorm Underwriting Association's ("MWUA") decision to calculate assessments arising from Hurricane Katrina based upon the grouping of affiliated insurance companies when such grouping was illegal and the MWUA had previously acknowledged that such grouping was illegal?

2. Should the Chancery Court be affirmed to the extent it invalidated MWUA's calculation of assessments arising from Hurricane Katrina based upon inaccurate reports of the underwriting of mobile homes and ordered MWUA to recalculate the assessments based upon accurate reports?

STATEMENT OF THE CASE

I. Nature of the Case, Course of Proceedings, and Disposition Below

Following Hurricane Katrina, MWUA assessed Aegis $15,882,733, although Aegis is a small insurer that does a small amount of underwriting in Mississippi. While Aegis suffered this huge assessment, other companies, that were protected by the grouping of financial data or failed to report properly their insurance on mobile homes, were assessed far less. Due to the disproportionate size of its assessment, Aegis filed an appeal with MWUA. Aegis identified two flaws in the assessment process in its challenge:

1. MWUA allowed affiliated companies to report their data as a group even though the governing statute barred grouping, which caused huge inequities in Hurricane Katrina assessments; and

2. MWUA failed to obtain correct information from insurance companies that had improperly misclassified insurance written on mobile homes, which resulted in MWUA improperly increasing the assessments on companies that had made accurate reports.

(RV 43 at 3370-3371). These were the only issues Aegis raised in its appeal, and they continue to be the only issues Aegis advances before this Court.

The MWUA denied Aegis's appeal by letter dated June 13, 2008 (RV 43 at 3372-3390), and Aegis appealed to the Commissioner of Insurance. (RV 43 at 3391-3392). The Commissioner consolidated Aegis's appeal with the appeals of seven other insurers and denied all of the appeals in his February 11, 2009 Consolidated Findings, Conclusions, and Order (the "Commissioner's Decision"). (RE Tab 10[3], RV 14 at 1901-1950). The Commissioner denied Aegis's appeal despite his recognition that MWUA's disproportionate assessment against Aegis resulted in large part from the "profoundly negative impact" that MWUA's practice of grouping had on Aegis and despite uncontradicted evidence that small insurers like Aegis were

[3] Designations to "RE" refer to the Record Excerpts filed in this Court by MWUA.

particularly and disproportionately affected by grouping. The MWUA and the Commissioner focused on protecting the assessment process MWUA created and implemented. In doing so, they erred by upholding MWUA's illegal methods of calculating assessments that severely and disproportionately affected Aegis.

Aegis and the other seven insurers appealed to the Chancery Court of Hinds County, First Judicial District, which consolidated the appeals and on December 15, 2009 reversed in part and affirmed in part (the "Chancery Court Order"). (RE Tab 6; RV 29 at 4159-4199). With regard to the issues raised by Aegis, the Chancery Court denied Aegis's challenge to the legality of grouping[4] but upheld Aegis's challenge to MWUA's calculation of assessments based on inaccurately reported mobile home underwritings.[5]

All of the parties that actively participated before the Chancery Court have appealed to this Court. Having filed its notice of appeal first, MWUA has been designated the appellant, and the eight insurance companies have been designated appellees. Aegis appeals from that part of the Chancery Court Order that upheld MWUA's illegal practice of grouping insurance companies when calculating assessments. In addition, Aegis opposes MWUA's appeal from that part of the Chancery Court Order that directs MWUA to recalculate assessments based upon accurate information concerning mobile home underwritings. The Chancery Court Order should be reversed to the extent it upheld the illegal practice of grouping but affirmed to the extent it corrected the injustice caused by calculating assessments based upon reports that improperly excluded mobile home underwriting.

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[4] Union National Fire Insurance Company and Homesite Insurance Company also challenge MWUA's decision to permit grouping.

[5] Union National Fire Insurance Company, Homesite Insurance Company, and Farmers Insurance Group of Companies also challenge MWUA's practice of calculating assessments based on inaccurately reported mobile home underwritings.

II. Statement of Facts

A. The MWUA Partnership

The Mississippi Legislature established the MWUA to provide sufficient windstorm and hail insurance for property owners in six storm-prone Mississippi coastal counties. *See* MISS. CODE ANN. §83-34-7 (Historical and Statutory Notes).[6] Under that law, insurers were required to be MWUA members to "write and engage[] in writing property insurance within this state on a direct basis." *See* MISS. CODE ANN. §83-34-3. Legally, the MWUA is a partnership with more than 300 partners. MWUA's members are the partners.

MWUA's members participate in its profits and losses through assessments that pay for reinsurance or shortfalls in reinsurance in a particular year. The applicable statute requires assessments to be based on the amount of wind and hail insurance written in Mississippi by each of its individual members:

> All members of the association shall participate in its writings, expenses, profits, losses, in the proportion that the net direct premiums of each such member written in this state during the preceding calendar year bears to the aggregate net direct premiums written in this state by all members of the association, as certified to the association by the commissioner after review of annual statements, other reports and any other statistics the commissioner shall deem necessary to provide the information herein required and which the commissioner is hereby authorized and empowered to obtain from any member of the association.

See MISS. CODE ANN. §83-34-9 (emphasis added). The statute further provides that such assessments are to be reduced based on credits earned for writing wind and hail insurance policies in the coastal counties:

> A member shall, in accordance with the plan of operation, annually receive credit for essential property insurance voluntarily written in a coast area, and its participation in the writings of the association shall be

[6] The statute governing MWUA, Miss. Code Ann. §83-34-1, et seq., was amended under the 2007 Mississippi Economic Redevelopment Act. The prior version of the statute applies here.

> reduced in accordance with the provisions of the plan of operation. Each member's participation in the association shall be determined annually in the manner provided in the plan of operation.

See MISS. CODE ANN. §83-34-9 (emphasis added).

