

NO. D-1-GV-08-000945

THE STATE OF TEXAS	§	IN THE DISTRICT COURT OF
	§	
v.	§	
	§	
MEMORIAL SERVICE LIFE	§	TRAVIS COUNTY, TEXAS
INSURANCE COMPANY, LINCOLN	§	
MEMORIAL LIFE INSURANCE	§	
COMPANY, AND NATIONAL	§	
PREARRANGED SERVICES, INC.	§	250TH JUDICIAL DISTRICT

MOTION TO LIFT STAY

Northstar Reinsurance Ireland Limited (“Northstar”) hereby moves that the Court lift the injunction entered on September 22, 2008 (the “Liquidation Order”), to allow the pending arbitration between Northstar and Lincoln Memorial Life Insurance Company (“Lincoln”) to proceed as to a certain dispute discussed below. In support of this motion, Northstar states as follows:

INTRODUCTION

1. Northstar entered into a Reinsurance Agreement (the “Agreement”) with Lincoln under which it reinsured life insurance policies issued by Lincoln in 2006, 2007 and part of 2008. A copy of the Agreement is attached as Exhibit A. Pursuant to the Agreement, Northstar provided a Letter of Credit and assets in trust which, combined, total over \$38 million, as security for its future obligations to Lincoln. The Agreement was terminated earlier this year – well before Lincoln was put into this delinquency proceeding – because Lincoln had failed to pay over \$846,000 due Northstar in January 2008, thereby prompting Northstar to send the 30-day notice of termination as required by the Agreement in April 2008. A copy of the termination notice is attached as Exhibit B. Pursuant to Article VII of the Agreement, when the Agreement is terminated for nonpayment of amounts due by Lincoln, Northstar has no further liability for

the reinsured business as of the date of termination. Consequently, on May 2, 2008 – again, before the delinquency proceeding was filed – Northstar asked an arbitration panel for a finding that Northstar had no further liability under the Agreement and for an order releasing the Letter of Credit and trust assets Northstar had posted as security. Before the issue was fully briefed and the Panel could make a decision, the Northstar/Lincoln arbitration was stayed by the May 13, 2008 Rehabilitation Order, and then by the Liquidation Order.

2. Northstar moves pursuant to Texas Insurance Code § 443.008(h)(1) and (h)(2)¹ for an order lifting the injunction so that the pending arbitration on the above termination issue can proceed. Northstar has a contractual right to arbitrate whether the Agreement has been terminated, and that right is protected by Section 443.005(e).²

If Northstar is correct that the Agreement has been terminated, then neither the Agreement nor the collateral posted pursuant to the Agreement is property of the estate and the injunction provided by the Liquidator does not apply. Under similar circumstances, courts have lifted automatic stays in Bankruptcy Court proceedings so that the issue of contract termination can be adjudicated.

The Reinsurance Agreement

3. Northstar is a reinsurance company domiciled in Dublin, Ireland. Effective January 1, 2006, Northstar entered into Reinsurance Agreement with Lincoln pursuant to which Northstar reinsured on a 90% quota share basis “pre-need” life insurance policies issued by Lincoln and its parent Memorial Service Life Insurance Company (“Memorial”) from January 1,

¹ Sections 443.008(h)(1)-(2) provide, in relevant part, that, “[o]n request of a party in interest... the receivership court may grant relief from the stay of Subsection (c) or (d),... (1) for cause...; or (2) with respect to a stay of an act against property under Subsection (c) if: (A) the insurer does not have equity in the property; and (B) the property is not necessary to an effective rehabilitation plan.”

² Section 443.005(e) provides, in relevant part, that, “[e]xcept as to claims against the estate, nothing in this chapter deprives a party of any contractual right to pursue arbitration.”

2006 through February 19, 2008. Pursuant to Article V of the Agreement, Northstar has provided a Letter of Credit and trust assets totaling over \$38 million as a security for its future payment obligations to Lincoln. The only circumstance under which Lincoln is permitted to draw upon this collateral is for payment of amounts due Lincoln under the Agreement. (See Exhibit A, Article V, paragraphs 4 and 5.) Article IX, Paragraph 1 of the Agreement provides, in part, that, “All disputes and differences between [Lincoln] and [Northstar] on which an agreement cannot be reached will be decided by arbitration...”

The Arbitration

4. On November 27, 2007, pursuant to the above arbitration clause, Northstar demanded arbitration of certain disputes with Lincoln (the “Arbitration”). Pursuant to the terms of the Agreement, a three member arbitration panel (the “Panel”) was selected. The Panel has scheduled discovery, briefing of motions, and if necessary, an evidentiary hearing.

