IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF MISSISSIPPI
JACKSON DIVISION

Association Casualty Insurance Company; Benchmark Insurance Company; Georgia Casualty & Surety Company; and National Security Fire and Casualty Company — Plaintiffs

v. — Case No. 3:07-cv-525-KS-JCS

Allstate Insurance Company; Mississippi Farm Bureau Mutual Insurance Company; Nationwide Mutual Fire Insurance Company d/b/a Nationwide Insurance Companies; State Farm Fire and Casualty Company; St. Paul Travelers Companies — Defendants

DEFENDANTS' BRIEF IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT

INTRODUCTION

Although not required to do so, since 1990, the Mississippi Windstorm Underwriting Association ("MWUA") through its Board of Directors ("Board"), whose members are appointed by and operate under the supervision of the Mississippi Insurance Commissioner ("Commissioner"), has purchased reinsurance to cover a portion of the MWUA's potential catastrophe risk. Each year the Board engaged in a rational process free of any conflict of interest to determine the type of reinsurance program to purchase under the guidance and direction of sophisticated reinsurance brokers and under the watchful eye of the Commissioner. The Board made its reinsurance purchases only after weighing a series of subjective and objective factors within the framework of the MWUA's statutory purpose, which is to provide an insurance market, preferably through private insurance companies, in the Mississippi coast area. Plaintiffs are or were MWUA members who erroneously contend that the Board owed them a

fiduciary duty to purchase more reinsurance prior to Hurricane Katrina, and whose claims are otherwise barred by the business judgment rule.

The Board's reinsurance purchase process was overseen by representatives of the Mississippi Department of Insurance who participated in meetings regarding reinsurance decisions and examined the MWUA's business activities. Member companies could obtain information about the reinsurance purchasing process from the MWUA's Manager, were invited to attend annual meetings, and each member had a statutory right to appeal any Board decision to the Commissioner. For the fifteen years before Hurricane Katrina, neither the Commissioner nor any member company took issue with the reinsurance process employed by the Board nor the amount of reinsurance the Board purchased.

In connection with its reinsurance purchase for the 2004 and 2005 storm seasons, the Board relied not only on the analysis, advice and recommendations of its reinsurance broker, but also received independent analyses and recommendations from some of the largest and most sophisticated reinsurance brokers in the world. The reinsurance program the Board purchased met or exceeded each of these broker's recommendations. In a comprehensive examination of the MWUA in December 2004, the Commissioner reviewed this reinsurance program -- the very one Plaintiffs complain about -- and found it to be consistent with the legislative intent of the MWUA and the MWUA's Plan of Operation.

Plaintiffs complain based solely on hindsight that the MWUA did not purchase enough reinsurance for the Katrina storm season. Plaintiffs do not argue that the MWUA's reinsurance purchase was inconsistent with the MWUA's statutory purpose of providing an insurance market on the Mississippi coast. Instead, Plaintiffs seek to recover most of the money they were required to pay for the MWUA policyholders' Katrina losses. Plaintiffs contend the Board

should have reinsured these losses. The Mississippi Legislature, however, established the MWUA so that MWUA members, such as Plaintiffs, are responsible to pay the MWUA's policyholders' losses.

The Plaintiffs originally sued several Board members, who are individuals employed by the Defendants and appointed to the Board by the Commissioner. However, after discovery closed the Plaintiffs amended their complaint to name only the Defendant companies, alleging that these companies were the Board members. While Defendants deny that the companies were the Board members, that issue need not be decided now, as Plaintiffs' claims against the Board should be summarily dismissed, regardless of the identity of the actual Board members. The Court should grant summary judgment in favor of Defendants because the Board's challenged reinsurance decision was made free of conflict and is protected by the business judgment rule. In addition, the Board did not owe a fiduciary duty to the Plaintiffs, as claimed.

FACTS

I. The MWUA Is A Not-For-Profit Entity Established To Provide A Market For Insurance In Six Coastal Counties.

The Court has detailed the origin, purpose, composition, and operation of the MWUA in prior opinions which, for purposes of economy, are not restated in full herein. (7/29/08 Memo. Opinion & Order Denying Plaintiffs' Mot. for Class Cert. at 3-6; 7/15/08 Memo. Opinion & Order Denying Defendants' Mot. for Summary Judgment at 3-5.) The MWUA is a not-for-profit entity that was established by the Legislature to "assure an adequate market for windstorm and hail insurance in the coast area of Mississippi"[1] and is composed of all insurers who write property insurance on a direct basis anywhere in Mississippi. 1987 MISS. LAWS, ch. 459, § 1;

[1] The statute defines the "Coast Area" as Hancock, Harrison, Jackson, Pearl River, Stone and George Counties. MISS. CODE ANN. § 83-34-1.

MISS. CODE ANN. § 83-34-3 (Supp. 2006);[2] (Portwood Dep. at 56-57, attached as Ex. 1.) The MWUA operates pursuant to a Plan of Operation that was approved by the Commissioner of Insurance.

The MWUA is operated and managed by specialized staff of the Mississippi State Rating Bureau, and the Board administers its business affairs and activities subject to the Commissioner's review. (Plan of Operation and Articles of Agreement ("Plan"), § XI(1), attached as Ex. 2); *see also* (Affidavit of Deputy Commissioner of Insurance for Mississippi, Lee Harrell ("Harrell Aff."), at ¶ 6, attached as Ex. 2A). From 1987-2007, the MWUA was administered by an eight-member Board, comprised of three independent insurance agents[3] plus an employee of five of the member companies, which at the relevant time were employees of Allstate, Mississippi Farm Bureau, Nationwide, State Farm and St. Paul Travelers, along with a non-voting member of the Commissioner's staff. [4] Representatives of the Mississippi Department of Insurance attended Board meetings.[5]

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[2] Chapter 34 of Title 83 of the Mississippi Code was revised in 2007 with an effective date of March 22, 2007. The statutory citations herein are to the versions effective at the time this lawsuit was filed in 2006 which had been unchanged since their initial passage in 1987.

