

Report for Special Master’s Status Conference

July 30, 2019

R-561 Capson Physicians Insurance Company

SDR: CANTILO & BENNETT, L.L.P.
Primary Responsible Person: Joseph N. West
Estate Counsel: Greg Pierce and Christopher Fuller
Receiver’s Counsel: Liz Solka and James Kennedy
RLO Analyst: Kathy Gartner

Background on Receivership

Date of Permanent Injunction (Rehabilitation/Liquidation): Feb. 11, 2019/June 28, 2019
Date of SDR Rehabilitation Appointment: February 11, 2019
Date of Conversion to Liquidation: June 28, 2019
Claims Filing Deadline: TBD
States Where Licensed: TX, AL, AK, AZ, AR, D.C., ID, IL, IN, KY, LA, MD, MS, MO, MT, NE, NV, NM, ND, OK, OR, SD, WA, WV, WI
Lines of Business: medical malpractice
Texas Property and Casualty Insurance Guaranty Association Triggered: June 28, 2019
Early Access Distributions: TBD

Statement of Assets and Liabilities as of June 30, 2019

Total Assets:	\$ 20,489,635
Cash & Invested Assets:	\$ 7,498,137
Non-Cash Assets:	\$ 12,991,498
Total Liabilities:	\$ 32,866,804
Negative Equity:	(\$ 12,377,169)

Status and Activity Since Last Status Conference

General Matters

The Agreed Order Appointing Rehabilitator and Permanent Injunction (Rehabilitation Order) was entered on February 11, 2019. The SDR was appointed effective February 11, 2019. The SDR began the receivership takeover process on February 12, 2019, when the SDR and estate subcontractors met with representatives from Capson Physicians Insurance Company (“CPIC” of the “Company”) and its parent Capson Corp. (“Corp.”) at the CPIC office in Austin. Takeover team members have been present at the CPIC offices since that date. The vast majority of the CPIC staff, including all claims personnel, have resigned to pursue other employment. The SDR continues to direct the activities of the remaining employees conducting the business of CPIC.

The SDR focused initial activities on gaining a clear picture of the financial status of CPIC as of December 31, 2018, and seeking to interest third parties in potential transactions to take over the Company or its claims liabilities. Upon completing the financial evaluation of CPIC, the SDR concluded that CPIC was insolvent and no longer able to continue as a viable insurance business. Moreover, the SDR concluded that further attempts to rehabilitate CPIC were futile, substantially increasing the risk of loss to policyholders, creditors, and the public. As such, on June 28, 2019, the Receivership Court, on application of the SDR, issued its order placing CPIC into liquidation (“Liquidation Order”).

Pursuant to the Liquidation Order, all litigation against CPIC is stayed for the duration of the receivership proceeding. Litigation against CPIC insureds is stayed pursuant to applicable guaranty fund statutes such as Tex. Ins. Code § 462.309(a), wherein such actions are stayed for six months from the date of liquidation, June 28, 2019. Furthermore, the Liquidation Order cancelled all insurance policies issued by CPIC, including any obligation to provide “tail” and/or “extended reporting” coverage at the earlier of:

- (1) July 28, 2019;
- (2) the date the policy terminates by its own terms; or
- (3) the date the insured replaces the CPIC policy with alternate coverage.

Receivership Action Against Corp. and Affiliated Subsidiaries

On June 28, 2019, the State of Texas, on behalf of the Texas Commissioner of Insurance, filed in the Receivership Court, its Application for Order Appointing Liquidator and Request for Injunctive Relief against CPIC’s parent, Corp. and its affiliated entities, Capson Physicians Insurance Agency (“Agency”) and Capson Healthcare Services, Inc. (“Tech”). Therein, the State of Texas alleges that Corp., Agency, Tech, and CPIC, as an insurance holding company system, violated the Texas Holding Company Act, prejudicing the policyholders of CPIC. The State of Texas further requests that the court consolidate the receivership proceeding of Corp., Agency, and Tech with the CPIC receivership in order to protect the assets of the holding company system, including but not limited to, the proceeds of two key man life insurance policies, and to ensure that all such assets are distributed properly.

A hearing to obtain the requested injunctive relief was scheduled for July 3, 2019; however, on the day of the hearing Corp., Agency, and Tech filed Voluntary Petitions for Chapter 11 Bankruptcy in the United States Bankruptcy Court for the Western District of Texas, to be jointly administered under Case No. 19-10890-hcm (“Capson Bankruptcy”). The State of Texas withdrew its setting for hearing on the requested injunctive relief in the receivership action against Corp., Agency, and Tech.

On July 9, 2019, Corp., Agency, and Tech filed a Motion to Reject Unexpired Lease of Non-Residential Real Property and Various Executory Contracts, and a Motion for Expedited Hearing regarding same (“Bankruptcy Motions”) in the Capson Bankruptcy. The SDR filed a Response in Opposition to the Bankruptcy Motions contesting the jurisdiction of the bankruptcy court due to the exclusive jurisdiction vested in the CPIC receivership court for all legal proceedings involving CPIC or its property. A hearing on the Bankruptcy Motions was held on July 11, 2019, at which

time the parties advised of ongoing discussions focused on resolving all issues in controversy existing between them. As a result, the hearing on the Bankruptcy Motions was continued to July 22, 2019, at which time the parties advised of an agreement resolving issues related to the unexpired lease and to work towards resolution of issues related to other executory contracts. Moreover, the parties further advised of continued settlement discussions seeking to compromise all remaining issues in dispute between Corp. and CPIC. Further hearing on the Bankruptcy Motions have been continued to August 8, 2019.