5. Initially, Northstar sought rescission of the Agreement and damages arising from the mass lapsation of policies caused by Lincoln and NPS (the “Fraud/Rescission Issue”). The Fraud/Rescission Issue arises from the manipulated lapsations of over 8,300 insurance policies covered by the Agreement; this mass lapse which was engineered by Lincoln and its affiliate, National Prearranged Services (“NPS”), not only violated the terms of the Agreement, it also violated numerous written representations Lincoln made to induce Northstar to enter the Agreement. At this time, Northstar is not asking that the stay be lifted as to the Fraud/Rescission Issue.

6. Subsequently, Northstar asked the Panel for a declaration that it had no further liability under the Agreement and sought release of the Letter of Credit and Trust Assets (the “Termination Issue”). The Termination Issue is a separate and independent issue which arises from Lincoln’s failure to pay over \$846,000 that Lincoln owed to Northstar as of January 31,

2008. There is no dispute that Lincoln owes Northstar at least this amount because the amount was calculated by Lincoln and set forth in its January statement of account to Northstar. (Exhibit C) In fact, Lincoln has made no payments under the Agreement for February 2008 or subsequent months. On April 2, 2008, after Lincoln's default continued for more than sixty days, Northstar exercised its right under Article VII of the Agreement to send Lincoln a 30-day written notice of termination. (Exhibit B) The Agreement terminated effective May 2, 2008, and thereafter, pursuant to Article VII, paragraph 3 of the Agreement, Northstar had no further liability for the reinsured policies.

7. On May 2, 2008, in the arbitration Northstar moved for summary judgment solely on the Termination Issue. Northstar sought an order from the Panel confirming that the Agreement was terminated, that it had no further liability under the Agreement and that the Letter of Credit and trust assets Northstar had established as security can be released. Northstar is not seeking damages or otherwise making a claim against Lincoln or the Lincoln estate on the Termination Issue. Per the scheduling order set forth by the Panel at the organizational meeting for the Arbitration, and absent the intervening rehabilitation proceeding, Lincoln's response to the motion for summary judgment would have been due on May 23, 2008, and Northstar's response would have been due on May 30, 2008, with a ruling by the Panel thereafter.

8. On May 13, 2008, while Northstar's motion for summary judgment on the Termination Issue was pending, Lincoln, Memorial, and NPS became the subject of this insolvency proceeding, and the Arbitration was stayed in accordance with the rehabilitation order entered by this Court.

ARGUMENT

9. Paragraph 5.1 of the Liquidation Order provides as follows:

An automatic stay is in effect with respect to actions against Defendants or their property as provided by TEX. INS. CODE § 443.008(c). In accordance with TEX. INS. CODE § 443.008(f), such stay of actions against Defendants is in effect for the duration of this proceeding, and the stay of actions against Defendants' property is in effect for as long as the property belongs to the receivership estate.

10. By seeking a lift of the stay, Northstar is not seeking to adjudicate a claim against the Lincoln estate, but only to adjudicate whether the Agreement has been terminated. The Receivership Act makes clear that a "claim" refers to an action for monetary amounts owed. *See* Texas Insurance Code, Sec. 443.252. Under these circumstances, Section 443.008(h) of the Texas Insurance Code permits the Court to lift a stay for two independent reasons. First, the stay can be lifted for "cause," pursuant to subsection (h)(1). The stay can also be lifted pursuant to subsection (h)(2) "with respect to acts against property" if the insurer does not have equity in the property, and the property is not necessary to an effective rehabilitation plan. The Court has a basis under both subsections (h)(1) and (h)(2) for lifting the stay against the Northstar/Lincoln arbitration so that the Arbitration Panel can decide the Termination Issue.

11. Pursuant to subsection (h)(2), the stay should be lifted because the Agreement is not property of the insurer's estate since it was terminated before Lincoln was put into rehabilitation. In essence, the Lincoln estate has no "equity" in the Agreement because of the termination. In addition, the Agreement is not necessary to an effective rehabilitation plan because Lincoln is no longer in rehabilitation, but is rather going to be liquidated.