[3] In 2004 and 2005, these agents were Bobby Portwood from Fox-Everett, Inc., David A. Treutel from Treutel Insurance Agency, Inc., and Christopher Boone from Stewart Sneed Hewes, Inc. *See* (9/7/04 Letter from Commissioner Dale to A. Parks and 10/15/04 Annual Membership Meeting Minutes, attached as Ex. 3.)

[4] *See* (8/29/03 Letter from Commissioner Dale to A. Parks, attached as Ex. 4); (Ex. 3); (Ex. 2, Plan, §§ XI(2), XII(10)); (Ex. 2A, Harrell Aff. at ¶ 4.)

[5] In fact, representatives of the Commissioner's office participated in the MWUA Board meetings where the reinsurance decisions at issue were discussed and made, and the Commissioner even attended one of these meetings. *See* (Ex. 2A, Harrell Aff. at ¶¶ 4-5); (1/29/04 Board Meeting Minutes; 3/3/04 Board Meeting Minutes, 6/24/04 Board Meeting Minutes; 10/15/04 Board Meeting Minutes, attached as Exs. 5-8 respectively); *see also* (9/12/94 Board Meeting Minutes, attached as Ex. 9) (noting Commissioner Dale's statement that he "could not force companies to write property insurance on the Coast, but he could do whatever he wanted to do regarding this Board.").

The Commissioner is authorized to examine the affairs of the MWUA and require it "at any time," to furnish him with additional information with respect to "any other matter which the [C]ommissioner deems to be material to assist him in evaluating the operation and experience of the association" and to file a statement summarizing the transactions, operations, and affairs of the MWUA with the Commissioner each year. MISS. CODE ANN. §§ 83-34-25, 83-5-209(3) (Supp. 2006); (Ex. 2, Plan § XIII (3)); *see* (Ex. 2A, Harrell Aff. at ¶ 6.) The Commissioner can review any decision of the MWUA through a formal administrative process. MISS. CODE ANN. § 83-34-19 (Supp. 2006); *see* (Ex. 2A, Harrell Aff. at ¶ 7.)[6]

A. The MWUA Has A Voluntary Writings Credit Mechanism Created By The Legislature To Promote A Private Insurance Market In The Coast Area.

The Legislature established the MWUA to operate as a market of last resort, issuing insurance policies that private insurers choose not to underwrite, but not to compete with the private market. (Arnold Dep. at 28: 23-25; 29:1-17, attached as Ex. 10); (Little Dep. at 18, 79, 103, 110-111, 113, attached as Ex. 11); (Ex. 2A, Harrell Aff. at ¶ 8.) To maximize the writing of wind insurance by private insurance companies in the Coast Area, the Legislature created a voluntary writings credit mechanism. MISS. CODE ANN. § 83-34-9; (Ex. 2, Plan, IX(2)); (Benchmark Dep. at 105, attached as Ex. 12) (Legislature trying to encourage private insurers to underwrite in the Coast Area); (Ex. 2A, Harrell Aff. at ¶ 9.)

This voluntary writings credit mechanism promotes the legislatively preferred private market by creating an incentive for MWUA members to write insurance that provides coverage for the perils of windstorm and hail in the Coast. *See* (Ex. 2A, Harrell Aff. at ¶¶ 8-9.) In exchange for issuing these policies, private insurers reduced their potential exposure to MWUA

[6] The decisions of the Board at issue in this case were never appealed by Plaintiffs or any other member companies to the Commissioner. *See* (Ex. 2A, Harrell Aff. at ¶ 7.)

losses. (Ex. 12, Benchmark Dep. at 107-09); (National Security Dep. at 47-49, attached as Ex. 13); (Association Casualty & Georgia Casualty ("ACIC/GC") Dep. at 91-92, attached as Ex. 14.) All insurers have the ability to avail themselves of the voluntary writings credit to reduce their exposure to MWUA losses. (Ex. 13, National Security Dep. at 47-49.)

Private insurance voluntarily underwritten in the Coast Area reduces the risk of loss to the MWUA, because a policy containing protection against windstorm and hail written in the private market will not be written in the MWUA. (Ex. 12, Benchmark Dep. at 107-109.) Conversely, if insurance is not voluntarily underwritten by a private insurer, the risk of loss to the MWUA increases because the MWUA itself will have to issue that policy. (*Id.* at 108: 10-23.) Accordingly, the Legislature's goal of promoting a private market for insurance in the Coast Area, and having the MWUA serve as a market of last resort, is advanced when insurers avail themselves of the voluntary writings mechanism. (Brouse Dep. at 114-116, attached as Ex. 15); (Spain Dep. at 51-52, attached as Ex. 16); (Ex. 2A, Harrell Aff. at ¶ 9.)

Reinsurance reduces the risk of loss to an insurance company by spreading that risk from the insurance company to the reinsurance company. (Compl. ¶ 37). The more reinsurance that is purchased, the less the risk of loss to the insurer. (*Id*.) Accordingly, the more reinsurance that the MWUA purchases, the less the risk of loss to the MWUA and its member companies. (*Id*.) If the risk of loss to individual insurance companies is reduced through reinsurance, there is less incentive for those insurers to avail themselves of the voluntary writings credit mechanism which is designed to mitigate that same risk of loss. (6/11/98 Reinsurance Committee Meeting Minutes, attached as Ex. 17); (Ex. 2A, Harrell Aff. at ¶ 11.) Accordingly, the Board must balance the effect of purchasing more reinsurance against the Legislature's preference to

maximize a private market for insurance in the Coast Area and have the MWUA operate as a market of last resort. (Ex. 17); (Ex. 2A, Harrell Aff. at ¶¶ 10-12); (*see, supra* Section I.A.)

II. The Board Engaged In A Rational Process To Purchase Reinsurance.

The MWUA's governing statutes and Plan authorize but do not impose a duty on the Board to purchase any amount of reinsurance at all. MISS. CODE ANN. § 83-34-5 (Supp. 2006); (Ex. 2, Plan, §§ IX(1), XIII(2).)