Pursuant to MISS. CODE ANN. §83-34-13, the MWUA adopted a Plan of Operation (RE Tab 11; RV 2 at 97-103) and a Manual of Rules and Procedures (RE Tab 12; RV 3 at 232-238), both of which were reviewed and approved by the Department of Insurance. The Plan of Operation, Section IX.2 (RE Tab 11 at 100; RV 2 at 100), repeated the language of MISS. CODE ANN. §83-34-9 essentially verbatim. In addition it also set forth the credit for voluntary underwriting as follows:

> a member shall annually receive credit for Essential Property Insurance voluntarily written and its participation in the writings of the Association shall be reduced accordingly, except all members shall participate in the first 10% of losses. Its participation in the expenses of the Association shall not be reduced thereby.

(*Id.*). Significantly, neither the Plan of Operation nor the Manual of Rules and Procedures makes any reference to grouping.

Historically, and after Hurricane Katrina, MWUA determined member assessments and credits by calculating participation percentages. Specifically (with the exception of members who misreported their mobile home writings), all members paid their share of 10% of the Hurricane Katrina loss based on the percentage that their net direct premiums written in the state bore to the total net direct premiums written in the state. As to the remaining 90% of the loss, a member would not have to pay any assessment if the member wrote its "required voluntary premiums." If a partner did not write its required voluntary premiums, that member, like Aegis, would receive an assessment for a portion of the remaining 90% of the loss. (*See e.g.* REA Tab 2 at 2760; RV 42 at 2760 under seal at Volume A, and RV 42 at 2966).

B. Aegis's History As A MWUA Member

Aegis writes insurance for mobile homes and extended coverage dwellings in Mississippi and has been a licensed insurance carrier in the state since 1985. (REA Tab 3 at 2828; RV 42 at 2828 under seal at Volume A). Aegis is a small insurer in comparison to Allstate, CNA, Fireman's Fund, and many other MWUA members.

Aegis has been a member of MWUA since it was created in 1987, and over the years, Aegis has accurately reported its insurance underwritings to MWUA, received distributions of excess funds from MWUA, and paid MWUA's storm assessments. (*See generally*, RV 43 at 3128-3369 under seal at Volume B). When paying MWUA's assessments, Aegis has relied on MWUA to accurately and lawfully calculate the assessments. (*See* RV 43 at 3094–3108; 3094-3107 are under seal at Volume B). Given the fact that each member's assessment affects the other members' assessments, Aegis has also relied on its fellow MWUA members to report their financial information to MWUA accurately. (May 14, 2008, Chancery Court Agreed Order of Consolidation and Scheduling, ¶6; RV 3 at 349).

C. Aegis Suffered A Massive And Unfair Katrina Assessment, While Other MWUA Members Improperly Benefited at Aegis's Expense

Aegis's massive $16,000,000 Hurricane Katrina assessment was made in three separate payments. Initially, in a letter dated August 31, 2005, MWUA assessed Aegis $232,070 related to Hurricane Katrina losses. This assessment was based on participation percentages of 0.941% of the first 10% of the Hurricane Katrina loss and 2.474% of the remaining 90% of the Hurricane Katrina loss. (REA Tab 2 at 2757; RV 42 at 2757 under seal at Volume A). Then, in its letter of December 2, 2005, MWUA assessed Aegis $6,613,995 related to Hurricane Katrina losses. This assessment was also based on participation percentages of 0.941% of the first 10% of the loss and 2.474% of the remaining 90% of the loss. (REA Tab 2 at 2758; RV 42 at 2758

under seal at Volume A). Finally, under cover of an April 16, 2006, letter, MWUA assessed Aegis an additional $9,036,668 related to Hurricane Katrina losses. This figure was based on recalculated participation percentages of 0.985% of the first 10% of losses and 3.129% of the remaining 90% of losses. (REA Tab 2 at 2760-2762; RV 42 at 2760-62 under seal at Volume A). Aegis paid each of these assessments.

In contrast to some MWUA members, Aegis accurately and timely reported its financial information to the MWUA, including through an amended Insurer Report for 2004 writings (REA Tab 3 at 2827-2829; RV 42 at 2827-2829 under seal at Volume A), but it was penalized for doing so, as the following points demonstrate:

1. At the time of the Hurricane Katrina assessments, Aegis had $2,700,000 of net direct premiums subject to assessment, making its $16,000,000 Hurricane Katrina assessment almost six times larger than its assessable writings. (*See* Recalculated Statement of Participation, Items 3 and 17, REA Tab 2 at 2760; RV 42 at 2760 under seal at Volume A).

2. At the time of the Hurricane Katrina assessments, Aegis had a policyholder surplus of $32,000,000, which meant that the Hurricane Katrina assessment was about 50% of that surplus. (RV 42 at 2765-2767 under seal at Volume A).

3. Aegis's recalculated participation percentage of 3.129% for the remaining %90 of Hurricane Katrina losses was more than three times Aegis's percentage of total net direct premiums, was the ninth largest participation percentage of all MWUA members, and was greater than the percentages calculated for Allstate, CNA, Fireman's Fund, and other major insurers. (REA Tab 4; RV 43 at 3109-3111).

MWUA's unauthorized and improper reliance on grouped financial information and its knowing acceptance of reports filed by some members that improperly failed to report mobile home premiums, each of which will be discussed in more detail below, significantly contributed to the disparity in Aegis's assessment. The grouping and mobile home issues caused many millions of dollars of losses to be disproportionately borne by Aegis and other insurers that could not group with affiliated companies and that reported their financial information accurately. Accordingly, MWUA members that arbitrarily benefited from grouping and that failed to disclose material financial information were able to reduce their assessment obligations at the expense of other members, including Aegis.

D. MWUA Permitted Grouped Financial Information Even Though Grouping Had No Lawful Basis And The MWUA Never Analyzed The Legal And Financial Issues Grouping Raised

1. Affiliated Companies Were Permitted To Group Their Financial Information

Each year MWUA members had to submit an Insurer's Report to MWUA. The Insurer's Reports had a section, usually section IV, for members reporting their financial information on a group basis. (*See e.g.* REA Tab 3 at 3189; RV 43 at 3189 under seal at Volume B). MWUA used the financial information from those reports to calculate member's participation percentages, including for the Hurricane Katrina assessments.

