UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

IN RE PLATINUM-BEECHWOOD LITIGATION,	Civil Action No. 1:18-cv-06658 (JSR)
WASHINGTON NATIONAL INSURANCE COMPANY and BANKERS CONSECO LIFE INSURANCE COMPANY, Cross-Claim and Third-Party Plaintiffs, v. PLATINUM MANAGEMENT (NY) LLC, et al., Cross-Claim and Third-Party Defendants.	Civil Action No. 1:18-cv-12018 (JSR)

THIRD-PARTY AND CROSS-CLAIM PLAINTIFFS BANKERS CONSECO LIFE INSURANCE COMPANY'S AND WASHINGTON NATIONAL INSURANCE COMPANY'S MEMORANDUM OF LAW IN FURTHER SUPPORT OF MOTION TO ENFORCE STATE SECURITY STATUTES

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PRELIMINARY STATEMENT[1]

Beechwood does not dispute and hence concedes Movants' central arguments:

(1) Under the Security Statutes, foreign reinsurers, such as Beechwood, who choose not to become licensed reinsurers under state law must post security to file any pleading in a case brought by its cedent;

(2) Under settled law, a "pleading" includes any motion filed in the case, such as a motion to compel arbitration or a motion to dismiss;

(3) In determining the amount of security, no consideration should be given to the merits of Beechwood's defenses;

(4) Beechwood benefitted from the Security Statutes by avoiding licensing requirements in New York and Indiana and thus cannot now disclaim the obligations imposed upon it by those very same Statutes; and

(5) The Security Statutes are important state insurance laws that the Second Circuit and courts within it have consistently applied to require insurers and reinsurers to post security before making any substantive motion.

Conceding the above, as it must, Beechwood makes four flimsy arguments. *First*, Beechwood argues that this Court should send the motion to arbitration, to have the Panel determine whether its prior Security Orders should preclude Movants' application under preclusion grounds. There are no grounds, however, to preclude this Court from ordering security based on the Panel's non-final interim Security Orders, which were not based on the merits, were preliminary, were decided on different law and different facts, and did not even address the cross-claim for contribution and indemnity based on the Receiver's suit against Movants. Moreover, Beechwood has it backwards. The posting of security is a threshold requirement that must be met ***before*** Beechwood can be permitted to file any pleading or motion, or make any application, and hence Beechwood's request to send matters to arbitration,

[1] All terms defined in the moving brief (Dkt. No. 245) ("Br.") are used as defined terms herein. Unless otherwise noted, citations to the docket refer to the docket in the case captioned *Cyganowski v. Beechwood Re Ltd, et al.*, No. 18-cv-12018-JSR.

including any decision on whether preclusion applies, should not even been considered until it posts adequate security.[2]

Second, Beechwood contends that security should be denied because all of Movants' claims are subject to arbitration. But, under settled law, Beechwood would *still* have to post a bond in an amount fixed by this Court before seeking to compel arbitration, and the bond would remain in effect until the arbitration was concluded.[3] So, whether Beechwood is ultimately entitled to arbitrate the cross-claims against it is irrelevant to the question of security.

Third, Beechwood takes issue with the amount of security being requested. As explained below and in the accompanying declaration and exhibits, however, the amount of security is easily established. *Fourth*, Beechwood argues that the Security Statutes do not apply to foreign reinsurers in liquidation, but Beechwood misrepresents the law.