A. The Board Retained And Relied Upon Sophisticated Reinsurance Brokers.

In 1998, the Board changed reinsurance brokers from E.W. Blanch to Cooney, Rickard & Curtin, Inc. ("CRC") based on CRC's willingness to pursue insurance from the excess and surplus lines market, not merely the traditional reinsurance market. *See* (6/27/90 letter designating E.W. Blanch Co. as broker of record for the MWUA, attached as Ex. 18); (6/19/98 Board Meeting Minutes, attached as Ex. 19); (Ex. 17); (*see also* Ex. 1, Portwood Dep. at 10-12.) According to Plaintiffs' own reinsurance expert, pursuing excess insurance was an astute decision as it allowed the MWUA to purchase more reinsurance for less premium. (Jacobus Van de Graaf ("VDG") Dep. at 153, attached as Ex. 20.) CRC is a sophisticated broker whose reinsurance experts employed state of the art analysis, including catastrophe modeling, to make recommendations to the Board about appropriate reinsurance programs for the MWUA. *See* (Oliphant Dep. at 77-78, attached as Ex. 21); (Cooper Dep. at 71-78, 337-338, 344-346, 348, attached as Ex. 22); (Ex. 6.)

Plaintiff Benchmark's Rule 30(b)(6) witness, Andrew O'Brien, a long-time reinsurance broker, explained the central role played by a reinsurance broker in a company's reinsurance purchasing decisions. Reinsurance brokers work with insurance companies to negotiate contracts with reinsurance companies. *See* (Ex. 12, Benchmark Dep. at 18: 5-9.) Reinsurance

brokers collect underwriting information from an insurance company, evaluate the insurance company's risk philosophies and risk appetite, analyze the insurance company's financial data and submit risk information to catastrophe modeling companies for analysis. (*Id*. at 37: 10-16.) Any determination whether to purchase reinsurance and, if so, how much is based on an evaluation of subjective and objective criteria. (*Id.* at 38-41.) Plaintiffs' reinsurance expert, a former reinsurance broker, testified that he views the broker as the "architect" of an insurance company's reinsurance program. (Ex. 20, VDG Dep. at 83.)

The fundamental role played by a reinsurance broker is underscored by Benchmark's Patricia Schaffran, who testified that while serving as its President and as a member of its board of directors, she participated with a sub-group of board members that reviewed and approved its reinsurance purchase. (Schaffran Dep. at 142, attached as Ex. 23.) Ms. Schaffran testified that she did not perform her own analysis of the proposed reinsurance purchase, but relied exclusively on the expertise and recommendations of Benchmark's reinsurance broker in approving the reinsurance purchase. (*Id.* at 142-143.) Ms. Schaffran testified she discharged her duties as a board member solely by relying on the recommendations of Benchmark's reinsurance broker. (*Id.* at 143.)

B. The MWUA's Reinsurance Purchases.

The MWUA's broker, CRC, collected and evaluated relevant underwriting and financial information in advance of each reinsurance purchase. (Ex. 21, Oliphant Dep. at 27-29, 63-65); (Ex. 22, Cooper Dep. at 72, 79-82.) CRC also periodically had the MWUA data evaluated under various catastrophe exposure models. (*Id.* at 45-46, 76-78; Cooper Dep. at 71-78, 243-245, 337-338, 344-346, 348.) CRC conveyed all of this analytical work to the Board and discussed recommended reinsurance programs with the Board and the Board's Reinsurance Committee.

See, e.g., (6/17/02 Reinsurance Committee Meeting Minutes; 6/19/2003 Board Meeting Minutes; 10/3/03 Board Meeting Minutes, attached as Exs. 24-26 respectively); (Ex. 21, Oliphant Dep. at 76-78.)

The Board evaluated different options to pay for reinsurance purchases. (Ex. 15, Brouse Dep. at 99.) One option was to pay for reinsurance out of funds available in the MWUA's budget. (*Id*.) Another was to assess member companies to pay reinsurance premiums. (*Id*.) When these options were considered from year to year, the Board decided to pay reinsurance premiums out of funds available in the MWUA budget and not to assess member companies for the premiums. (*Id*. at 99-100); (Ex. 10, Arnold Dep. at 212.) Assessing member companies to pay for reinsurance could operate to drive insurers out of the Mississippi market and/or deter insurance companies from entering the Mississippi Coastal market in the first place. (Ex. 11, Little Dep. at 102-103, 108-109) (assessing for reinsurance premiums would be "disastrous" for the industry and the availability of insurance in the state); (Ex. 1, Portwood Dep. at 53-54) (the Board did not want to assess members companies because "[i]t would have driven people off the market, off the coast."); (Ex. 2A, Harrell Aff. at ¶ 13.)

Based on the analysis and recommendations of its expert reinsurance brokers, the Board weighed a number of different factors in ultimately deciding upon the type and amount of reinsurance to purchase. *See, e.g.*, (Ex. 15, Brouse Dep. at 201-202, 213-214.) The Board made reinsurance purchasing decisions based on its judgment of how to best achieve the MWUA's statutory purpose of providing an adequate insurance market in the Coast Area. (*Id.* at 201-202.) The Board included independent insurance agent representatives who engaged in this process and unanimously approved the MWUA's reinsurance purchases, including the reinsurance purchase covering the Katrina storm season. *See, e.g.*, (Ex. 6); (Ex. 7); (Ex. 8.)

Among the objective and subjective factors the Board considered in making reinsurance determinations were:

- the potential exposure of the MWUA to loss from storms of different projected frequency based on catastrophe modeling results;
- the cost of reinsurance at particular levels of loss exposure;
- the trade-offs among coverage of loss exposure from several smaller storms in a single hurricane insurance season vs. a single large storm;
- the trade-offs among different levels of loss retention exposure at different layers of the reinsurance structure;
- the need to preserve an incentive for voluntary writings in the Coast Area by retaining the possibility of assessments in the event of catastrophe;
- changes in the cost of reinsurance relative to the changes in the premiums the MWUA was able to charge; and
- the impact of the hard budget constraints on reinsurance coverage imposed by the MWUA's long-standing policy of non-assessment of members for reinsurance costs beyond premium revenues.