Although the applicable statutory language and provisions of the Plan of Operation required assessments to be made for each member and although MWUA never adopted a rule or regulation authorizing grouping, MWUA allowed its members that were affiliated companies to report financial data on a group basis, and MWUA calculated their assessments on a group basis. (REA Tab 5; RV 42 at 2768, and RV 42 at 2904-2905). Group reporting permitted affiliated companies to submit on a collective basis the financial information required on the

Insurer's Report to the MWUA, rather than having each member submit its financial data individually. (*See e.g.* REA Tab 6; RV 42 at 2770 & 2813-2815 under seal at Volume A). MWUA then calculated Hurricane Katrina assessments based on group submissions instead of on each member's individual financial information.

Under this method of calculation, MWUA permitted each member of a group to benefit from the credits MWUA gave other members of the group for voluntarily writing insurance policies in the storm-prone coastal counties. Specifically here, grouping enabled a group member that had not written the required voluntary premiums to obtain credits and escape its proper assessment on the 90% portion of the Hurricane Katrina loss. In other words, even where an individual member did not have the right to credits based on its own writings, MWUA awarded it credits based on the writings of an affiliate.

Aegis and the other members that had no affiliates writing property insurance in Mississippi could not group, were not able to share credits, and were unfairly and disproportionately affected as a result.

2. In 2006, MWUA Recognized That Grouping Was Illegal But Only Stopped The Practice Prospectively

While MWUA and its predecessor permitted the grouping of financial data for well over 20 years, MWUA did not evaluate whether the applicable laws, Plan of Operation, or Manual of Rules and Procedures allowed grouping. Indeed, apparently the first time MWUA considered the legality of grouping was in or about October 2006 after receiving advice from its counsel that grouping was illegal. On November 7, 2006, MWUA acknowledged that grouping was illegal and sent a memorandum to MWUA's members who engaged in grouping notifying them that grouping was not permitted under the statutes governing MWUA:

> It has come to our attention that the statutes that create and govern MWUA do not allow for the use of group numbers in the determination of percentages of participation. Like Statutory Annual Statements, the data for MWUA must be by Member company and not by groups of member companies. Each insurance company writing property insurance in Mississippi is a separate Member of MWUA and must submit its own separate data.

(REA Tab 7; RV 42 at 2840) (emphasis added). The testimony of MWUA's manager, Joe Shumaker, provided at a hearing before the Deputy Insurance Commissioner, confirmed that MWUA recognized the illegality of grouping:

> Q. Okay. And we can agree, can we not, Mr. Shumaker, that the statutes have never allowed for the use of group numbers, correct.
>
> A. It's my understanding, yes.

(RV 42 at 2905).

Not only was grouping contrary to the statute and MWUA's Plan of Operation, MWUA allowed grouping without any reasoned basis. MWUA permitted grouping on the rationale that it encouraged MWUA members to voluntarily write property insurance in the six storm-prone counties. (RV 42 at 2908-2909)(Shumaker testimony). MWUA, however, did not present evidence that MWUA had studied that issue or that grouping actually succeeded in producing more voluntary writings. Moreover, MWUA did not present any evidence that MWUA had analyzed the effect of grouping on MWUA's non-grouping members.

Even more arbitrary was MWUA's decision to continue to use grouping in calculating the 2004 and 2005 Hurricane Katrina assessments after MWUA recognized that grouping was illegal. The 2004 and 2005 assessment years were still open in 2006 when MWUA recognized the illegality of its method of calculating assessments, but MWUA did not take steps to correct the illegality in the Hurricane Katrina assessments. Instead, MWUA advised its grouped members that they would not be permitted to file group reports in 2006, but MWUA chose to

perpetuate its unlawful method of calculating with regard to the Hurricane Katrina assessments. MWUA left the 2004 and 2005 assessments unchanged and for those years continued to grant credits for voluntary underwriting to companies that had not earned the credits. This decision materially benefited both the Allstate group and the State Farm group of companies, each member of which was assessed $0 on the remaining 90% of the Hurricane Katrina losses. It is noteworthy that the chairperson of the MWUA Board of Directors was a representative of Allstate, and a representative of State Farm was another Board member. (REA Tab 1 at 2523; RV 41 at 2523 under seal at Volume A, and REA Tab 10 at 2750; RV 42 at 2750 under seal at Volume A).

3. The Use Of Grouped Financial Information Had A Dramatic And Harmful Effect On Aegis

MWUA's failure to consider the effect of grouping and MWUA's failure to correct the illegality in the Hurricane Katrina assessments are alarming given the dramatic and harmful effect grouping had on Aegis.[7] At the time of Hurricane Katrina, MWUA had more than 300 members. Discovery disclosed that approximately 190 members – well more than 50% - reported in groups. (*See* RV 42 at 2769-2826 under seal at Volume A). Because of the large number of grouped companies, the financial results of grouping were enormous. MWUA members that would otherwise have to share in paying the 90% portion of the Hurricane Katrina loss paid little or nothing, and therefore benefited from grouping. Companies that did not group, such as Aegis, were left to cover huge losses that should have been shared among more member companies.

[7] Exact loss computations are impossible due to the unavailability of data. The President of Union National Fire Insurance Company testified that the economic impact of grouping was about $80,000,000. (RV 42 at 2894-95). Table A, which includes an example of pro-rata assessment, and which is the only reference point until a full, proper recalculation is done, shows that Aegis's pro-rata assessment would be $5,500,000, which is $10,500,000 less than what was assessed to Aegis, and paid.

TABLE A[8]
MWUA And Aegis Facts

Total Member Companies (Note 2)	350
Total Net Direct Premiums 2004	279,000,000
Total Katrina Assessment	545,000,000
Average Premiums Per Member (279,000,000/350)	800,000
Average Assessment Per Member (545,000,000/350)	1,500,000
Aegis pro rata % of total net direct premiums (279,000,000/2,700,000 (Note 3))	1%
Aegis pro rata % of total Katrina assessment (545,000,000 x .01)	$5,450,000

The table below is illustrative of the effects caused when the credits for voluntary underwriting are spread over an entire group. Had the voluntary underwriting credits been granted only to the companies that earned them, the wild divergence in contributions would have been reduced.

[8] The data for Table A and B is derived from REA Tab 2 at 2760; RV 42 at 2760 under seal at Volume A, and from REA Tab 8; RV 43 at 3415-3417 under seal at Volume B.