Financial Institutions: The Liquidation Order was delivered to all identified financial institutions. CPIC's securities have been liquidated and the SDR is in the process of transferring all cash and liquid assets to the Texas Treasury for safe keeping. The SDR maintains an operating account used to satisfy the ongoing obligations of the receivership estate. All financial institutions are maintaining compliance with the Rehabilitation Order, Liquidation Order, and the SDR's directives.

Defense Counsel: All defense counsel were notified of the Liquidation Order and advised of the continuation of the automatic stay. Moreover, the notice informed defense counsel of the cancellation of CPIC policies and the transfer of claims handling responsibilities to the state guaranty associations.

Granite State Insurance Company Program: CPIC entered into a "fronting" arrangement with Granite State Insurance Company ("GSIC") in 2016. Under this arrangement, Agency was to market/underwrite GSIC policies, with CPIC 100% reinsuring the GSIC policies. In reality, CPIC conducted all operations relating to the issuance and handling of the GSIC policies. On February 21, 2019, GSIC instructed that no new policies should be sold under this arrangement. Subsequently, GSIC amended its instruction to allow renewals to the extent required to comply with the obligation to provide at least ninety (90) days-notice prior to non-renewing a policy. The SDR continues to negotiate with GSIC in an effort to end the fronting arrangement and turnover all further management and claims handling relating to the GSIC policies to GSIC.

Vendors: The SDR is in the process of providing notice of the Liquidation Order to all known CPIC vendors. The SDR is currently working to ensure the continued provision of all services required for operation of CPIC in liquidation.

IT: Virtually all of CPIC's records are maintained in electronic format, but CPIC did not control its IT or data as management of this CPIC property was outsourced to third-party vendors through service agreements with Corp. As part of the takeover process, the SDR backed up and took possession of all data relating to CPIC's operations. Moreover, after the filing of the Capson Bankruptcy, the SDR contacted the third-party IT service providers and has begun the process of transitioning all service agreements from Corp. to CPIC as the contracting party.

Reinsurance: All intermediaries and reinsurers have been provided with notice of the Liquidation Order. Milford Consulting and Tharp & Associates continue to advise the SDR on reinsurance and to oversee monthly reporting to the intermediaries and reinsurers.

Guaranty Associations and Claims: With entry of the Liquidation Order, claims handling is being transitioned to the state guaranty associations. The SDR and its claims staff are working with the National Conference of Insurance Guaranty Funds and the Texas Property and Casualty Insurance Guaranty Association on data transfer issues to ensure that the guaranty associations have all CPIC data and information necessary for takeover of CPIC claims administration.

Regulatory Action: CPIC's license has been suspended or revoked in Alaska, Arkansas, Iowa, Kentucky, Louisiana, Maryland, Nevada, New Mexico, North Dakota, Oregon, Washington, and West Virginia. Regulators in New Mexico are in the process of initiating an ancillary receivership for the protection of New Mexico policyholders. The SDR does not oppose the New Mexico ancillary proceeding.

Asset Recovery Activity:

Statutory Deposits: CPIC had statutory deposits in Texas (\$1,907,000), New Mexico (\$330,000), and Oregon (\$425,000). The SDR is in the process of making application to recover the statutory deposits in Texas and Oregon. The New Mexico statutory deposit is being held in an ancillary receivership for the protection of New Mexico policyholders.

All reinsurers have been notified of the receivership and instructed to direct payments to the SDR. Reinsurance reporting has continued since receivership and is now handled by the SDR's subcontractors.

All E&O, D&O, and professional liability insurance policies have been reviewed and expiration/claim extension deadlines noted.

General Legal Activities

Litigation: No first party lawsuits involving CPIC exist. With respect to lawsuits against CPIC insureds, most courts continue to honor the automatic stay. The SDR has provided notice of the Liquidation Order to all defense counsel advising of the continuation of the automatic stay and the transfer of claims handling responsibilities to the state guaranty associations.

Conclusion

Summary of Major Achievements

Filed motion for liquidation and obtained Liquidation Order.

Completed the transfer of all CPIC assets to the Texas Treasury for safe keeping.

Provided notice of CPIC's liquidation to policyholders, defense counsel, financial institutions, intermediaries, reinsurers, guaranty associations, and all providers of services vital to the continued operation of CPIC in liquidation.

Completed the initial transfer of UDS data and began the transition of claims administration to the state guaranty associations.

Preserved the SDR's right to contest the jurisdiction of the Corp. bankruptcy court on all matters involving CPIC or its property.

Achieved significant progress towards the resolution of all disputes existing between CPIC, Corp, Agency, and Tech.

Updated CPIC www.capson.com and SDR www.capsonsd.com web sites to provide notice of liquidation.

Estate Goals to achieve prior to next Status Conference

File application with the receivership court for approval of proof of claim forms and claim filing deadlines.

Relocation of CPIC offices.

Transfer of CPIC records not required for operations to Safesite for storage.

Complete termination of GSIC fronting arrangement.

Complete new service agreements with all providers of vital services, substituting CPIC for Corp. as the contracting party.

Complete recovery of statutory deposits.

Estate Closing Date of Receivership: TBD

Identification of Factors Affecting Closing Date and Final Distribution: TBD