See, e.g., (Ex. 15, Brouse Dep. at 99, 138-139, 176-177, 192-194) (discussing the balancing of several factors and options that went into the Board's reinsurance purchase decisions each year, including CAT modeling results provided by their reinsurance broker); (Ex. 10, Arnold Dep. at 47-48, 65, 89, 97, 212, 227) (recognizing that the Board based its reinsurance decision on exposures, catastrophe modeling, availability of funds, A.M. Best standards, input from their reinsurance broker, and cost considerations); (Ex. 1, Portwood Dep. at 105, 114-115) (recognizing that each year CRC would show various insurance options based on different retentions and their intent was to buy as much reinsurance as possible with the money available); (Ex. 11, Little Dep. at 28-29, 54, 58, 69) (explaining that the Board considered various options relating to different levels of reinsurance and pricing issues, and relied on its reinsurance broker to provide up-to-date modeling based on their exposure).

III. The Board Purchased Reinsurance For The 2004 and 2005 Storm Season.

A. The Board Undertook A Full-Scale Review Of Its Reinsurance Program.

Prior to purchasing reinsurance for the 2004 and 2005 storm seasons the Board undertook a full scale review of its reinsurance program by seeking quotes and proposals from its existing broker CRC and three other brokers (who are the largest and most sophisticated reinsurance brokers in the world) in order to select a broker to represent the MWUA for the 2004-2005 reinsurance contract. *See* (4/16/03 Reinsurance Committee Meeting Minutes, attached as Ex. 27); (Ex. 26); (Ex. 12, Benchmark Dep. at 187: 17-24.)

The Board heard presentations from four insurance brokerage firms: Aon RE, Inc. ("Aon"), Guy Carpenter & Company, Inc. ("Guy Carpenter"), Benfield, Inc. ("Benfield"), and CRC. (Ex. 5.) These presentations, which lasted more than five hours, included state-of-the-art catastrophe models that estimated the MWUA's "probable maximum losses"[7] in different scenarios and possible reinsurance implications of various assumptions about storm frequency, storm intensity, property values at risk, the willingness of the MWUA to retain risk, and many other factors. (Reinsurance Presentations by Benfield and Guy Carpenter, attached as Exs. 28-29 respectively); (Ex. 21, Oliphant Dep. at 77-78) (stating CRC used most accurate data and state-of-the-art computer models). After considering the broker presentations, at the March 2004 Board meeting, the Board selected CRC as its reinsurance broker for the 2004 and 2005 storm seasons. (Ex. 6.)

[7] "Probable maximum loss" refers to the largest catastrophic loss that should be expected within a given period of time, typically measured in terms of 50, 100, 250, or 500 year terms. A one-in-500-year catastrophe would be larger and more damaging than, for example, a one-in-fifty-year event.

B. The Board Purchased A 20 Month Reinsurance Program Covering The 2004 and 2005 Storm Seasons.

In connection with its analysis of reinsurance options for the 2004 and 2005 storm seasons, the Board requested additional information from CRC relating to various reinsurance purchase considerations including an indication of renewal rates and structure layering, additional catastrophe modeling, the possibility of standardizing reinsurance forms, moving the renewal date from July to March, securing flat premium or unadjusted annual premium, and optional restructuring of layers. *See* (Ex. 5.)

CRC presented the Board with the results of three different state-of-the-art modeling programs -- RMS 4.2, RMS 4.3 and CATRADER -- along with a portfolio analysis of the MWUA book of business using each of those models. *See* (Ex. 6); (Ex. 21, Oliphant Dep. at 28-29) (explaining involved process of modeling the MWUA's business where CRC makes sure that the data is as accurate and up to date as possible). CRC's modeling was based on comprehensive underwriting data obtained from the MWUA about each MWUA insured property, including the address, county and zip code, the value of the insured property, and the value of the insured contents and the type of insured structure insured (i.e. number of stories, type of construction etc.). (Oliphant Dep. at 27-28.) CRC scrubbed this data for errors. (*Id*. at 28-29.) According to CRC, this was the most accurate data available at the time. (*Id.* at 77:17-20.) Based on this analysis and CRC's recommendations, the Board unanimously decided to purchase reinsurance to cover 100% of the first $100 million of MWUA losses, and any amount above this as funds were available. (Ex. 6.)

CRC representatives also advised the Board to consider obtaining a twenty-month contract, which would move the renewal date to a more favorable date in March. *See* (Ex. 7); (Ex. 22, Cooper Dep. at 50-51, 349-52) (change to March renewal date was part of his

recommendation as beneficial to the MWUA and locking in program for two storm seasons turned out to be an "[a]bsolutely, fabulous deal for the Windpool"); (Ex. 21, Oliphant Dep. at 78-79) (explaining that the decision for the MWUA to go to a two-storm season policy was a "great idea" because it moved away from the high profile time when many accounts that had high exposure to hurricanes went into the market). The Board analyzed this issue and agreed with CRC's recommendation. *See* (Ex. 15, Brouse Dep. at 169-171); *see also* (7/13/05 Board Meeting Minutes, attached as Ex. 30) (Oliphant advised that because of the Florida storms, it was very beneficial to have contract covering two hurricane seasons).

In addition, the Board purchased a reinsurance contract that had no reinstatement premium. (Ex. 20, VDG Dep. at 154-55.) As a result, if there was more than one named storm during the term of the reinsurance contract, the reinsurance limit would refresh itself after each storm without the payment of additional premium. (*Id*.) There was no limit to the number of named storms, such that a full refreshed limit would be available for every named storm. (*Id.*) Plaintiffs' reinsurance expert commends this feature of the reinsurance contract that the Board purchased. (*Id.*)

CRC representatives further advised the Board that an additional layer of $75 million in excess of $100 million could be purchased for $750,000. (*See* Ex. 7.) After consideration of CRC's analysis and advice, and after consultation with the MWUA fulltime staff, the Board unanimously decided to purchase the additional $75 million in excess of $100 million. (*Id.*) Taken together, the 20 month reinsurance program purchased for the 2004 and 2005 storm seasons contained no self-insured layers, such that the gross amount of reinsurance in this program reached $175 million. This total amount of reinsurance exceeded the gross amount purchased in recent years. *See* (Ex. 21, Oliphant Dep. at 103-104, 74); (Ex. 22, Cooper Dep. at

331-335) (the MWUA only had $150 million in reinsurance coverage in 2001-2002, $91 million in coverage in 2002-2003, and approximately $144 million in coverage in 2003-2004).