ARGUMENT

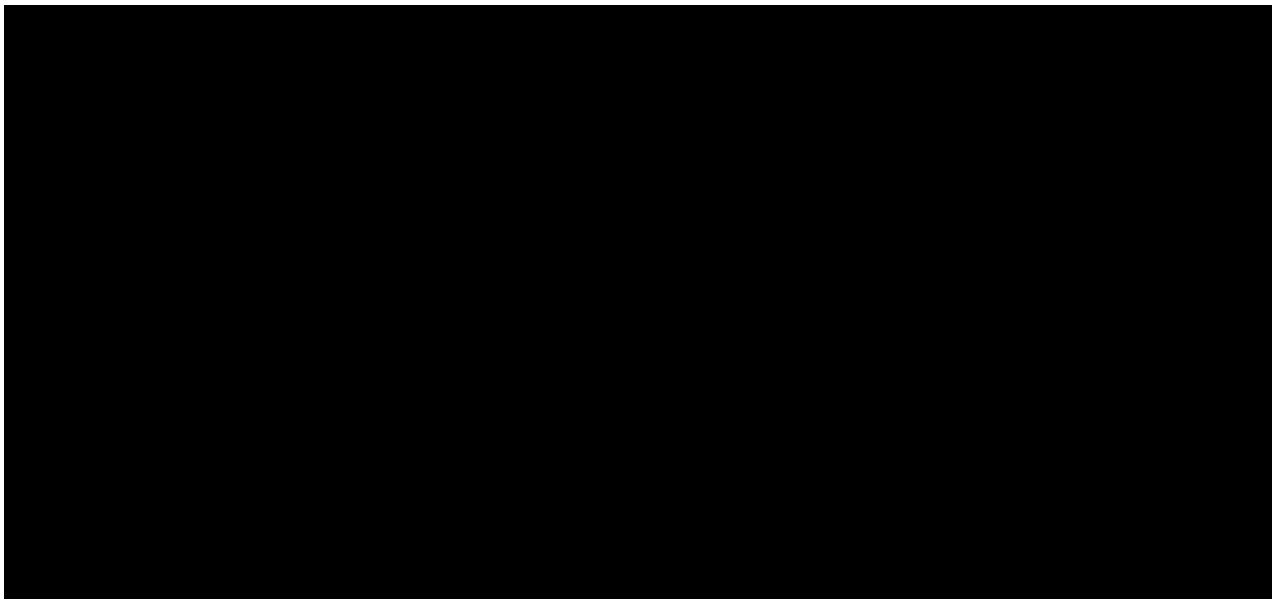
I. CLAIM AND ISSUE PRECLUSION DO NOT APPLY AND THE PANEL HAS ALREADY STATED THE ISSUE IS FOR THE COURT TO DECIDE

