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

MISSISSIPPI WINDSTORM UNDERWRITING ASSOCIATION — APPELLANT

V.

UNITED STATES FIRE INSURANCE CO. ET AL — APPELLEE

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

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# REPLY BRIEF OF CROSS-APPELLANT ZURICH AMERICAN INSURANCE CO.

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Ross F. Bass Jr., MS Bar No. [redacted]
Luther T. Munford, MS Bar No. [redacted]
PHELPS DUNBAR LLP
4370 I-55 North
Jackson, Mississippi 39211
Telephone: (601) 352-2300
Facsimile: (601) 360-9777
bassr@phelps.com
munfordl@phelps.com

**ORAL ARGUMENT REQUESTED**

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## INTRODUCTION

For good reason, the legislature required that participation percentages be determined according to a Plan of Operation which in turn calls for insurers to submit information in March of each year with the percentages to be established by June 15 of each year – before hurricane season. It is only fair to set the percentages before any member company knows whether or how it might be affected by that season. That is because the number fixed can result in participation in a loss if hurricanes hit the coast or participation in a gain if they do not.

The Brief of Cross-Appellant and Appellee Zurich American Insurance Co. ("Zurich Brief") at 4-5 sets out the method by which both statutes and the Plan of Operation mandate that MWUA fix percentages by June 15 and then limit the right to appeal. The cross-appellees' brief filed by six other insurers[1] ("Other Insurers' Brief") correctly points out that the form for the June 15 statement, like all statements of participation, says that it is a "preliminary accounting." But that is because there is a right to appeal, and is not because the accounting otherwise lacked finality. The only evidence is that the MWUA intended for the accounting to be final both on June 15 and on August 31 when it was used to assess the members. Zurich Brief at 6. No member appealed from either action and the

[1] Brief of Cross-Appellees Homesite Insurance Company, OneBeacon Insurance Group, United States Fire Insurance Company, a subsidiary of Crum & Forster Holding, Inc., Farmers' Insurance Group of Companies and Union National Fire Insurance Company.

members all paid the assessment within 30 days. The December 2, 2005 assessment used the same June 15 participation percentages that MWUA considered to be final. Zurich Brief at 7.

The April 17 participation percentages also were intended to be final, notwithstanding the continued use of the phrase "preliminary accounting" in the form statement of participation MWUA sent to its members. 39:1783. The eight appellees in this case timely appealed the new participation percentages to the MWUA board and began the journey which has brought them to this court. Zurich Brief at 9-14.

That is the orderly process that the statute contemplates, that the Plan of Operation and other MWUA rules require, and that the insurers followed who played by the rules. It is true that this case arises out of a colossal error by the MWUA board – it purchased reinsurance for the 2005 season that was more than $300 million less than what was needed – but that does not excuse its studied disregard for the established process for determining MWUA participation percentages.

This Court should enforce that process, require that the June 15, 2005 participation percentages be used to allocate 2005 liability, and decide the reinsurance allocation issue. That is all it needs to do in this case. In the alternative only, it should grant the eight appellees relief by ordering the MWUA

to recalculate the participation percentages based on the additional information they provided in their 2006 appeals, as the chancery court ordered.

## SUMMARY OF ARGUMENT

The procedures set forth in the Plan of Operation govern the determination of participation percentages. That is because the legislature has required that percentages be fixed as "provided in the plan of operation." Miss. Code Ann. § 83-34-9. The power the Plan confers on the board to take action "incident" to the Plan does not authorize the board to set aside that Plan whenever it chooses to do so.

Moreover, the MWUA's basic contention is that while a member's right to "appeal" is strictly limited, MWUA Response at 14 n.8, 26 n.17, 34 n.23 and 37, the MWUA board can act on its own initiative at any time if a member "informally notifies" the board that it needs relief. A better formula for insider politics would be difficult to craft.

Finally, the MWUA Response and the Other Insurers' Brief question whether Zurich's appeal is timely because it did not appeal the true-up letters when they were sent in January and February 2006. But the fundamental requirement for any appeal is that a party be aggrieved. The Plan of Operation only allows an "affected" member to appeal and the governing statute describes the insurer eligible to appeal as an "affected insurer who may be aggrieved," Miss. Code Ann. § 83-34-19. Zurich was not aggrieved by the true-up letters which neither fixed

percentages nor assessed amounts. Zurich was aggrieved by the May 17 assessment, and it timely appealed that assessment. Zurich Brief at 17-18.