TABLE B[9]
Aegis Compared To Grouped Companies

	AEGIS (Not Grouped)	ALLSTATE GROUP	STATE FARM GROUP
No. in group	1	8	3
Net Direct Premiums 2004	$2,753,000	$21,866,000	$63,120,000
Katrina Assessment on First 10% of Loss	$537,000	$4,264,000	$12,309,000
Katrina Assessment on Remaining 90% of Loss	$15,346,000	0	0
Total Katrina Assessment	$15,883,000	$4,264,000	$12,309,000
Katrina Assessment as % of Net Direct Premiums	593%	18%	19%

In testimony before the Mississippi Insurance Department, the President of Appellee/cross-appellant Union National Fire Insurance Company ("UNFIC") estimated that the economic effect of grouping could be $80,000,000. (RV 42 at 2894-2895). That means there could be at least $80,000,000 of losses that were assessed against non-grouped members,

[9] The data for Table A and B is derived from REA Tab 2 at 2760; RV 42 at 2760 under seal at Volume A, and from REA Tab 8; RV 43 at 3415-3417 under seal at Volume B.

like Aegis, that should have been assessed against members of groups that had not written voluntary policies in the six county coastal region.[10]

E. MWUA Failed To Address The Effect On The Assessment Process Of Members That Failed To Report Their Premiums For Mobile Homes

1. Aegis Was Prejudiced Due To The Failure Of Other MWUA Members To Report Their Mobile Home Premiums To MWUA

Aegis reported its mobile home insurance writings to the MWUA and the Mississippi Insurance Department. (*See* e.g., REA Tab 3 at 2827-2829; RV 42 at 2827-2829 under seal at Volume A). Doing so prejudiced Aegis in the MWUA assessment process because other members did not report their mobile home writings, allowing them to escape or reduce assessments that Aegis and other members bore. The mobile home issue has not been resolved, and while its precise financial effect on MWUA assessments is not presently known, it is likely to be significant, as explained below.

The net direct premiums that must be reported to MWUA include premiums "written for coverage on mobile homes at a fixed location." (Mississippi Insurance Department Bulletin 2006-6, RE Tab 16; RV 36 at 767-768). Despite that, there are MWUA members that did not report mobile home premiums to the MWUA, but instead, took steps to shield those premiums from disclosure. Some MWUA members reported their mobile home writings under the

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[10] Another illustration of grouping's harmful impact exists within these appeals. Through its appeal, the Farmers Group of Insurance Companies seeks to group its financial data with the Foremost Insurance Group. Since Farmers did not seek to group within MWUA's deadlines, MWUA denied Farmer's belated effort to group with Foremost. Given that Foremost had credits for voluntary writings that Farmers could share if Farmers was permitted to group with Foremost, grouping may reduce Farmer's $40,000,000 assessment by about one-half, or $20,000,000. (See, RV 43 at 3116 and 3120-3121; 3120-3121 are under seal at Volume B). If Farmers' grouping is permitted, this $20,000,000 would be redistributed to other MWUA members, including Aegis, compounding the injuries Aegis and members like it have suffered.

category of "Auto Physical Damage" on statements filed with the Insurance Department. (RV 42 at 2886).

MWUA members that excluded their mobile home writings from the MWUA assessment process in this unlawful manner lowered their reported net direct premiums and, therefore, their assessments for the 10% of the Hurricane Katrina losses. That, in turn, reduced any assessment such members had for the 90% portion of the Hurricane Katrina loss. The actions of these members in unlawfully excluding their mobile home writings were harmful to their fellow members, including Aegis, that were burdened with higher assessments.

2. MWUA Was Aware of the Mobile Home Reporting Issue

Aegis may have been the first to alert MWUA to the mobile home reporting issue. As a mobile home insurer, Aegis recognized that the failure to report mobile home writings was a material issue, and on February 28, 2006, Aegis notified MWUA:

> We are requesting that the Association pay particular attention to those carriers licensed and admitted in Mississippi who may be writing mobile homeowner's policies but may not be reporting them correctly to the Association.

(REA Tab 3 at 2828; RV 42 at 2828 under seal at Volume A). Not long after, MWUA acknowledged there was a problem with mobile home premium reporting. The minutes of MWUA's May 9, 2006, Executive Session state as follows:

> There was also a discussion concerning treatment of some companies which may not have reported premiums correctly regarding coverage on mobile homes. Greg Copeland advised that it was the Insurance Department's responsibility to first obtain an accurate report of premiums, then the MWUA would take appropriate action concerning any adjustments to MWUA's participation percentages.

(REA Tab 9; RV 42 at 2756 under seal at Volume A).

Recognizing that the failure to report mobile home premiums was unlawful and a significant problem, the Mississippi Insurance Department issued a May 16, 2006, bulletin to "all licensed insurance companies writing property and casualty insurance in the State of Mississippi." The bulletin explained the proper accounting treatment of such premiums and how to amend financial statements that did not follow that approach. (RE Tab 16; RV 36 at 767-768).

3. The Failure To Report Mobile Home Premiums Affected The MWUA Assessment Calculation

The failure of certain MWUA members to report mobile home premiums affected the Hurricane Katrina assessment calculations. Although the precise effect is not presently known, the available information suggests that millions of dollars have been unlawfully excluded from the Hurricane Katrina assessment calculations. For example, the minutes of a July 28, 2006, MWUA Board meeting show that the mobile home reporting failures of just two MWUA members, American Modern Home and American Family Homes, unlawfully excluded millions of dollars from the Hurricane Katrina assessment calculations:

> First was the issue of American Modern Home and American Family Homes reporting their mobile home writings under the automobile lines of coverage. This issue is being addressed by the Mississippi Insurance Department (MID) and the MID has directed them to go back two years and correct their reports. Both companies are challenging this ruling by the MID along with revisions to the MWUA Report of Premiums to reflect removal of mobile home coverage from the automobile line of coverage. Revising their report of premiums could result in an additional Hurricane Katrina assessment of almost $10,000,000 for those companies.

