

CAUSE NO. D-1-GN-19-000723

THE STATE OF TEXAS
Plaintiff,

v.

CAPSON PHYSICIANS INSURANCE
COMPANY,
Defendant.

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IN THE DISTRICT COURT OF

TRAVIS COUNTY, TEXAS

250TH JUDICIAL DISTRICT

**SPECIAL DEPUTY RECEIVER’S APPLICATION TO APPROVE
SETTLEMENT AGREEMENT**

[Capson Corp., Agency, Tech and GSIC]

TO THE HONORABLE JUDGE OF SAID COURT:

CANTILO & BENNETT, L.L.P., Special Deputy Receiver of Capson Physicians Insurance Company (the “SDR” and “CPIC,” respectively) files this *Application to Approve Settlement Agreement [Capson Corp., Agency, Tech and GSIC]* (the “Application”) and shows the following:

I. INTRODUCTION

1.1 The SDR seeks approval of a settlement of claims between and/or among the SDR, Capson Corp. (“Corp.”), Capson Physicians Insurance Agency, Inc. (“Agency”), Capson Healthcare Services, Inc. (“Tech”) (collectively, Corp., Agency, and Tech will be referred to as the “Corp. Parties”), and Granite State Insurance Company (“GSIC”). The SDR seeks this Court’s approval of the settlement under TEX. INS. CODE § 443.154(y) because it involves a claim exceeding \$5 million. In summary, the settlement agreement provides a three-way resolution of various claims asserted between and/or among the SDR, the Corp. Parties, and GSIC. The settlement provides for the Corp. Parties to make payments to the SDR (\$6.5 million) and to GSIC (\$1.62 million), for the parties to otherwise retain any funds received from each other, and for the parties to otherwise release all claims against each other. The releases involved, however, will not

include releases of any liability under any reinsurance obligations under any reinsurance agreement. Finally, any distribution to GSIC by the CPIC estate will be reduced by the amounts GSIC received/retained under the settlement. The settlement is in the best interests of the receivership estate and its policyholders and creditors and has been approved by the Receiver.

II. BACKGROUND AND JURISDICTION

2.1 CPIC was placed in receivership for rehabilitation in this proceeding on February 11, 2019. The Receiver designated CANTILO & BENNETT, L.L.P. as SDR on that same date. Subsequently, on June 28, 2019, the Court entered its *Order Appointing Liquidator and Permanent Injunction* (the "Permanent Injunction"), placing CPIC into liquidation.

2.2 This Court has jurisdiction over the subject matter of this Application and of the parties and property affected herein pursuant to TEX. INS. CODE § 443.005. The Court has personal jurisdiction over all claimants against the assets of the receivership estate of CPIC ("Claimants") because this is a civil proceeding arising under and related to a delinquency proceeding under Chapter 443 of the Texas Insurance Code (the "Code"), the transactions and occurrences which form the basis for the proceeding occurred, in whole or in part, in this state, because the Claimants fall under the Court's statutory personal jurisdiction set out in TEX. INS. CODE § 443.005(d) and TEX. CIV. PRAC. & REM. Code Chapter 17, alternatively, because the Claimants reside and/or conduct business in this state that is directly related to the subject matter of this proceeding, and because the exercise of jurisdiction over any non-resident Claimant comports to customary standards of fair play and substantial justice and complies with the protections of the Constitutions of the United States of America and the State of Texas.

2.3 The SDR is authorized to file this Application pursuant to TEX. INS. CODE § 443.154(y).

2.4. The subject matter of this Application has been referred to the Special Master appointed in this proceeding in accordance with Paragraph III of the *Order of Reference to Master* entered on February 21, 2019 and Paragraph II of the *Supplemental Order of Reference to Master* entered on September 18, 2019.

III. THE DISPUTES BEING SETTLED

A. Disputes with the Corp. Parties

3.1 Before receivership, two key man life insurance policies covering Maury Magids were purchased. Those policies named Maury Magids as insured and named Corp. as beneficiary. The policies were issued by AXA Equitable Life Insurance Company (the “AXA Policy”) in the face amount of \$10 million and by Nationwide Life and Annuity Insurance Company (the “Nationwide Policy”) in the face amount of \$5 million. Both policies were purchased using funds improperly diverted from CPIC in violation of Texas law. Moreover, CPIC funds were used to pay the policies’ premiums in violation of the supervision order entered against CPIC in early 2018.