Moreover, this argument by the MWUA is particularly ill-founded when its misleading letters did not reveal the true motives behind the "true-up" and Zurich did not find them out through discovery until after its appeal had reached the Commissioner of Insurance in 2008.

## ARGUMENT

### I. The appeal deadlines set by the Plan of Operation are binding.

Zurich's Brief at 4-5 demonstrates that the MWUA's Plan of Operation is law binding on MWUA and that the Plan establishes deadlines for appeals to be taken. MWUA repeatedly agrees with this statement in so far as appeals by members are concerned. See MWUA Response at 13 n.8, 26 n.17, 34 n.23, and 37. This is consistent with court rulings in Texas, which also has a windpool. Zurich Brief at 21.

The governing statute said that "Each member's participation in the association shall be determined annually in the manner provided by the plan of operation." Miss. Code Ann. § 83-34-9. In turn, the Plan of Operation provided that:

> The Commissioner shall certify to the Association, after review of annual statements, other reports, and any other statistics he shall deem necessary, the aggregate net direct premiums written by all members. . . . Each member's participation in the Association shall be

> determined annually in the manner provided in the Plan of Operation.

By statute, Miss. Code 83-34-29, the MWUA also had the authority to adopt rules and the rules are found in the Manual of Rules and Procedures, RE 12. While the rules speak of "tentative" and "interim" participation percentages based on company information, they do not change the fact that, after Commissioner verification, the percentages were to be "determined annually." In fact, the Manual says that, while interim reports may be given, "At the end of each fiscal year (December 31) there will be an annual report to member companies based on their percentage of participation for the previous calendar year . . ." RE 12 § VIII 2.E. In this case, at the very least, the December 2, 2005 assessment was such a report.

In its brief the MWUA; for the first time, invokes its power to take decisions "independent of any member appeal" because the Plan provides that it may perform all other duties "necessary or incidental to the administration of the Plan." RE 11 § XIII 2. It then spins out at parade of horribles ending with the possibility that the insurance commissioner might become a "superauthority" over the MWUA. MWUA Response at 14 n.7.

What the MWUA board's authority may have been with respect to matters other than fixing member's participation percentages is not relevant to this case. What is relevant here is that the legislature has said that percentages are to be fixed according to the Plan of Operation. The power to do what is "necessary or

incidental to the administration of the Plan" does not carry with it the authority to scrap the Plan and start over.

The need to fix percentages by June 15 is particularly acute. The MWUA is not an entity unique to our state. Many states have windpools. Zurich Brief relies on cases involving windpools in North Carolina and Texas and their rules. See Zurich Brief at 14 and 21.

In fact, the Alabama windpool in 2006 faced the same post-Katrina fork in the road as the MWUA. The Alabama windpool, however, decided to stick to its established procedures. It rejected post-Katrina requests to reallocate percentages. The courts upheld its decision. One court explained the reason for requiring information to be submitted in March before hurricane season:

> The undisputed evidence demonstrates that March 31 has been the deadline for many years and the Association has never waived nor changed the deadline. The March 31 deadline furthers a legitimate interest in that the voluntary credit reports are filed before the beginning of hurricane season. Any burden on [the insurer] to file the report is minimal compared to the Association's interest in establishing a firm deadline for receipt of the necessary data to calculate the Association's losses and profits for the year. *The March 31 deadline comes after the end of the year and before the beginning of hurricane season.*

*Alabama Municipal Insurance Corp. v. Alabama Insurance Underwriting Ass'n,* 2008 WL 4493433 at *12 (M.D. Ala. 2008) (emphasis added).

In this case there is also no evidence that the MWUA – before 2006 – had ever made an exception to its deadlines, and the MWUA's rule 30(b)(6) testimony was that no exceptions had been made. Zurich Brief at 6-7. The Other Insurers' Brief at 8 argues to the contrary but it is mistaken. An unspecific offhand comment by MWUA counsel, CP 30:33, is not evidence. A letter from an insurer in 2006 discussing a change made on August 12, 1999, is perfectly consistent with an appeal from the June 15 notice being dealt with in August. Ex. V. 3 at Ex. 10. And that letter does not identify any other specific change.