C. The Board Extended The $75 Million Layer Of Reinsurance For The 2005 Storm Season.

The $75 million in reinsurance excess of $100 million expired after the 2004 storm season. (Ex. 8); (Ex. 11, Little Dep. at 58.) CRC recommended that the Board act immediately upon expiration to extend the $75 million layer through the 2005 storm season because the 2004 storm season had been severe, with four named storms, and CRC had concerns about imminent capacity issues and premium increases. (Ex. 21, Oliphant Dep. at 82-83.) At the October 15, 2004 Meeting, the Board accepted CRC's recommendation and unanimously voted to immediately extend the $75 million. (Ex. 8.) CRC went to the reinsurers to secure the $75 million for the 2005 storm season, and the reinsurers sold this coverage without requesting any new MWUA underwriting data or catastrophe modeling. (Oliphant Dep. at 83-84.) The $175 million of reinsurance in place for the 2005 storm season reinsured to between a one-in-100-year and one-in-250-year event. (Ex. 10, Arnold Dep. at 68, 84-85, 130.)

D. The Board's Reported Its Purchase Of Reinsurance For The 2004 and 2005 Storms Seasons to The MWUA Member Companies.

The Board reported its reinsurance decision to the members of the MWUA at the annual meeting in October 2004 and written notice of the decision was provided to the members in February 2005: "During the past year, the MWUA reviewed its reinsurance program by soliciting proposals from several brokers, and the decision was made to continue using CRC. Due to some softening in the reinsurance market, the MWUA was able to purchase 100% of $175 million of coverage." *See* (Chairman's Report attached to 10/15/04 Annual Meeting Minutes, attached as Ex. 31.) There is no record of any member company ever questioning or

taking issue with this reinsurance purchase, asking the Plan Manager for information related to this reinsurance purchase, encouraging the Board to purchase a different amount of reinsurance for the 2005 storm season, or disputing the process the Board followed in determining how much reinsurance to purchase. (Parks Dep. at 46, attached as Ex. 32); (Ex. 13, National Security Dep. at 178-179) (acknowledging that they could have contacted the MWUA to ask about the reinsurance purchase, but they did not do so); (Ex. 12, Benchmark Dep. at 217) (same); (Aegis Dep. at 127, attached as Ex. 33) (same); (Ex. 14, ACIC/GC Dep. at 261) (same).

E. The Commissioner Reviewed The Reinsurance Program For The 2004 And 2005 Storm Seasons.

In late 2004, the Commissioner did a complete examination of the MWUA, including a review of the MWUA's purchase of reinsurance for the 2004 and 2005 storm seasons. (Ex. 2A, Harrell Aff. at ¶ 6.) This review included the policy limits ("the Association would retain the first $10,000,000 of ultimate net loss arising from each loss occurrence and cede the excess up to $175,000,000") and the period of coverage ("[t]he agreement period extends from July 1, 2004 to March 1, 2006"). (12/31/04 Report of Examination of MWUA at 5-6, attached as Ex. 34.) The Commissioner's examination "did not reveal any areas that appeared to be in contravention of the approved Plan of Operations or the intent of the Legislature in establishing the Mississippi Windstorm Underwriting Association." (*Id*. at 12); (Ex. 2A, Harrell Aff. at ¶ 6.)

F. The MWUA's Reinsurance Program For The 2004 And 2005 Storm Seasons Met Or Exceeded The A.M. Best Recommendation And The Reinsurance Programs Purchased By Other Windpools.

According to A.M. Best, the preeminent insurance rating agency, reinsuring to a 1-in-100-year hurricane event is reasonable. (Ex. 10, Arnold Dep. at 65:1-15.) The Board utilized A.M. Best's position as a "benchmark" in making its reinsurance purchasing decisions. (*Id.*) A.M. Best recommended this 1-in-100-year PML to Plaintiff National Security. (Brunson Dep.

at 50: 11-18, attached as Ex. 35.) Plaintiffs Association Casualty and Georgia Casualty relied on advice from its reinsurance broker, Benfield, and Benfield provided A.M. Best's position when making reinsurance recommendations to these companies. (Howell Dep. at 98:4-17, attached as Ex. 36.) The MWUA's purchase for the 2004 and 2005 storm seasons reinsured to between a one-in-100-year and one-in-250-year event. (Ex. 10, Arnold Dep. at 68, 84-85, 130.)

Plaintiffs alleged in their original Complaint that there is an industry standard that required the MWUA to purchase reinsurance to a 1-in-500-year probable maximum loss. (Compl., ¶ 47). However, Plaintiffs' own reinsurance expert testified that this allegation is incorrect because there is *no* industry standard applicable to the MWUA's reinsurance purchases. (Ex. 20, VDG Dep. at 141-143.) In their Amended Complaint, filed after the close of discovery, Plaintiffs dropped their incorrect allegation about a 1-in-500-year PML industry standard. *See* (Amended Complaint.) Plaintiffs now allege that the Board failed to purchase "reasonable and appropriate" reinsurance and further allege that the appropriate amount of reinsurance was $450 million which Plaintiffs contend reflects a 1-in-500-year PML. (*Id.* at ¶¶ 1, 50.)

The MWUA' s reinsurance program for the 2004 and 2005 storm seasons, which reinsured to between a one-in-100-year and a one-in-250-year event (*see* Ex. 10, Arnold Dep. at 68, 84-85, 130), met or exceeded reinsurance purchases made by similar windpools in other states. For example, in 2004, the Florida Beach Plan did not even purchase reinsurance, the Texas Beach Plan purchased to a one-in-50-year event, and the South Carolina Beach Plan bought to a one-in-100-year event. (Demerjian Decl. ¶ 4, attached as Ex. 37.) In fact, the highest event level purchased by another state's Beach Plan in 2004 is a one-in-187-year event for the Alabama Beach Plan, and this coverage dropped to a one-in-129-year event in 2005. (*Id.*

at ¶ 5.) None of the Beach Plans came anywhere close to reinsuring to a one-in-500-year event. (*Id.* at ¶ 6.)