12. In analogous circumstances, bankruptcy courts have lifted the automatic stay imposed by the U.S. Bankruptcy Code where contracts were terminated before the bankruptcy petition was filed. For example, *In re Meinke, Peterson & Damer P.C.*, 44 B.R. 105 (Bankr. N.D. Tex. 1984) involved a group insurance policy that expired due to non-payment before the

debtor filed for bankruptcy. The policy provided that it would terminate for failure to pay premium within a 30-day grace period. *Id.* at 107. The debtor did not pay the premium in November and December of 1983 and filed its Chapter 11 petition on January 6, 1984. *Id.* The court determined that the automatic stay was not violated when the defendant insurer sent a notice of cancellation on January 12, 1984 because the policy had been terminated, by its own terms, when the debtor failed to make the November 1983 payment within the 30-day grace period. *Id.* at 110.

13. If the Receiver disputes that the Agreement was terminated, Northstar has both a contractual and statutory right to have this issue determined by arbitration. Texas Insurance Code § 443.005(e) provides, in part, that “[e]xcept as to claims against the estate, nothing in this chapter deprives a party of any contractual right to pursue arbitration. A party in arbitration may bring a claim or counterclaim against the estate, but the claim or counterclaim is subject to Section 443.209.” In analogous circumstances, federal bankruptcy courts have recognized the need to lift the litigation stay imposed by the Bankruptcy Code in situations where the prior proceeding that has been stayed will serve to determine what assets of the debtor actually comprise part of the bankruptcy estate. *See In re White*, 851 F.2d 170, 174 (6th Cir. 1988) (upholding trial court’s decision to lift bankruptcy stay to allow divorce proceeding to conclude because, “until [the domestic relations court] makes a specific determination of the property rights as between the Debtor and his spouse, what is property of the Debtor’s estate in this cause is unclear, and the reorganization of Debtor’s business cannot proceed in an orderly fashion.”); *In re Paro*, 362 B.R. 419, 427 (Bankr. E.D. Ark. 2007) (lifting stay in order to allow state court to determine whether debtor or third-party had title to certain real estate); *see also In re Stockwell*, 262 B.R. 275, 283 (Bankr. D. Vt. 2001) (retroactively lifting stay to allow foreclosure

action pending at the time of bankruptcy to proceed). Thus, the Northstar/Lincoln arbitration should be allowed to proceed because the arbitration will resolve the threshold issue: whether the Agreement and the collateral securing the Agreement are property of the estate. Northstar contends that they are not.

14. In addition, pursuant to Texas Insurance Code § 443.008(h)(1), this Court may grant relief from the receivership stay for cause. Under the analogous federal Bankruptcy Code provision, 11 U.S.C. § 362, courts have recognized that “[c]ause is an intentionally broad and flexible concept, made so in order to permit the courts to respond in equity to inherently fact-sensitive situations.” *Mooney v. Gill*, 310 B.R. 543, 546-47 (N.D. Tex. 2002) (stating that “cause” may include a desire to permit an action to proceed to completion in another tribunal); *see also In re Hudgins*, 188 B.R. 938, 946 (Bankr. E.D. Tex. 1995) (stating that “cause” encompasses many different situations).

15. Cause exists that entitles Northstar to relief from the insolvency stay for the purpose of resolving the Termination Issue in the pending Arbitration, as permitted by the above-cited provisions of the Texas Insurance Code.

16. The prompt resolution of the Termination Issue would determine whether the Agreement is property of the estate, and thus whether the \$38 million in security posted by Northstar, would potentially be available to pay claims.

17. Resolution of the Termination Issue will make the liquidation proceeding more efficient. If Northstar prevails on the Termination Issue with an order stating that Northstar bears no further liability to Lincoln under the Agreement, then the receiver will know definitively that no potential reinsurance recoverables under the Agreement exist. This administrative need for lifting a stay of litigation has been recognized in the federal bankruptcy

context. *In re Quad Systems Corp.*, 2001 WL 1843379, at *7 (E.D. Pa. Mar. 20, 2001). In *In re Quad Systems*, the debtor declared bankruptcy during the pendency of an arbitration involving a breach of contract claim against the debtor and a counterclaim by the debtor also for breach of contract. *Id.* at *2. The debtor's opposing party in the arbitration filed a motion to lift the bankruptcy stay to allow the arbitration to proceed to conclusion. *Id.* at *1. The court asserted that "the stay may be lifted when there is an administrative need in the bankruptcy case to fix the amount of the claim and the claim dispute has been pending for considerable time in a non-bankruptcy forum." *Id.* at *7. The court also recognized that resolution of the bankruptcy debtor's counterclaim could "have a significant impact on the bankruptcy estate and thus the debtor's ability to make distributions to creditors." *Id.* Accordingly, the court lifted the bankruptcy stay in order to permit the arbitration proceeding to proceed to conclusion. *Id.* at *8.