(REA Tab 10 at 2752; RV 42 at 2752 under seal at Volume A)(emphasis added).

F. MWUA Knew From The Start That Its Assessment Process Would Harm Small Companies, Like Aegis, But Made No Effort To Find Solutions

Just months into the Hurricane Katrina assessment process, MWUA knew that its methods of calculating assessments disproportionately harmed small insurance companies, some severely, but did not take any meaningful steps to address such problems. The minutes of a December 13, 2005, meeting of the MWUA Board state as follows:

> Commissioner Dale expressed concern over the impact this assessment will have on the financial status of the member companies. It is believed that some of the smaller companies could be severely impacted by this assessment. Lee Harrell advised the law allows companies to request the Insurance Department to grant a deferral from the assessment provided it presents a financial hardship to the company. The Insurance Department anticipates several companies will request a deferral. Greg Copeland explained that the remaining companies will be required to pay the deferred assessments until such time the company which received the deferral has time to pay its assessment along with interest.

(REA Tab 11 at 2859; RV 42 at 2859 under seal at Volume B)(emphasis added). Rather than correcting the disproportionate impact, MWUA made no changes to its methods of calculating assessments.

Moreover, after MWUA recognized that grouping violated its governing statute, (REA Tab 7; RV 42 at 2840), MWUA took no steps to eliminate the impact of grouping on the Hurricane Katrina assessment calculations. Rather, MWUA left grouping in place for the Hurricane Katrina assessments. MWUA did so purportedly on the rationale that since grouping had been allowed in the past those that grouped should be permitted to continue to do so. MWUA did not present any testimony or documents that MWUA made this choice in favor of grouping after considering if there was a way to assist non-grouping companies like Aegis which had unfairly borne the financial burden of the assessments.

G. The Insurance Commissioner Upheld Aegis's Hurricane Katrina Assessment Based On Grouping And Ruled That The Mobile Home Reporting Issue Was Not Ripe For Review

The Insurance Commissioner's February 11, 2009, Order upheld MWUA's $16,000,000 assessment on Aegis. The Commissioner reached this decision despite his recognition that the assessment was "extraordinary" and had a "profoundly negative impact" on Aegis. (RE Tab 10 at 1946; RV 14 at 1946). The Commissioner justified this conclusion in part by finding that allowing grouping was not an unreasonable interpretation of the MWUA statute. (RE Tab 10 at 1919-1921 & 1945-1946; RV 14 1919-1921 & 1945-1946). The Commissioner further reasoned that grouping never was challenged until the Hurricane Katrina assessments and that those challenging it were too late in doing so. (Re Tab 10 at 1946; RV 14 at 1946). And the Commissioner noted that in 2007 the Mississippi legislature amended the MWUA statute to allow grouping. (RE Tab 10 at 1921 n.2 & 1946; RV 14 1921 n.2 & 1946). Additionally, the Commissioner ruled that the issue of misreporting mobile home premiums was not ripe for review:

> The issue of purported misreporting of mobile home premiums is still under review by the [Mississippi Insurance Department] and has not been concluded. While significant progress has been made by the MID, it is the opinion of the Commissioner that this issue is not ripe for review.

(RE Tab 10 at 1947; RV 14 at 1947).

H. The Chancellor Upheld MWUA's Calculation of Assessments Based Upon Grouping But Ordered MWUA To Recalculate The Hurricane Katrina Assessments Utilizing Accurate Mobile Home Reports

The Chancery Court reversed in part and affirmed in part. The Chancery Court denied Aegis's challenge to the legality of grouping and held that the controlling statute, MISS. CODE ANN. 83-34-9, did not preclude grouping:

> This Court is unconvinced that this statute grants any rights to Aegis, Homesite, and Union National Fire regarding grouping in any manner. As the Commissioner found, nothing in the statute prohibits group reporting.

(RE Tab 6 at 4193; RV 29 at 4193). However, the Chancellor upheld Aegis's challenge to MWUA's calculation of assessments based on inaccurately reported mobile home underwritings and ordered MWUA to recalculate the Hurricane Katrina assessments based on member reports that accurately classify mobile home underwritings. (RE Tab 6 at 4193-4197; RV 29 at 4193-4197).

SUMMARY OF ARGUMENT

Under any applicable standard of review, the Insurance Commissioner's decision must be reversed to the extent it upheld MWUA's practice of calculating the Hurricane Katrina assessments for groups of affiliated companies. This practice violated the terms of the statute that established MWUA as well as MWUA's Plan of Operation, both of which expressly required that MWUA calculate assessments for each member individually. MWUA may not violate its governing statute or its Plan of Operations. Moreover, even if the statute and Plan of Operation did not preclude grouping, it would be illegal because grouping exceeded MWUA's authority, in that nothing in the statute, the Plan of Operation or MWUA's Manual of Rules and Procedures authorized grouping. MWUA has illegally acted in excess of its authority.

MWUA expressly recognized the illegality of grouping and in November 2006 prospectively stopped the practice, but MWUA's Board of Directors decided to preserve the effects of illegal grouping for the Hurricane Katrina assessments. The decision not to correct the calculations underlying the Hurricane Katrina assessments was illegal and violated MWUA's statutory duty to administer the association in a "fair and nondiscriminatory" manner.

The decision was made without explanation and arbitrarily burdened MWUA members that did not file in groups.

MWUA counsel's assertion, that the reliance of members that had filed in groups justifies the perpetuation of the illegal calculations, must be rejected. An alleged balancing of equities cannot justify violations of statutory law, and there is no evidence that any reliance interest of the group filers exceeded the clear harm to the non-group filers. Additionally, if the group filers actually have a reliance claim against MWUA, then all MWUA members should share that liability, and MWUA should not be permitted to shift its liability to its non-group members, such as Aegis. Moreover, Aegis timely objected to MWUA's practice of calculating assessments in groups, and the Insurance Commissioner and the Chancellor both erred by asserting that MWUA's decision not to correct the illegal assessments was justified by the absence of an earlier objection by non-group members.