IV. Plaintiffs' Action Challenges The Board's Reinsurance Purchases.

Plaintiffs instituted this action alleging that certain of the alleged members of the Board of the MWUA breached their fiduciary duty or were negligent in failing to procure "reasonable and appropriate" reinsurance on behalf of the MWUA for the 2004 and 2005 hurricane seasons. (*See* Complaint ¶¶ 1-2, 51.) Defendants deny that they owed any fiduciary duties to the Plaintiffs, and assert that regardless, the decisions made by the alleged Board members relating to the 2004-2005 reinsurance purchase met any applicable standard of care and are protected from liability by the business judgment rule.

ARGUMENT

I. The Business Judgment Rule Bars Plaintiffs' Claims

A. The Business Judgment Rule Creates A Presumption That Protects The Board Against Plaintiffs' Challenge To The Reinsurance Purchase For The 2005 Storm Season.

While principles of corporate law should not be indiscriminately applied to an unincorporated association, the Board's reinsurance purchasing decision is protected by the business judgment rule. Under the business judgment rule, the Board is presumed to have made its reinsurance purchase decisions in good faith, and in the honest belief that the action taken was in the best interests of the company. *City of Picayune v. S. Reg'l Corp.*, 916 So. 2d 510, 523 (Miss. 2005) ("As a general rule, the courts refrain from interfering with internal management of a corporation and do not interfere in the affairs of a private corporation in the absence of proof of bad faith or fraud on the part of those entrusted with its management."); *Omnibank of Mantee v. United S. Bank*, 607 So. 2d 76, 85 (Miss. 1992); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d

946, 954 (Del. 1985); *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled in part on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000); *Hoffman v. Kramer*, 362 F.3d 308, 317 n.4 (5th Cir. 2004) ("Because the directors are entrusted with discretion and judgment to pursue the best interests of the corporation, and they are presumed uniquely situated to make these decisions, their conclusions are due deference under the … Business Judgment Rule."); *Lee v. Interinsurance Exch. of the Auto Club of S. Cal*, 50 Cal. App. 4th 694, 711 (Cal. Ct. App. 1996) ("The business judgment rule is a judicial policy of deference to the business judgment of corporate directors in the exercise of their broad discretion in making corporate decisions."). The rule protects board decisions no matter how poor their business judgments, unless they acted fraudulently, illegally, or oppressively. *Hill v. State Farm Mut. Ins. Co.*, 166 Cal.App.4th 1438, 1491 (Cal. Ct. App. 2008).

To rebut this presumption, the Plaintiffs bear the burden of introducing evidence that the Board either lacked good faith or acted in self-interest. *See, e.g.*, *Aronson*, 473 A.2d at 812; *In re Compucom Sys., Inc. Stockholders Litig*., 2005 Del. Ch. LEXIS 145, at *21 (Del. Ch. Sept. 29, 2005) (unpublished cases are attached as Ex. 38); *Emerald Partners v. Berlin*, 787 A.2d 85, 90-91 (Del. 2001); *Hoffman*, 362 F.3d at 317 n.4 ("'courts refrain from second guessing business decisions made by corporate directors in the absence of a showing of fraud, unfairness or overreaching'") quoting *Capital Bancshares, Inc. v. F.D.I.C.*, 957 F.2d 203, 207 (5th Cir. 1992).

If Plaintiffs fail to meet their evidentiary burden, the business judgment rule bars their claims. *Emerald Partners*, 787 A.2d at 90-91; *Tomczak v. Morton Thiokol, Inc.*, 1990 WL 42607, at *7, 12 (Del. Ch. 1990); s*ee also Atkins v. Hibernia Corp.*, 182 F.3d 320, 325 (5th Cir. 1999) (affirming summary judgment for defendant directors of bank holding company because,

pursuant to the business judgment rule, the court would not review board decisions where Plaintiffs failed to establish a genuine issue of material fact concerning any disabling conflict of interest); *Bach v. Nat'l Western Life Ins. Co.*, 810 F.2d 509, 510, 512-13 (5th Cir. 1987) (affirming summary judgment for defendant committee in shareholders derivative suit under business judgment rule where Plaintiff failed to present any genuine issue of fact regarding the good faith and independence of the committee). "Overcoming the presumptions of the business judgment rule on the merits is a near-Herculean task." *In re Tower Air, Inc.*, 416 F.3d 229, 238 (3d Cir. 2005). In effect, "a plaintiff must demonstrate that no reasonable business person could possibly authorize the action in good faith. Put positively, the decision must go so far beyond the bounds of reasonable business judgment that its only explanation is bad faith." *Id*. at 238 (internal citation omitted); *Cottle v. Storer Commc'n, Inc*., 849 F.2d 570, 574-75 (11th Cir. 1988) (the presumption of good faith cannot be overcome absent a clear showing of fraud, bad faith, or abuse of discretion.)

In evaluating the Board's reinsurance purchase decision, the court should not substitute its judgment for that of the Board if the Board's decision can be "attributed to any rational business purpose." *Unocal*, 493 A.2d at 949, quoting *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971); *see also Trenwick Am. Litig. Trust v. Ernst & Young, LLP*, 906 A.2d 168, 173-174 (Del. Ch. 2006) ("What Delaware law does not do is to impose retroactive fiduciary obligations on directors simply because their chosen business strategy did not pan out. . . . To sanction such a bizarre scenario would undermine the wealth-creating utility of the business judgment rule."); *In re Marvel Entm't Group v. Mafco Holdings, Inc.*, 273 B.R. 58, 78 (D. Del. 2002) (a court will not interfere with the judgment of a board unless there is a showing of "gross and palpable overreaching"); *In re Walt Disney Co. Derivative Litig*., 731 A.2d 342, 362 (Del.