3.2 On February 11, 2019, Maury Magids died. Subsequently, Corp. made a claim on both policies. The AXA Policy proceeds were paid to Corp. in March 2019. The Nationwide Policy proceeds were, eventually, placed into escrow pending settlement discussion between the SDR and Corp. In March 2019, Corp. paid \$5.2 million of the AXA Policy proceeds to certain individuals/entities that had loaned \$5 million to Corp. (the “Noteholders”). In 2018, the Noteholders loaned \$5 million to Corp., which Corp. then contributed to CPIC as additional capital.

3.3 Additionally, the SDR uncovered improprieties at CPIC that led to its failure, and financial reporting improprieties at CPIC masked its insolvency for several years, increasing the size of its insolvency by millions, all to the injury of CPIC, its policyholders, and creditors. The

SDR asserted its claim to the proceeds of the two key man life insurance policies as well as claims based upon Corp.'s mismanagement of CPIC.

3.4 Furthermore, on June 28, 2019, the State of Texas, now aware of the improprieties involving CPIC and the Corp. Parties, filed its Plaintiff's Original Petition, Application for Order Appointing Liquidator, and Request for Injunctive Relief (the "Corp. Receivership Action") in the action styled Cause No. D-1-19-003720, *State of Texas v. Capson Corporation, et al.*, in the 126th Judicial District Court for Travis County, Texas (the "Corp. Receivership Action"). The Corp. Receivership Action sought to place Corp. Parties into receivership along with CPIC.

3.5 A few days after Corp. Receivership Action was filed, the Corp. Parties filed petitions in bankruptcy.¹ At the time of filing, the only assets held by the Corp. Parties were the remaining proceeds of the AXA Policy (in the approximate amount of \$4.2 million as of the bankruptcy filing) and Corp.'s claim to the Nationwide Policy proceeds (in the amount of approximately \$5 million). The SDR challenged the jurisdiction of the bankruptcy court to entertain any disputes with the SDR (or indeed to entertain the bankruptcy itself). Soon after the bankruptcy filing, however, the SDR and the Corp. Parties entered into settlement discussions seeking resolution by agreement.

B. Disputes with GSIC

3.6 Prior to receivership, CPIC, Agency, and Corp. entered into a "fronting agreement" with GSIC (the "GSIC Program"). Under the GSIC Program, Agency was to market GSIC policies which would be 100% reinsured by CPIC. Agency was required to collect premiums, remit those premiums, less a commission, to GSIC, which would then deduct taxes and a "fronting fee" and return the remaining premiums to CPIC as "reinsurance premiums." CPIC was also required to

¹ In light of Corp.'s/Agency's/Tech's bankruptcy filings, the proposed agreement will also need to be reviewed and approved by the bankruptcy court.

obtain further reinsurance of the risks covered by the GSIC policies, and to provide “cut-throughs” for GSIC, whereby GSIC could collect reinsurance recoveries directly, without CPIC involvement. CPIC also contracted to handle/pay all claims. Corp. separately agreed to guarantee all obligations of both Agency and CPIC under the fronting program. Finally, pursuant to its obligations to reinsure the GSIC policies, CPIC issued an \$800,000 letter of credit (the “GSIC LOC”) in favor of GSIC.

3.7 Shortly after CPIC’s placement into receivership, GSIC directed that no further GSIC policies be sold unless required by law. The SDR and GSIC then worked, over a number of months, to coordinate future handling of policy and claims administration for the GSIC issued policies and to account for funds received and/or owed between them under the GSIC Program. Upon CPIC’s placement into liquidation (on June 28, 2019), CPIC’s reinsurance obligations were terminated. GSIC drew down all funds under the GSIC LOC and held those funds pending ultimate determination of CPIC’s reinsurance liabilities to GSIC under the GSIC Program.

3.8 After filing bankruptcy, the Corp. Parties sought a determination from the bankruptcy court that GSIC’s claims against Corp. (based upon the liabilities owed to GSIC from Agency and CPIC) would be zero. GSIC responded, alleging that it had a claim against Corp. of approximately \$6 million (largely based upon actuarial estimates of potential claims under policies issued under the fronting agreement).

