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Texas Court Approves Highlands Amended Rehabilitation Plan

Introduction

On May 15, 2008, the Texas district court overseeing the receivership of Highlands Insurance Company (“Highlands”) formally approved the First Amended Rehabilitation Plan (“Amended Plan”) proposed by the Special Deputy Receiver (“SDR”) for the proceedings.¹ The SDR had proposed this Amended Plan in August 2007, in the wake of a recommendation by a court-appointed Special Master² to reject the initial plan (the “Original Plan”) that the SDR had proposed in 2006.³ Now that the court has approved the Amended Plan, policyholders with claims against Highlands may wish to familiarize themselves with the Amended Plan’s procedures for the resolution of claims and its statements regarding the financial condition of the estate.

The Amended Plan’s Policyholder Claim Procedures

Although the Amended Plan anticipates an “orderly runoff”⁴ of Highlands’ liabilities through specified procedures by which Highlands’ SDR will review, rule on, and ultimately pay policyholder claims, the timing of these events remains unclear. As did the Original Plan, the Amended Plan employs a threshold requirement that policyholders must have submitted their claims by filing a proof of claim form (“POC”)

- ¹ See First Amended Rehabilitation Plan for Highlands Insurance Company in Receivership, filed on August 17, 2007 in [State of Texas v. Highlands Insurance Company](#), No. GV3-04537 (Travis County, Texas).
- ² See Memorandum Recommendation and Findings of Fact and Conclusions of Law (Proposed Plan of Rehabilitation), filed on April 18, 2007 in [State of Texas v. Highlands Insurance Company](#), No. GV3-04537 (Travis County, Texas); see also McGonigle, David F. and John M. Hagan, Special Master Recommends Rejection of Highlands Rehabilitation Plan, [Insurance Coverage Alert](#) (April 2007) (discussing the Special Master’s recommendation), available at <http://www.klgates.com/newsstand>.
- ³ Rehabilitation Plan for Highlands Insurance Company in Receivership, filed on July 24, 2006 in [State of Texas v. Highlands Insurance Company](#), No. GV3-04537 (Travis County, Texas). For a detailed discussion of the Original Plan, please see McGonigle, David F. and John M. Hagan, Highlands Proposes Rehabilitation Plan, [K&LNG Alert](#) (August 2006) (discussing the Original Plan), available at <http://www.klgates.com/newsstand>.
- ⁴ Amended Plan, at 5.

with the SDR by March 30, 2007.⁵ For POCs that met this deadline, the Amended Plan empowers the SDR to review each POC individually and recommend whether the claim should be allowed, disallowed, or compromised in whole or in part.⁶ Unfortunately, no explicit timetable is provided in the Amended Plan for the review of any particular POC, so it appears that the SDR has significant discretion in deciding how to order its review of the thousands of POCs that were received by the deadline. Likewise, although the Amended Plan speaks to the payment of allowed policyholder claims “as they come due on a timely basis,”⁷ it also gives the SDR discretion to make distributions over time on individual claims if the SDR determines that the cash assets of the estate warrant a delayed payout.⁸

The Amended Plan also addresses how disputes between the SDR and policyholders about the validity and valuation of particular claims will be resolved. First, where the SDR determines that a particular policyholder claim

should be disallowed, in whole or in part, the SDR must provide written notice to the policyholder and its attorney of that decision.⁹ If the policyholder wishes to challenge that determination, it has 45 days from receipt to serve written objections on the SDR.¹⁰ If the policyholder fails to file timely objections, then the SDR’s recommendation is final and the claim may be processed, and paid if applicable, without further court order.¹¹ But, if the policyholder does file timely objections and the policyholder and SDR cannot resolve these objections, then the SDR shall submit the dispute to the receivership court, which will resolve the claim.¹² The Amended Plan states that the receivership court’s determination of the claim constitutes a final judgment,¹³ and either party may then appeal the court’s decision.¹⁴

Of potentially great consequence for policyholders with “Incurred But Not Reported” (“IBNR”) claims against Highlands, the Amended Plan authorizes the SDR to set a second claim bar date in the future “to fix a final claims liquidation and bar date by which any remaining claim must be filed, whether or not liquidated, mature or contingent.”¹⁵ If this second bar date is announced, the SDR will “describe the process for estimating and paying at present value any remaining contingent or unmatured claims, or for disallowing such claims as allowed by the [Texas] Insurer

5 Amended Plan, at 37. If a policyholder failed to file a POC by March 30, 2007, the policyholder may still file a POC and its claim will receive the same priority as timely-filed claims if (1) the policyholder did not know of the March 30, 2007 deadline and had not received notice thereof, (2) a POC is filed by the earlier of March 31, 2009 or 90 days after learning of the March 30, 2007 deadline, and (3) payment of the claim will not prejudice the orderly administration of the Highlands estate. Amended Plan, at 38. Otherwise, a late-filed POC will receive lower priority than timely-filed claims. Amended Plan, at 37.