18. Northstar is a relatively small reinsurer and its posted security represents a significant percentage of its capital, which remains unavailable to Northstar until the conclusion of the Arbitration. Because it is such a large percentage, Northstar is effectively prevented from writing any significant new business until this issue is resolved. If the Panel were to grant Northstar's motion for summary judgment on the Termination Issue, then Northstar would have no further liability under the Agreement and would be entitled to take down the security and free its capital. Given that the Agreement has been duly terminated and in light of the amount at stake, both practical and equitable considerations weigh against forcing Northstar to wait indefinitely for a ruling on the Termination Issue. If the Agreement is not property of the estate, Lincoln should be allowed to go about its business.

19. The litigation of this matter will not impose an undue burden on the estate. The Termination Issue has already been submitted to the Panel in the Arbitration via Northstar's motion for summary judgment. The issue to be resolved is straightforward – namely, whether the Agreement has been validly terminated such that Northstar has no liability thereunder. Further, the facts giving rise to the termination of the Agreement are straightforward, and Northstar believes there is no real dispute regarding material facts relevant to the Termination Issue. Thus, the burden on the estate to arbitrate this issue is small. In addition, any expense that the receiver may incur to prepare its response to the motion will be relatively small – and the receiver would eventually have to incur that expense in order to resolve the issues between Lincoln and Northstar in any event. Courts have granted relief from the automatic bankruptcy stay to unsecured creditors for “cause” to allow matters which were on the verge of decision when the bankruptcy was filed to proceed when no great prejudice to the bankruptcy estate would result. *See In re Bruce*, 2000 WL 968777, at * 3 (Bankr. E.D. Pa. July 10, 2000); *see also In re Beguelin*, 220 B.R. 94, 98 (B.A.P. 9th Cir. 1998) (bankruptcy stay may be lifted as a matter of juridical economy); *In re Walker*, 927 F.2d 1138, 1143-44 (10th Cir. 1991) (fact that debtor may incur some legal expense is not a basis to refuse to lift bankruptcy stay).

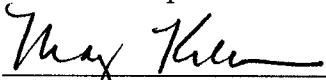
20. For all of these reasons, the litigation stay in this proceeding should be lifted for the purpose of allowing the Panel to resolve the Termination Issue.

WHEREFORE, Northstar respectfully requests that this Court enter an Order modifying the stay to permit the Arbitration to proceed for the limited purpose of resolving Northstar's previously-filed motion for summary judgment on the Termination Issue.

Dated: October 16, 2008

Respectfully submitted,

WINSTEAD PC
401 Congress Avenue, Suite 2100
Austin, Texas 78701
512.370.2840 telephone
512.370.2850 telecopier

By: 
Mary Keller SBN 11198299

ATTORNEYS FOR MOVANT
NORTHSTAR REINSURANCE IRELAND
LIMITED

CERTIFICATION OF SERVICE

I hereby certify that a true and correct copy of the foregoing instrument was served on the following by electronic mail, except as specifically noted on this 16th day of October, 2008.

Via Email: Leanne.Layne@tdi.state.tx.us
Leanne Layne
Texas Department of Insurance
Liquidation Oversight - 305-1D
PO Box 149104
Austin, TX 78714-9104

Via Email: Rachel.Giani@tdi.state.tx.us
Rachel Giani
Texas Department of Insurance
Financial Counsel/Legal Services - 821
PO Box 149104
Austin, Texas 78714-9104

Via Email: James.Kennedy@tdi.state.tx.us
James Kennedy
Texas Department of Insurance
872- Legal Services\Liquidation Allocated
110-1A
PO Box 149104
Austin, Texas 78714-9104

Via Email: Kathy.Gartner@tdi.state.tx.us
Kathy Gartner
Texas Department of Insurance
582 - Rehabilitation & Liquidation Oversight
305-1C
PO Box 149104
Austin, Texas 78714-9104

Via Email: jrixen@rixenlaw.com
Jackie Rixen
The Law Office of Jacqueline Rixen
8500 N. Mopac, Suite 605
Austin, Texas 78759
Counsel to TLAHHSIGA

Via Email: jglover@rothgerber.com
Joel A. Glover
Rothgerber, Johnson & Lyons LLP
One Tabor Center, Suite 3000
1200 Seventeenth Street
Denver, CO 80202
Counsel to NOLHGA Task Force

Via Email: hdeleon@dbilaw.com
Hector De Leon
De Leon, Boggins & Icenogle
221 W. 6th Street, Suite 1050
Austin, Texas 78701
Counsel for National Heritage Enterprises, Inc.
and Forever Enterprises, Inc.