The Chancellor should be affirmed, however, in ordering MWUA to recalculate the Hurricane Katrina assessments to correct for the mis-reporting of mobile home underwritings by certain members. MWUA was aware of this mis-reporting but arbitrarily elected not to recalculate the Hurricane Katrina assessments using correct information, to the detriment of Aegis and other MWUA members whose assessments were thereby increased. Without such a recalculation, Aegis and the other members that filed accurate reports of mobile home underwritings will never be made whole. The Chancellor correctly determined that the Insurance Commissioner erred in holding that the issue was not ripe. This proceeding is Aegis's only forum in which to challenge its assessment, and declaring the issue unripe will deprive Aegis of ever receiving a review. It was arbitrary for MWUA not to recalculate the assessments using correct information concerning mobile home underwritings, which would

ensure that MWUA's members were accurately assessed for Hurricane Katrina, and therefore this element of the Chancellor's decision should be affirmed.

ARGUMENT

I. The Chancery Court Order Upholding Grouping Should Be Reversed Under A *De Novo* Standard Of Review And Is Reversible Even Under A Deferential Standard Of Review

MWUA is not a state agency and, therefore, its decisions concerning grouping and mobile home reporting – as well as the Insurance Commissioner's Decision upholding the MWUA - are reviewed by the courts *de novo* and are not entitled to deference. *See Owens Corning v. Mississippi Insurance Guaranty Association*, 947 So.2d 944, 945 (Miss. 2007).

Moreover, the Insurance Commissioner's Decision should be reversed even under a deferential standard of review that evaluates whether his decision is: (1) not supported by substantial evidence; (2) arbitrary or capricious; (3) outside of the Commissioner's authority; or (4) in violation of statutory or constitutional rights. *See Shelter Mutual Insurance Co. v. Dale*, 914 So.2d 698 (Miss. 2005). Indeed, the Commissioner's Decision upholding grouping and the calculation of assessments based upon inaccurate reports concerning mobile home underwriting should be reversed because they violated Aegis's statutory rights, exceeded MWUA's authority, and were arbitrary and capricious.

II. The Chancery Court Erred In Ruling That MWUA's Decision To Allow Grouping Was Permitted Under The MWUA Statute

As previously noted, the Chancellor held that "nothing in the statute prohibits group reporting." (RE Tab 6 at 4193; RV 29 at 4193). This decision is incorrect both under *de novo* and deferential standards of review.

The applicable statute required assessments to be based on the amount of insurance written by each of MWUA's individual members:

> All members of the association shall participate in its writings, expenses, profits, losses, in the proportion that the net direct premiums of each such

> member written in this state during the preceding calendar year bears to the aggregate net direct premiums written in this state by all members of the association, as certified to the association by the commissioner after review of annual statements, other reports and any other statistics the commissioner shall deem necessary to provide the information herein required and which the commissioner is hereby authorized and empowered to obtain from any member of the association.

See MISS. CODE ANN. §83-34-9 (emphasis added). The statute further provided that a member's assessments are to be reduced based on credits earned by that member for voluntarily writing insurance policies in the coastal counties:

> A member shall, in accordance with the plan of operation, annually receive credit for essential property insurance voluntarily written in a coast area, and its participation in the writings of the association shall be reduced in accordance with the provisions of the plan of operation. Each member's participation in the association shall be determined annually in the manner provided in the plan of operation.

See MISS. CODE ANN. §83-34-9 (emphasis added). The statute required that members be treated individually, and grouping violated the terms of the statute. MWUA could not follow procedures that are inconsistent with a governing statute. *See Mississippi State Tax Comm. v. Reynolds*, 351 So.2d 326, 327 (Miss. 1997). These same provisions were included in MWUA's Plan of Operation (RE Tab 11 at 100; RV 2 at 100), and MWUA also lacked the power to violate its Plan of Operation. MWUA recognized the illegality of grouping in 2006 and prospectively terminated the practice.

The legislative amendment of MISS. CODE ANN. §83-34-9 in 2007 that authorized some grouping further emphasizes that grouping was illegal prior to the amendment. The Insurance Commissioner attempted to support his decision on grouping by relying on the amendment (RE Tab 10 at 1921 n.2; RV 14 at 1921 n. 2), but this reliance was misplaced. The 2007 amendment allows grouping only under certain circumstances and requires provisions concerning grouping to be prescribed in the Plan of Operation:

> The association may allow affiliated insurers to combine their annual net direct premiums and other data, including data that supports any incentives that may be allowed by the association, to the extent that such grouping promotes the voluntary writing of essential property insurance in the coast area. Any provisions for credits and grouping of data shall be prescribed in the plan of operation.

MISS CODE ANN. §83-34-9(1) (Supp. 2007) (emphasis added). This amendment does not provide the MWUA with *carte blanche* authority to allow grouping. It is conditioned on a finding that MWUA has not yet made through a proper administrative process, i.e. that grouping promotes the voluntary writing of property insurance in the coast area. Furthermore, the 2007 amendment requires provisions regarding grouping to be placed in the Plan of Operation, and did not authorize the use of "unwritten" "rules." Finally, there is no indication that the 2007 amendment was intended to apply retroactively, and it cannot be used to infer a legislative intent in the earlier statute to authorize grouping.

Instead, the 2007 amendment is an admission that the statutory language applicable to the Hurricane Katrina assessments did not permit grouping and that MWUA acted illegally in allowing grouping. The legislature's amendment is similar to a repair of a broken or defective product. The rules of evidence recognize that such a repair would be an admission of a problem if allowed into evidence. *See* MISS. R. EVID. 407; FED. R. EVID. 407 ("Subsequent Remedial Measures"). Here, there are no evidentiary concerns, and the legislature's adoption of MISS. CODE ANN. §83-34-9(1) is strong indication that the MWUA statute precluded grouping and needed to be amended if grouping were to be permitted.