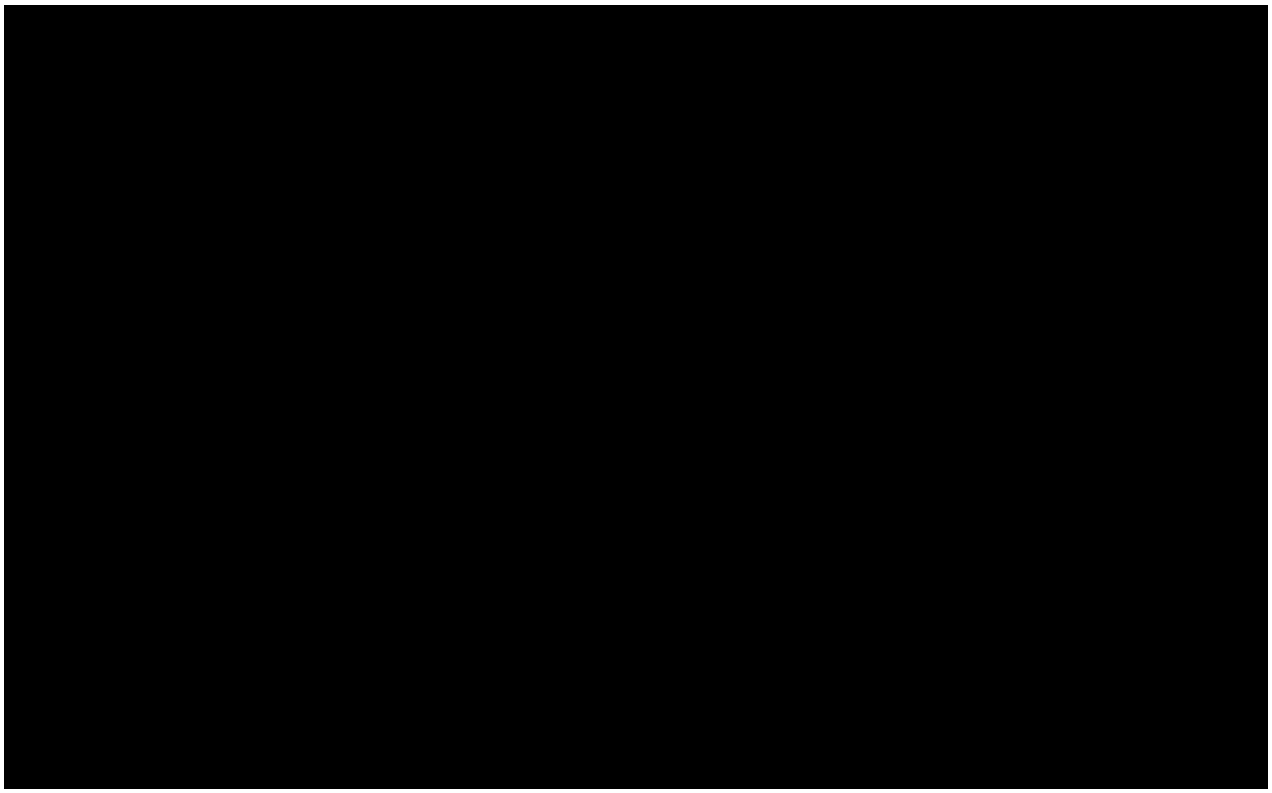
Beechwood claims it complied with the order and posted the required security in 2017, Dkt. No. 306 ("Opp."), at 7, [redacted] Beechwood stalled complying with the Security Orders for nearly two years. Beechwood's last excuse was based on this case, but the Panel would have none of it.

More specifically [redacted]

[2] *In re MF Glob. Holdings Ltd.*, 569 B.R. 544, 550 (S.D.N.Y. Bankr. 2017) ("[N.Y. Ins. Law Section 1213(c)(1)] ***requires*** an unauthorized foreign insurer to either obtain a license to conduct insurance business in New York, or to post a bond with the clerk of the court in which the proceeding is pending, before filing ***any*** pleading in a proceeding against it.") (emphasis added).

[3] *MF Glob.*, 569 B.R. at 553 n. 9 ("If the insured files a court proceeding in New York . . . ***a bond must be posted even if arbitration is ultimately ordered***. The protection the statute provides to New York insureds cannot otherwise be assured.") (emphasis added).





[4] The cases cited by Beechwood are inapposite. *Nat'l Union Fire Ins. Co. of Pittsburgh v. Belco Petroleum Corp.* involved *successive arbitrations* between the same parties. 88 F.3d 129, 131 (2d Cir. 1996). *Moore v. Aegon Reins. Co. of Am.* involved a prior judicial determination in federal court that the reinsurer was a state actor exempted from the security statutes under the Foreign Sovereign Immunities Act. 608 N.Y.S.2d 166, 168 (N.Y. App. Div. 1994). Because the federal court resolved that particular issue in a final order, the state court held that it was preclusive on the state court. *Id.* at 173. These cases are far afield from the situation here, where the Panel, applying different facts and law, entered an expressly non-final order.