Via Email: Jean.Sustaita@tdi.state.tx.us
Jean Sustaita
Texas Department of Insurance
582 Liquidation Oversight
PO Box 149104
Austin, Texas 78714-9104

Via Email: jramsey@jramsey-law.com
Jennifer Ramsey, P.C.
400 W. 15th St., Suite 200
Austin, Texas 78701-1647

Via Email: jennifer.jackson@oag.state.tx.us
Jennifer Jackson
Ass't. Attorney General
PO Box 12548
Austin, TX 78711-2548

Via Email: karen.pettigrew@oag.state.tx.us
Karen Pettigrew
Ass't. Attorney General
PO Box 12548
Austin, TX 78711-2548

Via Email: ekaye@skeltonwoody.com
Edward F. Kaye
Skelton & Woody
PO Box 1609
Austin, TX 78767-1609

Via Email: eric.haab@lovells.com
Eric Haab
Lovells, LLP
330 N. Wabash Avenue
Suite 1900
Chicago, IL 60611
Counsel for Hannover Life Re

Via Email: kyelkin@gardere.com
Kimberly Yelkin
Gardere Wynne Sewell
600 Congress Ave. Suite 3000
Austin, TX 78701-2978

Via Email: sharon.euler@ago.mo.gov
Sharon K. Euler
Assistant Attorney General
Fletcher Daniels State Office Bldg.
615 E 13th Street Suite 401
Kansas City MO 64112

Via Email: phobbs@mcginnislaw.com
Penny Hobbs
McGinnis, Lochridge & Kilgore
600 Congress Avenue #2100
Austin, TX 78701
Counsel for Henneke Funeral Home

Via Email:
Douglas.schmidt@huschblackwell.com
Douglas Schmidt
Husch Blackwell & Sanders
4801 Main Street #1000
Kansas City, MO 64112

Via Email: hskelton@skeltonwoody.com
J. Hampton Skelton
Skelton & Woody
PO Box 1609
Austin, TX 78767-1609

Via Email: Marybeth.wilkinson@lovells.com
MaryBeth Wilkinson
Lovells, LLP 330 N. Wabash Avenue
Suite 1900
Chicago, IL 60611
Counsel for Hannover Life Re

Via Email: kay.wilde@lovells.com
Kay Wilde
Lovells, LLP
330 N. Wabash Avenue
Suite 1900
Chicago, IL 60611
Counsel for Hannover Life Re

Via Email: jwerner@rmqlawfirm.com
John Werner
Reaud, Morgan & Quinn LLP
801 Laurel Street
PO Box 26005
Beaumont, TX 77720-6005
Counsel for Broussard's Mortuary, Inc.

Via First Class Mail
Internal Revenue Service
Special Procedures Branch
P.O. Box 250
300 East 8th Street, Suite 352
Mail Stop 5022AUS
Austin, TX 78701

Via First Class Mail

Chad J. Snyder
Denzer-Farison-Hottinger & Snyder Funeral
Home
360 East Center Street
Marion, OH 43302

Via Email: mponder@cbmplaw.com

J. Michael Ponder
Cook, Barkett, Maguire & Ponder, L.C.
715 N. Clark
P.O. Box 1180
Cape Girardeau, MO 63702-1180
Interim Class Counsel for James & Gahr

Via Email: bcculley@mcculleymccluer.com

R. Bryant McCulley
McCulley McCluer, PLLC
One Independent Drive, Suite 3201
Jacksonville, FL 32202
Interim Class Counsel for James & Gahr

Via Email: smccluer@mcculleymccluer.com

Stuart H. McCluer
McCulley McCluer, PLLC
1109 Van Buren Avenue
Oxford, MS 38655
Interim Class Counsel for James & Gahr

Via Email: lyork@mcginnislaw.com

Larry York
McGinnis, Lochridge & Kilgore
600 Congress Avenue #2100
Austin, TX 78701
Counsel for Henneke Funeral Home

Via Email: jwhatley@wdklaw.com


Joe R. Whatley
Whatley Drake & Kallas, LLC
1540 Broadway, 37th Floor
New York, NY 10036
Interim Class Counsel for James & Gahr

Via Email: tbutler@wdklaw.com

Thomas J. Butler
Whatley Drake & Kallas, LLC
2001 Park Place North, Suite 1000
Birmingham, AL 35203
Interim Class Counsel for James & Gahr

Via Email: cfuller@fullerlaw.org

Christopher Fuller
Fuller Law Group
4612 Ridge Oak Dr
Austin, TX, 78731
Counsel for Special Deputy Receiver



Mary F. Keller