6 Amended Plan, at 39.

7 Amended Plan, at 15; see also Amended Plan, at 30 (stating, “Policy Claims shall be payable in full in the allowed amounts during the course of the rehabilitation proceedings, except as otherwise provided herein”).

8 Amended Plan, at 30. Regardless of the timing of payment, any allowed claim in excess of \$1 million must receive court approval before it can be paid. Amended Plan, at 39.

9 Amended Plan, at 39.

10 Amended Plan, at 39.

11 Amended Plan, at 39-40.

12 Amended Plan, at 40. The Amended Plan does not provide an explicit deadline, or any specific timetable, for when the SDR must submit disputed claims to the district court.

13 Amended Plan, at 40.

14 TEX. CIV. PRAC. & REM. CODE ANN. § 51.012 (2007).

15 Amended Plan, at 38.

Receivership Act.”¹⁶ Thus, based on this provision of the Amended Plan, the SDR may try to use a second bar date to cut off contingent and/or unliquidated claims – such as those faced by many policyholders with significant environmental or toxic tort liabilities. At present, the SDR has provided no indication of *if* it will set this final bar date, let alone *when*, so policyholders with IBNR claims may wish to monitor the Highlands proceedings.

The Highlands Estate’s Financial Condition

One of the key assertions by the SDR in the Amended Plan (and the Original Plan), which appears to have been accepted by the Texas district court given its recent approval of the Amended Plan, is that the Highlands estate should have sufficient assets to permit the payment of approved policyholder claims in full over the next several years. More specifically, the Amended Plan projects – subject to various caveats – that the estate will be able to pay 100% of approved policyholder claims as they come due through at least the end of 2015.¹⁷ This projection is based upon the Amended Plan’s economic cash flow model (“ECFM”),¹⁸ which purports to account not only for future payouts, but also for future recoveries by the estate, such as from

Highlands’ reinsurers.¹⁹ Ultimately, the ECFM predicts that at the end of 2015, after nearly a decade of payouts on approved claims, the Highlands estate will still have approximately \$163.5 million remaining in cash and investments.²⁰ Of course, some policyholders and observers are skeptical of these arguably rosy projections, as evidenced by the fact that the SDR has consummated a number of policy buyouts over the last two years at levels significantly below 100% of the claimed values.

Skepticism of the long-term accuracy of the ECFM model is heightened by the fact that the Amended Plan explicitly empowers the SDR to request, at any time, that the district court convert Highlands’ rehabilitation into a liquidation proceeding. As the plan describes it, whenever the SDR determines that the estate’s financial condition will be insufficient to pay all allowed policyholder claims in full as they come due, the SDR may file an application for liquidation.²¹ Again, policyholders may wish to monitor the Highlands proceedings, including the periodic financial reports purporting to itemize the estate’s total liabilities and total assets, to see over time how the ECFM model’s projections fare against reality – with an eye towards discerning how that reality might impact the policyholder’s valuation of its unresolved claim against Highlands.

¹⁶ Amended Plan, at 38.

¹⁷ Amended Plan, at 12-14.

¹⁸ Amended Plan, at 13.

¹⁹ Amended Plan, at 16.

²⁰ Amended Plan, at 15-16.

²¹ Amended Plan, at 51-52.

Conclusion

Absent some successful appeal of the Texas district court's recent decision, the Amended Plan will govern the resolution of policyholder claims against the Highlands estate for the foreseeable future. Therefore, policyholders that filed timely POCs may wish to acquaint themselves with the claim-resolution procedures provided in the Amended Plan and monitor the overall health of the estate until their individual claims are resolved and paid. Policyholders with IBNR claims may wish to watch for the SDR to set a second claim bar date, which could require the submission of additional information and could have the effect of cutting off contingent or unliquidated claims. Policyholders may monitor ongoing developments in the Highlands rehabilitation at the SDR's website: <http://www.highlandsrehabplan.com>.

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