In any event, as explained in the moving brief, the limited prior security for costs ordered by the Panel in arbitration is irrelevant to the issue of what security is required now in this court action. Br., at 14–18. Beechwood does not dispute that the Panel was operating under a different set of facts. Beechwood had been withholding production of its documents, so the scope of its fraud had not been fully revealed, and the recaptured assets were still being sold. Nor does Beechwood dispute that the Panel was applying different legal principles. AAA rules grant arbitrators great flexibility and arguably preclude the awarding of default judgments based on the Security Statutes, even though the Security Statutes require security and contemplate default judgments when security is not posted.[5]

And the Security Orders were expressly *not final*. Br., at 17. This point is critical, because both collateral estoppel and res judicata require a "final judgment on the merits" for any prior decision to bind another court. *Monahan v. N.Y.C. Dep't of Corr.*, 214 F.3d 275, 284–85 (2d Cir. 2000); *Purdy v. Zeldes*, 337 F.3d 253, 258 (2d Cir. 2003). The Security Orders, by their terms, are interim orders that can be changed for any reason. That is the opposite of a final judgment. Nonetheless, according to Beechwood, "[n]umerous courts recognize that confirmed arbitration awards are final judgments for purposes of *res judicata*." Opp., at 12. The main case cited by Beechwood, *Ufheil Constr. Co. v. Town of New Windsor*, 478 F. Supp. 766 (S.D.N.Y. 1979), does not even concern an award of interim security, however. The other cases Beechwood cites address only whether the arbitration panel's interim security orders constituted

[5] Beechwood states that the Panel awarded only $5 million in security for costs "because CNO failed to establish a rational basis for its $137 million request." Opp., at 14. Not true. As detailed in the moving brief, the Panel expressly held that, because Beechwood had no money, ordering security would not result in a "final and binding" award. Br., at 14–15. Thus, the Panel was clear that it denied greater security because Beechwood lacked the funds to post it. Before this Court, however, Beechwood's ability to post the security is irrelevant. Br., at 16.

"arbitral awards" subject to judicial review—not whether they were "final" awards for purposes of claim or issue preclusion.

Courts in this district that have reviewed and confirmed interim security awards under the Federal Arbitration Act ("FAA") have done so as an *exception* to the rule of "finality."[6] That is, courts have recognized that such awards are *not* final—they provide temporary equitable relief and can be changed at any time—but they nevertheless review them to further the underlying purpose and goals of arbitration.[7] Not only is an interim security order not a "final" order, it also fails to satisfy the "on the merits" requirement for applying preclusion. A security award is "separable from the merits of the arbitration." *British Ins. Co.*, 93 F. Supp. 2d at 514.[8] Beechwood's entire argument is that the interim order somehow morphed into a final judgment on the merits simply because this Court reduced it to the form of a judgment. But courts confirm security orders as an exception to the finality rule, not because interim security awards are final.

What's more, both claim and issue preclusion prevent litigation of only those issues that were *previously litigated*. Opp., at 12, 15. Thus, the Security Orders have no bearing on the *contribution and indemnity* claims Movants assert here because they were not, and could not have been, asserted in arbitration (because the Receiver had not yet sued Movants, and hence

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[6] *Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Source One Staffing LLC*, 2017 U.S. Dist. LEXIS 75056, at *4 n.1 ("Although the award is interim in nature, it is nevertheless considered 'final' *for purposes of judicial review in this Court*.") (emphasis added) (collecting cases).

[7] *See, e.g.*, *British Ins. Co. v. Water St. Ins. Co.*, 93 F. Supp. 2d 506, 514 (S.D.N.Y. 2000) ("Although a district court does not have the power to review an interlocutory ruling by an arbitration panel [under the FAA], an award of *temporary equitable relief such as a security award*, separable from the merits of the arbitration, is subject to federal review.") (emphasis added) (quotation marks and internal citation omitted).