Ch. 1998), *rev'd in part on other grounds*, 746 A.2d 244 (Del. 2000) ("[A] court will not apply 20/20 hindsight to second guess a board's decision, except in rare cases where a transaction may be so egregious on its face that board approval cannot meet the test of business judgment") (internal citations omitted); *McGowan v. Ferro*, 859 A.2d 1012, 1031-1032 (Del. Ch. 2004) (summary judgment was appropriate where director Defendants proffered a number of legitimate reasons for their decision to extend merger agreement).

Instead, the Court should focus solely on the Board's decision-making process and not the merits of the Board's ultimate decision. *See, e.g., In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996) (under business judgment rule, whether the trier of fact considering the matter after the fact believes the decision to be substantively wrong, "stupid … egregious, or irrational, provides no ground for director liability, so long as the process employed was either rational or employed in … good faith"); *Hill*, 166 Cal. App. 4th at 1493 (explaining that the business judgment rule is process-oriented and that "courts do not measure, weigh or quantify directors' judgments") (internal citations omitted); *Brehm* 746 A.2d at 264 (same).

B. The Board Engaged In A Rational And Good Faith Process, Free of Any Conflict Of Interest.

The Board's reinsurance decision was made in good faith without any conflict of interest. While plaintiffs allege that the defendants had a financial incentive to cause the MWUA to under-reinsure, the record clearly establishes that this allegation is false. Plaintiffs' own reinsurance accounting expert concedes that, given the way the MWUA *actually* treated reinsurance premiums, Defendants had no financial incentive to hold down the amount of reinsurance. (Kramer Dep. at 123, 219, attached as Ex. 39.) As the Board had no incentive to under-reinsure, the Board had no conflict of interest and, as exemplified above, made the

challenged reinsurance purchase decision in good faith. Therefore, the business judgment rules bars Plaintiffs' claims.

The Board engaged in a rational and good faith process to purchase the reinsurance program that was in effect for the 2005 storm season. (*See, supra* Section II.) Like the Plaintiffs did in their own reinsurance purchases, the Board retained and relied upon a sophisticated reinsurance broker, and consulted other sophisticated brokers, who analyzed comprehensive underwriting data and made recommendations to the Board about reinsurance purchase options. (*Id.* at Sections II and III.) These reinsurance brokers analyzed the most current MWUA data using state-of-the-art catastrophe models. (*Id.* at Section III.A.)

The Board relied, as did Plaintiffs, on the recommendations of its broker. (*Id.* at Sections II and III.) Benchmark's past-President and board member testified that she did not perform her own analysis of Benchmark's own proposed reinsurance purchase, but relied exclusively on the expertise and recommendations of Benchmark's reinsurance broker in approving that reinsurance purchase. (*Id.* at Section II.A.) One of the broker's recommendations that the Board followed was to act immediately to extend the $75 million layer of reinsurance for the 2005 storm season based on the broker's strong warnings about potential impending premium increases and capacity issues in the reinsurance market. (*Id.* at Section III.C.)

The Board evaluated a host of subjective and objective criteria, and balanced numerous factors to make business judgments about the reinsurance program to purchase. (*Id.* at Section II.B.) The record reflects the deliberative process that the Board engaged in to make these business judgments in connection with the reinsurance purchase for the 2004 and 2005 storm seasons. (*Id.* at Section II.) Plaintiffs now challenge those business judgments with the benefit of hindsight. These business judgments were made in the context of a reinsurance purchase that

Plaintiffs reinsurance expert testified involves a unique entity that is not subject to any industry standards. (*Id.* at Section III.F.) The Plaintiffs' reinsurance expert says that even reasonable reinsurance brokers might disagree about an appropriate reinsurance program for the MWUA. (Ex. 20, VDG Dep. at 193.)

The Board had to make business judgments consistent with the public purpose of the MWUA, which is to provide a market for insurance in the Coast Area and not to mitigate the risk of loss to individual member companies. (*See*, *supra* Section I.) The Legislature expressed a clear preference for private insurers to write as much of this market as possible by requiring a voluntary writings credit mechanism. (*Id.* at Section I.A.) Private insurers that voluntarily underwrite policies in the Coast Area receive significant credits that reduce their share of MWUA losses. (*Id*.) This incentive mechanism is designed to encourage the private market for windstorm and hail insurance in the Coast Area and make the MWUA the market of last resort, with the MWUA only issuing polices for properties and/or insureds that private insurers will not cover. (*Id*.)

Given the MWUA's legislative mandate to provide an adequate insurance market in the Coast Area, the Board had to weigh the implications of buying reinsurance. Reinsurance is a mechanism through which an insurance company shifts a certain portion of its risk of loss to a reinsurance company. (*See*, *supra* Section I.A.) Therefore, if the MWUA purchases reinsurance, it merely shifts a portion of the risk of MWUA losses from member companies to reinsurance companies. This risk shifting does nothing to advance the MWUA's public purpose of providing a market for insurance in the Coast Area. In fact, the MWUA's purchase of reinsurance may impede the ability of the MWUA to promote the legislatively preferred private market in the Coast Area. (*Id.*) This is because the risk of MWUA losses shifted away from

member companies through reinsurance is the same risk that member companies can be relieved of by voluntarily underwriting insurance in the Coast Area. (*Id*.) Accordingly, purchasing more reinsurance can result in less voluntary underwriting, a smaller private market, and a greater share of the Coast Area insured by the MWUA. (*Id*.)

Because purchasing reinsurance does not automatically advance the MWUA's public purpose, and may in fact inhibit that public purpose, the Board must make a business judgment as to whether to purchase reinsurance at all. And if it decides to purchase reinsurance, the Board must make business judgments that balance the amount of reinsurance to purchase against the public purpose of the MWUA. (*Id*.) For example, the Board had to make business judgments about whether to pay for reinsurance premiums out of budgeted funds or whether to assess member companies understanding that an annual assessment might drive insurers out of Mississippi, a result that clearly does not promote the provision of a market for insurance in the Coast Area. (*See, supra* Section II.B.)