IV. THE SETTLEMENT

4.1 The proposed settlement agreement² to resolve the claims between and/or among the SDR, the Corp. Parties, and GSIC would operate as follows:

² The parties continue to work on preparing formal settlement documents memorializing the proposed settlement described herein. Once complete, those formal documents will control to the extent of any inconsistency between the description of the settlement herein and the formal settlement documents themselves.

- (1) Corp. would pay the SDR \$6.5 million;
- (2) Corp. would pay GSIC \$1.62 million;
- (3) GSIC would retain the \$800,000 in funds it received by drawing down upon the GSIC LOC;
- (4) GSIC and the SDR would retain any other funds they had received pursuant to the GSIC fronting program;
- (5) all claims between/among the Corp. Parties, the SDR, and GSIC (including claims against respective officers, directors, employees, agents, attorneys, and representatives) would be released;
- (6) notwithstanding the releases, no party would release any claim to recover under any contract of reinsurance, but all such reinsurance obligations would remain unaffected by the settlement;
- (7) to the extent that GSIC ever becomes entitled to a distribution from the CPIC estate, such distribution will be reduced by the amounts received/retained by GSIC under the settlement; and
- (8) all parties would be responsible to pay their own attorney's fees and expenses in connection with the disputes and/or their resolution.

4.2 The proposed settlement is in the best interest of the CPIC estate, its policyholders, and creditors. First, total funds currently available from the Corp. Parties to pay claims asserted by the SDR and by GSIC (and by anyone else) is at best \$8.9 million (the approximately \$3.9 million³ remaining from the AXA Policy proceeds and the approximately \$5 million of the Nationwide Policy proceeds). While the SDR believes that it has good claims against Corp. to recover all of those funds and more, such claims are subject to litigation risk. Furthermore, such litigation would be complex, expensive, and would likely take years to complete. Moreover, the Corp. Parties' available assets would be further reduced as they paid their counsel to fight the claims asserted by the SDR. Furthermore, GSIC is also actively seeking a substantial recovery against Corp. in the Corp. Parties' bankruptcy proceedings. Any sums that GSIC demonstrates itself to be entitled to

³ The funds held by the Corp. Parties at the time of filing bankruptcy have been reduced by fees incurred due to the disputes with the SDR and GSIC.

recover could also potentially reduce any distribution to the SDR in the Corp. Parties' bankruptcy proceeding.

4.3 By entering into the proposed settlement, the SDR will recover \$6.5 million now – approximately 50% of the current estimated insolvency of the CPIC estate. Moreover, the SDR will avoid any risk of adverse rulings, as well as avoiding the possibility of receiving less actual recovery due to diminution of the Corp. Parties' assets and/or increase in the amounts recoverable by GSIC against Corp. As such, entering into this settlement is in the best interest of the CPIC estate, CPIC policyholders, and CPIC's creditors.

V. NOTICE

5.1 The SDR has served this Application to all known parties at interest and all individuals and entities identified by the SDR in the Certificate of Service by email, or such other method as is described in the Certificate of Service.

VI. OFFER OF PROOF AND VERIFICATION

6.1 This Application is verified by the affidavit and certification pursuant to TEX. INS. CODE § 443.017(b) by Joseph N. West, Partner in CANTILO & BENNETT, L.L.P., Special Deputy Receiver of Capson Physicians Insurance Company.

VII. NOTICE OF ELECTRONIC SERVICE REQUIREMENT

7.1 Pursuant to the *Order Granting Special Deputy Receiver's Application to Require Electronic Service of Pleadings and Notices* entered on April 3, 2019, all pleadings filed in response to this Application or in regard to the estate shall be served by email on the undersigned counsel and all parties shown in the attached Certificate of Service.