[8] *See also Nat'l Union Fire Ins. Co. of Pittsburgh*, 2017 U.S. Dist. LEXIS 75056, at *7 ("By its very nature, however, a request for pre-hearing security is made on a limited record at an early stage of the arbitration proceedings . . . .").

those contribution claims had not yet arisen). By the same token, much more is now known about the fraud—and efforts to conceal it—than was known in early 2017 when Movants sought security before the Panel. As just one example, [redacted] Beechwood did not want the Panel to know the truth (and had not produced documents when the interim security motion was litigated), so the true facts [redacted] were never before the Panel. In any event, whether pre-pleading security is required in one proceeding is a distinct issue from whether it is required in a different proceeding.[10] The Panel's 2017 security rulings, made when the Co-conspirators' schemes and admissions were still being concealed, do not now shackle this Court.

[redacted]

[10] *See Sec. Ins. Co. v. Trustmark Ins. Co.*, 283 F. Supp. 2d 602, 611 n.10 (D. Conn. 2003) ("[T]he power to stay is discretionary and vested in the court, not the arbitrator. The fact that plaintiff first sought a stay from the arbitration panel has no preclusive effect on its ability to seek the same relief through authority specifically allocated to the court under California law.").

II. THE SECURITY STATUTES APPLY TO FOREIGN REINSURERS IN LIQUIDATION

Beechwood argues that N.Y. Ins. Law. Section 1213 does not apply because it is in liquidation. Opp., at 24–25. But Section 1501(d) of the Bankruptcy Code is explicit that insurance security statutes like Section 1213 may not be abrogated by Chapter 15:

> The court ***may not grant relief under this chapter with respect to any*** deposit, escrow, trust fund, or other ***security required*** or permitted ***under any applicable State insurance law or regulation*** for the benefit of claim holders in the United States.

11 U.S.C. § 1501(d) (emphasis added).[11] The Security Statutes are just that—state insurance laws requiring the posting of security for the benefit of claim holders like Movants. Congress ensured that state insurance laws requiring foreign insurers and reinsurers to post security would be enforced. Beechwood's request that such state laws be set aside violates Section 1501(d).[12]

III. MOVANTS REQUEST SECURITY IN A REASONABLE AMOUNT

Beechwood takes issue with the amount of security Movants request. That amount has two parts. *First*, Movants seek $70 million related to its contribution and indemnity claims arising out of the Receiver's claims against Movants.[13] Thus, Movants properly seek security in

[11] The Receiver and JOLs also oppose awarding security, but they proffer the same misunderstanding of bankruptcy law. Dkt. No. 297.

[12] Beechwood, the Receiver and the JOLs rely heavily on *In re Laitasalo*, 193 B.R. 187 (Bankr. S.D.N.Y. 1996), but *Laitasalo* was decided under the now-repealed Section 304 of the Bankruptcy Code. Section 1501(d), quoted above, demonstrates that *Laitasalo* no longer has any vitality. *Id*. at 190. In that case, the bankruptcy court noted that if the plaintiff were to proceed against the debtor in state court under N.Y. Ins. Law Section 1213, the plaintiff's claim would be converted from an unsecured claim to a secured claim contrary to bankruptcy policy. *Id*. at 193. For that reason, the bankruptcy court declined to enforce Section 1213. *Id*. at 194. But Section 304 of the Bankruptcy Code is no longer effective and has been replaced with Chapter 15 and Section 1501(d) of the Bankruptcy Code. That section explicitly provides that N.Y. Ins. Law Section 1213 ***must*** be enforced in a Chapter 15 proceeding.

[13] There is no question that the Movants are being sued derivatively for Beechwood's conduct—indeed, the Receiver's entire theory of liability against Movants is that they did not "blow the whistle" on the Platinum-Beechwood fraud.

the amount of the Receiver's claims. While Beechwood questions the strengths of the Receiver's case (as we do), the amount of those claims is the "amount of any judgment" that could be awarded in respect of them.