The fact that the Board's purchase of reinsurance might inhibit the MWUA's public purpose is significant. Tellingly, the balancing of interests in which the Board must engage when considering a reinsurance purchase in light of the MWUA's public purpose to provide a market for insurance in the Coast Area is completely ignored by the Plaintiffs, who essentially allege that the Board's paramount concern should have been protecting MWUA member companies from risk of loss. Plaintiffs' position is not only blatantly self-serving, it is incorrect. (*See, supra* Section I.) The legislature did not create the MWUA to protect member companies – it created the MWUA to provide an insurer of last resort for the Coast Area.

When the Board's reinsurance purchase process is properly considered in the context of its actual public purpose -- to provide a market for insurance in the Coast Area -- it is clear that

the Board made the various business judgments rationally and in good faith. This conclusion is validated by the Commissioner's review of the Board's reinsurance purchase for the 2004 and 2005 storm seasons which found that it was consistent with the legislative intent of the MWUA and the Plan of Operation. (*See*, *supra* Section III.E.)

C. Plaintiffs' Claim Is Nothing More Than An After-The-Fact Challenge That Is Clearly Barred By The Business Judgment Rule.

Despite the fact that the Board reported its reinsurance purchases to the MWUA members, that the information the Board considered in its reinsurance decisions was available to members by request, and that representatives of the Commissioner oversaw the Board's reinsurance purchases, there is no record of anyone taking issue with the process that the Board consistently followed or the reinsurance programs it purchased. (*See*, *supra* Section III.D-E.) It was not until after the unprecedented and catastrophic damage caused by Katrina that a very small group of members took issue with the Board's decision because they paid their statutorily required share of MWUA policyholders' losses. (*Id.* at Sections III-IV.)

Plaintiffs' claims are nothing more than the application of twenty-twenty hindsight to one of the worst natural disasters in the history of the United States. It is beyond doubt that every insurer that suffered Katrina losses -- and Defendants sustained billions of dollars in losses -- would have preferred to be in a different position after the storm. However, the business judgment rule is designed to prevent Plaintiffs from second guessing the result of the Board's reinsurance purchase if the Board engaged in a rational and good faith process to purchase that reinsurance. Accordingly, the business judgment rule bars plaintiffs' claims.

While not necessary to establish a bar to Plaintiffs' claim under the business judgment rule, the facts also demonstrate that the Board's reinsurance purchase for the 2005 storm season was reasonable. According to Plaintiffs' reinsurance expert, there is no industry standard

applicable to the reinsurance program that the Board purchased. (*See*, *supra* Section III.F.) Yet, the MWUA's challenged reinsurance purchase exceeded the benchmark of a leading insurance rating agency, A.M. Best, and met or exceeded the reinsurance programs secured by other state windpools. (*Id*.) These objective and verifiable comparisons establish that the reinsurance program the Board purchased was reasonable. In contrast, Plaintiffs offer nothing more than their own personal, subjective, and unverifiable opinions in support of their contention that the Board should have purchased exponentially more reinsurance. *See*, *e.g.*, (Ex. 20, VDG Dep. at 142-43; 188; 193; 219.)

II. THERE IS NO FIDUCIARY DUTY OWED BY THE BOARD TO ANY INDIVIDUAL MWUA MEMBER COMPANY.

In addition to being protected by the business judgment rule, the Board did not owe Plaintiffs a fiduciary duty. Under Mississippi law, Plaintiffs have the burden of proving *by clear and convincing evidence* that they were owed a fiduciary duty. *Smith v. Franklin Custodian Funds, Inc.*, 726 So. 2d 144, 150 (Miss. 1998). Plaintiffs did not bring this case as a derivative action which would rely on an alleged fiduciary duty owed by the Board to the MWUA as a whole. Instead, Plaintiffs allege the existence of a fiduciary duty between themselves individually (and not on behalf of the MWUA itself) and the Board. There is no basis to establish a fiduciary duty between a board and individual members of an unincorporated association. Plaintiffs' fiduciary claim is further attenuated, and separately fails, because the Defendant entities were not Board members at the time of the challenged reinsurance transaction.

Plaintiffs never specified how the Board owes them an individual fiduciary duty. There is no basis to impose such a duty. The MWUA is not a corporation, but a unique entity with a

public welfare mission. (*See*, *supra* Section I). Under any applicable legal principle the Board, at most, might owe a duty to the MWUA, but only *collectively* to the members. However, the Board would *not* owe a duty individually to the members. *Allyn v. Dually*, 725 So. 2d 94, 103 (Miss. 1998) ("Directors and officers of a corporation owe a fiduciary duty to their corporation. Any fiduciary duty owed to shareholders of a corporation is owed to the shareholders collectively and not individually."), quoting *Pond v. Equitable Life & Cas. Ins., Co.*, 872 P.2d 1070, 1072 (Utah Ct. App. 1994). Moreover, Defendants were not even board members at the time of the challenged reinsurance transaction. Accordingly, Plaintiffs cannot meet their burden of proving *by clear and convincing evidence* that they were owed a fiduciary duty as individual members of the MWUA. The Board had no shared goals with, or effective control over, individual members in this organization which is comprised of almost 200 competitors who were part of an association statutorily established for the sole public purpose of providing an insurance market in the Coast Area and where the Board was appointed by and operated under the control of public officials to carry out the MWUA's public purpose. (*See*, *supra* Section I); *see also* (Ex. 20, VDG Dep. at 120) (Acknowledging Board's inability to exercise control over members because of potential "antitrust violations"). Accordingly, neither the Board members nor Defendants owed a fiduciary duty to Plaintiffs.

CONCLUSION

WHEREFORE, Defendants respectfully request that this Court grant its Motion for Summary Judgment because Defendants do not owe a fiduciary duty to Plaintiffs and since Plaintiffs' negligence claim is barred by the Business Judgment Rule. Accordingly, Defendants request that the Court enter an order dismissing Plaintiffs' claims with prejudice.

This 14th day of November, 2008. Respectfully submitted by,

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CERTIFICATE OF SERVICE

I hereby certify that on November 14, 2008 I electronically filed the foregoing with the Clerk of the Court using the ECF system which sent notification of such filing to the following:

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And I further certify that I have mailed by United States Postal Service, postage prepaid, the document to the following non ECF participants: None.

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