In addition, the MWUA board's proposed freedom to maneuver, when combined with its policies of secrecy, is a recipe for insider politics, not to mention breach of fiduciary duty. The MWUA brief repeatedly says that members must abide by the 15-day appeal period. But then it argues that it can make an "independent decision" when that decision is motivated by "notification by several MWUA members, including its servicing carrier." MWUA Response p. 14.

It is simply not true for the MWUA to claim, as it does in MWUA Response at 29, that no one company was given information on any other company. The MWUA board, at the time of the Katrina decision, was composed of representatives who worked for Allstate Insurance Company, St. Paul Travelers Company, Mississippi Farm Bureau Mutual, State Farm Fire and Casualty Company, and Nationwide Insurance Company. ZRE 2. Zurich's belief at the time of the true-up was that St. Paul Travelers benefitted from the true-up to the

tune of $12 million. Zurich Brief at 9. MWUA's claimed power to reallocate percentages whenever a member informally tells it about a problem is a bad idea in theory and a worse one in practice.

Under a system which allows the use of "notification" as a substitute for appeal, these companies would never have to follow the appeal deadlines found in the Plan of Operation and could simply ask the Board – at any time – to take notice of their concerns. The MWUA cites no authority for this cockeyed proposal and surely there is none.

## II. No company had a duty to appeal from the notice of the "true-up."

The MWUA Response and the Other Insurers' Brief suggest that if Zurich is right about appeal deadlines, then it should not be able to argue about appeal deadlines because it "failed" to appeal the decision to send out the true-up letters dated January 17 and February 1, 2006. The MWUA makes its argument even though it previously conceded that Zurich's timely appeal from the third assessment was timely and procedurally correct. CP 43:3437. The fundamental rule of appeals is that a party may only appeal when it is "aggrieved." *King v. Pike County National Bank*, 952 So.2d 1036, 1038 (Miss. Ct. App. 2007). The MWUA Response is wrong when it says there are no rules to determine when an appeal may be taken. An appeal may be taken under the Plan of Operation and the statute when an insurer is "an affected insurer who may be aggrieved." See p.4, *supra*. The true-up letters did not "aggrieve" Zurich. They fixed no participation

percentage and assessed no payment. There is no evidence that anyone regarded them as being so "final" as to require payment and or appeal.

Rather, it was the April 17, 2006 notice that demanded Zurich pay an additional $28 million. That notice aggrieved Zurich. Zurich timely appealed from that decision. Zurich Brief at 9.

It is particularly ironic that the MWUA should now claim – for the first time in five years – that Zurich had a duty to appeal from the true-up letters. It is of the very essence of the argument by all of the insurer parties to this appeal that these notices were inadequate and affirmatively misleading. See Other Insurers' Brief at 2 and 12; Zurich Brief at 7, 8, 11, 16 and 25-26. For example:

* The notices did not reveal that $31 million already had been reallocated for the benefit of Audubon.

* The notices stated that the numbers already had been confirmed with the insurance commissioner.

* The notices failed to reveal that a substantial additional assessment would be made. See Zurich Brief at 11.

Apparently attempting to justify its secrecy, the MWUA now claims for the first time that it was not a partnership at all, but was merely an "association" that could assert attorney-client privilege against its members. MWUA Response at 30 and n.21. There could be no better proof that the right hand of the MWUA has never known what the left hand was doing. In 2007, the legislature rewrote the

MWUA statute. The new plan of operation adopted by the MWUA specifically states that before 2007 the MWUA was a partnership:

> Prior to the passage of HB 1500 on March 22, 2007, the **Association** was a partnership that consisted of every insurance company authorized to and actually selling property insurance in Mississippi. These member companies shared in the costs of the **Association** on a percentage basis equal to the company's annual percentage of the property market.

2011 Plan of Operation at 7.01, www.msplans.com, last accessed May 2, 2011 (emphasis in original).

## CONCLUSION

The MWUA got things right when it admitted in the chancery court that the "letter of the law" was consistent with Zurich's position. CP 17:2301. Zurich got things right when it told the MWUA that "changing the rules when the chips are down not only penalizes those members that follow the rules but casts a long shadow on the credibility of the MWUA." CP 39:1790.