PRAYER

WHEREFORE, PREMISES CONSIDERED, CANTILO & BENNETT, L.L.P., Special

Deputy Receiver of Capson Physicians Insurance Company prays that the Court enter an order as follows:

1. Granting the Application;
2. Approving the settlement;
3. Authorizing the SDR to perform any and all actions necessary to document a settlement agreement substantially in conforming to the terms described herein;
4. Authorizing the SDR to perform any and all actions necessary to perform pursuant to any settlement agreement substantially conforming to the terms described herein;
5. Authorizing the SDR to take any action necessary to carry out the Order;
6. Finding that the Order constitutes a final judgment fully resolving all issues relating to the Application, provided that this Court shall retain jurisdiction to issue further orders pursuant to TEX. INS. CODE Chapter 443;
7. Finding that the Order shall not affect in any way, the Receiver's and the SDR's immunities from suit and shall not give rise to any right to sue or create any causes of action against the Receiver or the SDR;
8. Finding that the Permanent Injunction and the automatic stay under TEX. INS. CODE § 443.008 remain in effect; and
9. Granting the SDR such other and further relief to which it may be justly entitled.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that on January 27, 2020, a true and correct copy of the foregoing *Application to Approve Settlement Agreement [Capson Corp., Agency, Tech and GSIC]* was served pursuant to the Supplemental Order of Reference to Master, the Texas Rules of Civil Procedure and TEX. INS. CODE 443.007(d) on the following by email, except as specifically otherwise noted.

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/s/ Greg Pierce
Gregory A. Pierce

APPLICANT'S NOTICE OF SUBMISSION

Pursuant to the terms of the Supplemental Order of Reference to Master entered by the District Court in this cause, the Special Deputy Receiver's *Application to Approve Settlement Agreement [Capson Corp., Agency, Tech and GSIC]* is hereby set for written submission before the Special Master, Tom Collins, on **February 10, 2020**.

The Special Master has asked that the following rules be provided you:

1. Any objection must be filed with the Travis County District Clerk at least three (3) calendar days before the submission date.
2. A copy of any objection shall be served by e-mail by such date on:
 - (a) The Special Master's Docket Clerk, at specialmasterclerk@tdi.texas.gov;
 - (b) The undersigned counsel, Greg Pierce at gpierce@gpiercelaw.com; and
 - (c) All interested parties, including those listed on the SDR's Certificate of Service.
3. The objecting party shall coordinate with the SDR's counsel and the Docket Clerk [(512) 676-6915] to obtain an oral hearing setting for argument on the Application and Objection, and complete and attach an "Objecting Party's Notice of Oral Hearing" to the objection.
4. The written objection must specifically list all reasons for objection with supporting references to and discussion of statutory and case authorities. Reasons not stated in writing will not be considered orally.
5. **Please note that if an objection is not filed as described in the Notice of Submission, the Master may consider the Application without a hearing.**
6. **Failure to file timely a written objection before the Special Master constitutes a waiver of the right to object to the Special Master's recommendation to the District Court.**
7. Any Acknowledgment of Notice and Waiver to be filed by the Guaranty Association or other interested party should be filed at least three (3) calendar days before the submission or hearing date.

/s/ Greg Pierce
Gregory A. Pierce

**SPECIAL DEPUTY RECEIVER'S VERIFICATION AND CERTIFICATION
PURSUANT TO TEX. INS. CODE ANN. §443.017(b)**

AFFIDAVIT OF JOSEPH N. WEST

STATE OF TEXAS §
 §
COUNTY OF TRAVIS §

BEFORE ME, the undersigned authority appeared Joseph N. West, who after being by me duly sworn, stated the following under oath:

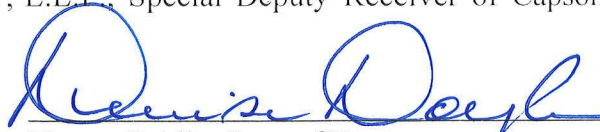
1. “My name is Joseph N. West. I am of sound mind, capable of making this affidavit, and am competent to testify to the matters contained in this affidavit.
2. I am a partner in CANTILO & BENNETT, L.L.P., the Special Deputy Receiver of Capson Physicians Insurance Company (the “SDR” and “CPIC” respectively), and I am duly authorized to make this Affidavit on behalf of the SDR.
3. I have reviewed the *Application to Approve Settlement Agreement [Capson Corp./Agency/Tech/GSIC]* and the facts stated therein are true and correct based on my personal knowledge, my review of estate records, and my consultation with the staff and subcontractors.

FURTHER AFFIANT SAYETH NOT.”



JOSEPH N. WEST

SUBSCRIBED AND SWORN TO BEFORE ME on January 27, 2020, by Joseph N. West, partner in CANTILO & BENNETT, L.L.P., Special Deputy Receiver of Capson Physicians Insurance Company.



Notary Public, State of Texas