Alternatively, if MISS. CODE ANN. §83-34-9 is interpreted as taking no position with regard to grouping, MWUA's practice of grouping was still illegal because nothing affirmatively authorized MWUA to group members while calculating assessments. Certainly, there was nothing in the MWUA statute prior to 2007 permitting grouping, and no provision in

MWUA's Plan of Operation or its Manual of Rules and Procedures provided for group reporting of financial data. MWUA admitted that point in its November 7, 2006 memorandum to "Member Companies Submitting Group Data" (REA Tab 7; RV 42 at 2840), and in the testimony of its Manager, Joe Shumaker, at the May 16, 2007 hearing. (RV 42 at 2904-2905). This undermines any contention that grouping was legal. In fact, in the absence of statutory or other authority for grouping, it was beyond MWUA's authority to permit grouping. MWUA could exercise only the authority granted to it by statute or necessarily implied in its grant of authority. *See Wilkerson v. Mississippi Employment Sec. Comm.*, 630 So.2d 1000, 1001-02 (Miss. 1994) (in which this Court found that the Employment Security Commission did not have authority to use an "unwritten" rule, not found in the unemployment compensation law, under which the Commission added three days to a fourteen day appeal period to account for mailing time.) In principle, the unwritten rule rejected in *Wilkerson* is no different than the MWUA's allowance of grouping, because neither the applicable statutes nor rules that governed the MWUA expressly or implicitly authorized it. Accordingly, the grouping of financial information was illegal because it was beyond MWUA's lawful authority.

III. MWUA's Decision To Continue The Practice Of Grouping After It Recognized The Illegality Of The Practice Was Unfair And Discriminatory

MWUA also violated MISS. CODE. ANN. §83-34-13 by permitting the use of grouped financial information for Hurricane Katrina assessments after MWUA recognized that grouping violated MISS. CODE. ANN. §83-34-9. The decision to eliminate grouping prospectively and to continue to enforce the Hurricane Katrina assessments that were calculated using grouping violated MISS. CODE. ANN. §83-34-13, which obligates MWUA to ensure the "fair and nondiscriminatory administration of the association." By continuing to implement a practice that it recognized was illegal, MWUA certainly acted unfairly. Knowingly implementing a

policy that one recognizes to be illegal is the epitome of unfairness. Moreover, MWUA discriminated against its members that could not affiliate in that MWUA arbitrarily supported the interests of MWUA members that grouped over those that did not.

MWUA failed to provide a basis for not eliminating the effects of grouping on the Hurricane Katrina assessments. The MWUA board provided no rationale for its decision to eliminate grouping only prospectively. Where policies or interests compete, an agency acts without authority and arbitrarily "by definition" where an agency makes a decision based on an "unreasoned preference" for one policy or set of interests over another competing policy or set of interests. *See Mississippi Sierra Club v. Mississippi Department of Environmental Quality*, 819 So.2d 515, 523 (Miss. 2002) (citation omitted). Under this standard, MWUA acted without authority and in an arbitrary manner in failing to eliminate the effect of grouping on the Hurricane Katrina assessments. That MWUA's Board members were voting consistently with the interests of their employers is further evidence of the arbitrariness of the decision.

To fill this void, MWUA's counsel has previously argued that MWUA's decision to leave grouping in place for the Hurricane Katrina assessments was based on MWUA's view that "it would be inequitable and unfair to require the [] 35 groups to de-group without any notice. Thirty-five groups . . . relied on their ability to report as a group." (MWUA's brief filed with the Commissioner of Insurance on December 8, 2008, at 19). To the contrary, it was inequitable for MWUA to change its policy concerning grouping only prospectively. Knowingly applying an illegal policy which injures some of MWUA's members, including Aegis, was grossly inequitable. Any action that certain MWUA members may have taken in reliance upon the continuation of MWUA's grouping policy was likely outweighed by the injury suffered by Aegis and the non-grouping members in the form of illegally increased assessments. In that

regard, it is noteworthy that MWUA did not demonstrate that, for the purposes of Hurricane Katrina assessments, members that grouped would suffer greater impacts from de-grouping than non-grouping members suffered from leaving the groups in place. Moreover, if MWUA breached a duty to its members that were forced to de-group retroactively, then MWUA should compensate those members and not evade its liability by illegally increasing the assessments of its non-grouping members.

MWUA's decision to preserve grouping retroactively cannot be justified based on MWUA's desire to avoid the work of recalculating the Hurricane Katrina assessments. MWUA's administrative convenience is not a rationale that can justify the perpetuation of illegality, and now that the Chancellor has ordered MWUA to recalculate the Hurricane Katrina assessments, that rationale carries even less weight. MWUA should be ordered to recalculate the Hurricane Katrina assessments in full compliance with the law and in the process calculate the assessments without reference to grouping.

IV. Aegis Is Not Barred From Challenging Grouping

The Insurance Commissioner incorrectly ruled that Aegis and other insurers waited too long to challenge grouping, (RE Tab 10 at 1946: RV 14 at 1946), and the Chancellor also emphasized the "open and obvious nature of group reporting." (RE Tab 6 at 4192; RV 29 at 4192). These decisions were based on laches, even though they did not use the term, and they should be reversed under either a *de novo* or deferential standard of review.

The application of laches requires a showing of the following elements:

> (1) a delay in asserting a right or claim; (2) that the delay was not excusable; and (3) that there was undue prejudice to the party against whom the claim is asserted.

See Allen v. Mayer, 587 So.2d 255, 260 (Miss. 1991).

Laches does not apply here. First, Aegis filed a timely appeal. MWUA's decision denying the appeal expressly stated "Aegis timely appealed its assessment for the MWUA policyholders' Hurricane Katrina losses." (RV 43 at 3372). Under the statute, Aegis is entitled to challenge each new assessment and should not be deprived of its right to appeal the Hurricane Katrina assessment because it had not appealed earlier assessments. With regard to the Hurricane Katrina assessments, there was no delay.