Following the letter of the law is particularly important where millions of dollars are being allocated in secret by an organization that by its very nature is rife with conflicts of interest. This court should enforce the letter of the law and require the MWUA to reallocate liability for the 2005 hurricane season pursuant to the percentages originally set in 2005, subject to whatever ruling this court makes on the reinsurance allocation question.

In the alternative only, all of the eight companies participating in this appeal should be allowed to submit revised information because the "true up" was both unfair and discriminatory and so violated the MWUA's statutory obligations. Zurich Brief at 25-27. The cure for conflicts of interest is full disclosure and the "true-up" notices fell far short of that goal.

Under no circumstances should any insurer who is not a party to this appeal be given relief. There is no justification for the MWUA's request that the entire process be reopened once again. That was its mistake in 2005. It should not be made again. To do so would make a mockery not just of the MWUA's appellate process, but of the appellate process of the courts as well.

Respectfully submitted, this the 9th day of May, 2011.

**ZURICH AMERICAN INSURANCE CO., Appellee and Cross-Appellant**

BY: 

Ross F. Bass Jr., MS Bar No. [redacted]
Luther T. Munford, MS Bar No. [redacted]
PHELPS DUNBAR LLP
111 E. Capitol Street, Ste. 600
Jackson, Mississippi 39201
Telephone: (601) 352-2300
Telecopier: (601) 360-9777
bassr@phelps.com
munfordl@phelps.com

## CERTIFICATE OF SERVICE

I, Ross F. Bass Jr., do hereby certify that I have filed this Brief of Appellee and have sent it by regular first class mail to the following:

Tori Lavon Winfield
P O Box 14503
De Moines, Iowa 50306
Counsel for GuideOne Ins. Co.

David A. Norris
McGlinchey Stafford, PLLC
Post Office Drawer 22949
Jackson, Mississippi 39225-2949
Counsel for Aegis Security Insurance Company

Brian Austin Hinton
Mitzi Leasha George
P O Box 2540
Ridgeland, MS 39158
Counsel for State Auto Mutual Insurance Co. and State Auto Property & Casualty Co.

Craig D. Ginsburg
Hamburg & Golden, P.C.
1601 Market Street, Suite 3310
Philadelphia, Pennsylvania 19103
Counsel for Aegis Security Insurance Company

Lydia Catherine Warren
P O Box 800
Ridgeland, MS 39158
Counsel for Mississippi farm Bureau Mutual Insurance Co.

Jennifer R. Warden
Middleberg Riddle & Gianna
201 St. Charles Avenue, 31st Floor
New Orleans, Louisiana 70170
Counsel for Farmers Insurance Group

Stephanie Ganucheau
Special Assistant Attorney General
Mississippi Department of Insurance
P O Box 79
Jackson, MS 39205
Counsel for the Department of Ins.

Marshall S. Ney
Anton L. Janik, Jr.
Mitchell, Williams, Selig, Gates & Woodyard, PLLC
425 West Capitol Street, Ste. 1800
Little Rock, Arkansas 72201
Counsel for Homesite Insurance Company

Michael B. Wallace
Wise Carter Child & Caraway, P.A.
401 East Capitol Street, Ste. 600
P O Box 651
Jackson, MS 39205
Counsel for Allstate Property & Casualty
Insurance Company

Eric F. Hatten
Forrest Latta
Burr & Forman LLP
The Heritage Building
401 East Capitol Street, Suite 100
Jackson, Mississippi 39201
Counsel for RLI Insurance Group

Jeffery S. Dilley
Henke-Bufkin
P O Box 39
Clarksdale, MS 38614
Counsel for the Hartford Companies

Arthur Jernigan
Samuel L. Anderson
Harris, Jernigan & Geno
587 Highland Colony Parkway
Ridgeland, MS 39157
Counsel for UNFIC

Charles G. Copeland
Rebecca Blunden
Copeland, Cook, Taylor & Bush, P.A.
P.O. Box 6020
Ridgeland, Mississippi 39158
Counsel for Mississippi Windstorm Underwriting Association

Robert B. House
Janet D. McMurtray
Watkins Ludlam Winter & Stennis, P.A.
Post Office Box 427
Jackson, Mississippi 39205-0427
Counsel for United States Fire Insurance Company and OneBeacon Insurance Company

Honorable J. DeWayne Thomas
Hinds County Chancery Court
316 S. President Street
Jackson, Mississippi 39205

This, the 9th day of May, 2011.

Ross F. Bass Jr.