Second, Movants seek $180 million—the amount of its cross-claim against Beechwood arising from Beechwood's breach of contract. That amount is supported by the accompanying Declaration of Timothy Bischof, and is the amount of damages that could be awarded—the test under the Security Statutes. Beechwood's damages analysis is based on a pack of lies. Under the Reinsurance Agreements, upon recapture Beechwood was required to pay assets having a "fair market value equal to the statutory reserves attributable to the liability being recaptured" (that is, assets equal to policyholder liabilities), plus the $42.2 million negative ceding commission. Kaiser Decl. (Dkt. No. 170), Exs. A & B (§ 9.3(vi) (in both agreements); § 9.3 (vii), Schedule 9.3 (in the WNIC Agreement)). [redacted] Opp., at 21. But [redacted] is not a reliable source (to put it mildly).[14]

What's more, Platinum (the Receiver and the JOLs) have in fact *admitted* that Beechwood's formulation of damages is fraudulent. [redacted] Platinum has now admitted how worthless this [redacted] was. The JOLs, for example, note that, as late as August 2016, Platinum "and its

[redacted]

executives were still publicly claiming that PPVA had a NAV of nearly $1 billion." *Trott v. Platinum Management (NY) LLC, et al.*, No. 18-cv-10936-JSR ("*Trott*"), Dkt. No. 285, at ¶ 16. The JOLs then admit that this claim was fraudulent and that the NAV was less than zero.[15] This was one of the major tranches of Trust assets [redacted] The Receiver admits the same was true for the PPCO assets Beechwood placed in the Reinsurance Trusts.[16]

[redacted]

[15] "PPVA's remaining investments (i) had little to no net value; (ii) required so much investment and were at such an early stage they effectively had no value to PPVA in liquidation; and/or (iii) were valuable but subject to significant creditor liens and/or claims." *Trott*, Dkt. No. 1, at ¶ 31. Indeed, the JOLs admit that by 2016, PPVA had "hundreds of millions of dollars of creditor claims that PPVA could not pay." *Id.*, Dkt. No. 285, at ¶ 33.

[16] The Receiver notes that, in its year-end 2014 financial statements, Platinum and its executives reported a NAV for PPCO of "$470,287,139." Dkt. No. 1, at ¶ 59. The Receiver admits, however, that this reported valuation of PPCO assets consisted of "distressed and wildly-overstated investments," most of which ($448,488,499) was in illiquid Level 3 assets. *Id.* at ¶¶ 7, 386. Accordingly, the "PPCO Funds . . . required funds from Beechwood to sustain themselves." *Id.* at ¶ 387. The Receiver further admits that, in fact, "[b]y the fall of 2015," the PPCO Funds "were insolvent in that each of their liabilities exceeded each of their assets." *Id.* at ¶ 400. [redacted]

[redacted] Frankly, it is mind-boggling that Beechwood now asks this Court to rely on [redacted][18] And, in any event, the saleable assets were liquidated, so we now know what value they brought in the market, post-recapture, in arm's-length negotiations, which is the best evidence of value.[19]

At best for Beechwood, there are litigable issues concerning the amount of damages Movants are entitled to—something that is always true in complex commercial cases. But the presence of disputed issues should not defeat the Security Statutes; if they did, the Security Statutes would be meaningless as the insurer could always claim some dispute as to the quantum of damages. This Court should thus award Movants the security they seek and are entitled to under the Security Statutes.

[redacted]

[18] It is even more incredible that Beechwood seeks to go on the offensive and complain that [redacted] Opp., at 1. That is absurd.

[redacted] Movants, on the other hand, based their calculations of statutory reserves upon a much lower discount rate that is consistent with a prudent portfolio of investments designed to support liabilities flowing from long-term care insurance policies.

CONCLUSION

WNIC and BCLIC respectfully request (a) that Beechwood's May 16 and May 17 filings on their motions to dismiss the claims of WNIC and BCLIC and their motion to compel arbitration be stricken, (b) that WNIC and BCLIC be awarded security under the New York and Indiana Security Statutes in the amount of $250 million and (c) for such other and further relief as the Court deems just.

Respectfully submitted,

Dated: July 3, 2019

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