Second, the fact that Aegis had not challenged grouping with regard to its two earlier MWUA storm loss assessments in 1998 and 2004 was reasonable and does not justify the imposition of laches. The record demonstrates that year-after-year Aegis filed its insurer reports, paid assessments, and shared in distributions. (*See generally,* RV 43 at 3128-3369 under seal at Volume B). Aegis did so relying on MWUA to properly administer the partnership. From 1987 to 2004 there was no reason for Aegis to suspect that the MWUA was performing calculations that were unauthorized, contrary to law, arbitrary or capricious, and unfair. Indeed the assessments and distributions were virtually equal over the eighteen years and gave Aegis no cause for concern. The distributions and assessments concerning Aegis follow:

Table C[11]

Year	Aegis Assessments	Distributions to Aegis of Excess Funds
1987	0	$1,483
1988	0	$3,984
1989	0	$16,448
1990	0	$7,288
1991	0	$3,644
1992	0	$3,569
1993	0	$7,801
1994	0	$2,523
1995	0	$10,795
1996	0	$11,361
1997	0	$1,951
1998	$112,060 (Hurricane Georges)	$18,440
1999	0	$19,677
2000	0	$6,176
2001	0	$16,675
2002	0	$28,221
2003	0	$34,371
2004	$80,220 (Hurricane Ivan)	0
TOTAL	$192,280	$194,407

The Hurricane Katrina assessment revealed for the first time how grouping lowered the assessments for the group members and increased the assessments for Aegis and other non-group members.

MWUA did not communicate adequately with the members about the consequences of grouping financial information. MWUA included a document in its welcome package that purported to explain how it credited voluntary writings in the storm-prone coastal counties. (REA Tab 12 at 819-820; RV 36 at 819-820). The document, however, only alluded vaguely to how grouping may affect credits and assessments, and did not, for example, advise members of how many groups existed and how that might affect assessments. Aegis and the other non-

[11] The data in Table C is derived from documents in RV 43 at 3128-3215 under seal at Volume B.

grouping members had no reason to object to grouping before the Hurricane Katrina assessments.

Third, MWUA will not be prejudiced if the challenge to grouping is permitted. All of the information regarding the Hurricane Katrina assessment process is available, and MWUA has been provided a full opportunity to defend its position on grouping in this proceeding.

MWUA has in no way been prejudiced by the timing of Aegis's appeal from its assessment. Aegis appealed its Hurricane Katrina assessment in May 2006. In October 2006, MWUA's counsel acknowledged that grouping was illegal, and in November 2006 MWUA's board announced its decision to eliminate grouping prospectively. In that MWUA's board decided to preserve the impact of grouping on the Hurricane Katrina assessments after challenges to those assessments had been lodged, MWUA cannot claim that it was unaware of the issue when it acted. It would be wholly inequitable to apply laches to insulate MWUA's illegal calculations from judicial review, and the Insurance Commissioner and the Chancellor erred to the extent they did so.

V. The Chancellor's Decision Ordering That Mobile Home Reporting Failures Be Corrected Should Be Affirmed

The Chancellor correctly ordered MWUA to recalculate the Hurricane Katrina assessments base upon accurate reports of mobile home premiums and reversed the Insurance Commissioner's holding that the issue was not ripe for review.

The issue clearly was ripe. The mobile home reporting failures had already severely injured Aegis and MWUA's other members that accurately reported their mobile home premiums in that the reporting failures increased those members' Hurricane Katrina assessments by many millions of dollars. This appeal is Aegis's opportunity to correct this injustice and to deny Aegis relief now will deprive it of ever being made whole.

MWUA contends that it will eventually force those members that filed inaccurate premium reports to pay increased assessments some time in the future. Aegis has no assurance that this is true, but even assuming *arguendo* that it is, Aegis will not be adequately compensated. MWUA contended before the Commissioner and the Chancellor (and reiterates its contention in its brief to this Court at p. 60) that it might use the proceeds of the increased assessments collected from the mis-reporters to avoid issuing an additional Hurricane Katrina assessment or it might distribute the proceeds to its members on a "pro-rata" basis. Neither of these proposed courses of action, however, will restore Aegis to the position it would have been in had the assessments been recalculated using accurate information concerning mobile home premiums. To distribute the funds properly, MWUA will have to recalculate the Hurricane Katrina assessments, something that it has demonstrated it has no intention of doing. Instead, MWUA intends to distribute any excess "back to the other MWUA member companies *pro-rata*, based on their participation percentages" (MWUA's brief p. 60.) In that Aegis paid almost 3% of all Hurricane Katrina assessments while its participation percentage was less than 1% of all net direct premiums, Aegis will continue to be harmed unless the proper mobile home calculations are applied to the years governing the Katrina assessment.

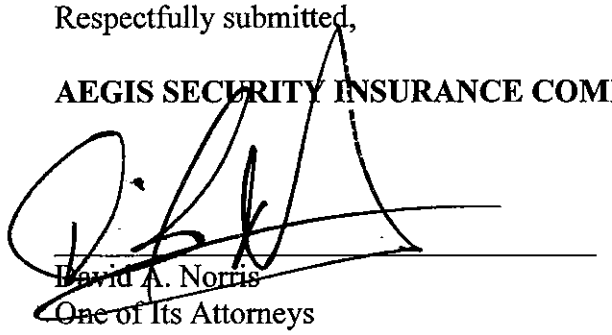
Further delay will accomplish nothing. MWUA can recalculate the assessments now and should do so to properly relieve Aegis from the illegality of the Hurricane Katrina assessments. That issue is ripe, and the Chancellor should be affirmed.

CONCLUSION

For the foregoing reasons, Aegis requests this Court to reverse the Chancery Court Order's decision on grouping and to affirm that Court's decision that the Hurricane Katrina assessments be recalculated using corrected reports of premiums resulting from mobile home underwritings.

Respectfully submitted,

AEGIS SECURITY INSURANCE COMPANY



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CERTIFICATE OF SERVICE

I, David A. Norris, certify that on November 29, 2010, a true and correct copy of the foregoing ***Brief of Appellee/Cross-Appellant, Aegis Security Insurance Company***, was served via regular United States postal delivery to the following:

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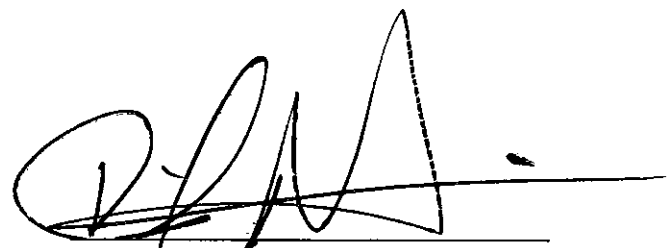
THIS, the 29th day of November, 2010.



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