



Seven
Times
Square
New York
New York
10036
tel 212.209.4800
fax 212.209.4801

August 16, 2018

BY HAND DELIVERY AND BY EMAIL (mlmicdemutualization@dfs.ny.gov)

New York State Department of Financial Services
c/o Linda Krebs
Property Bureau
MLMIC Demutualization
One State Street
New York, NY 10004

Re: Proposed MLMIC/NICO Transaction

Dear Ms. Krebs:

Enclosed is a copy of a class action complaint which we have filed in New York Supreme Court, Kings County concerning the proposed MLMIC/NICO Transaction (the "Proposed Transaction") which will be reviewed by your office. We intend to appear at the hearing on August 23, 2018 and respectfully request permission to make an oral statement at the August 23 hearing, if it proceeds on August 23. We seek to raise at least the following matters (which are addressed in more detail in the Complaint):

1. **The failure on the part of the MLMIC directors to fully disclose the negotiation process which has resulted in the current proposed transaction:** The negotiations related to the Proposed Transaction have taken place over more than two years and the Board has failed to keep policyholders apprised of the negotiations, including prior bids and other parties who may have sought to bid. These negotiations also apparently involved the Board negotiating to retain their Board seats after the transaction is closed. We believe this is highly unusual and that policyholders are entitled to a full and transparent explanation of these negotiations and the process by which the board became entrenched.

2. **The apparent failure of the Board to have obtained a fairness opinion prior to recommending the transaction and the failure of the board to have disclosed the actual findings of the Keefe, Bruyette & Woods ("KBW") firm, with respect to the fair value of MLMIC:** This is highly material information with respect to policyholders' vote on the Proposed Transaction and must be disclosed prior to the actual vote. The apparent failure of the Board to have obtained a fairness opinion also calls into question how they could have reasonably concluded that the NICO deal was fair and reasonable to the policyholders. Indeed, Bloomberg in July 2016 reported that KBW, MLMIC's financial advisor, publicly stated that the



NICO offer in 2016 may have been \$2.7 billion – \$200 million more than the current cash consideration, despite the fact that MLMIC has earned more than \$200 million since then.¹ This fact, among others, calls into question whether the current deal is truly in the policyholders' best interest.

3. **The inadequacy of the Cash Consideration:** As described in the Complaint, the proposed cash consideration is demonstrably inadequate. The Ernst & Young Report shows that current adjusted book is (using their median number) approximately \$2.7 billion. The Report also discusses the fact that comparable sales of medical malpractice insurers and similar insurers have recently sold at multiples to book in the range of 1.7 times book. A similar report prepared by Deloitte & Touche, LLP, concludes that such multiples during 2017 were actually higher. The Board has actually negotiated a negative multiple to adjusted book and thus, the price is per both the Deloitte and Ernst & Young reports grossly unfair and inadequate to policyholders.

Given our *bona fide* concerns and the pendency of the class litigation, we suggest that the hearing be rescheduled allowing the parties to undertake six weeks of expedited informal or formal discovery in the case and attempt to resolve the issues raised in the Complaint and as set forth herein. If the hearing nonetheless proceeds on August 23, we respectfully request permission to make an oral statement at the hearing on August 23.

Very truly yours,

Sigmund S. Wissner-Gross, Esq.
May Orenstein, Esq.
Brown Rudnick LLP
7 Times Square
New York, NY 10036

Richard L. Stone, Esq.
Blackner Stone & Associates P.A.
123 Australia Avenue
Palm Beach, FL 33480

Encl.

¹ See Bloomberg News, July 18, 2016, "Buffett Buys \$1.8 Billion 'Gem' of a Medical Insurer in N.Y." (noting that, according to a KBW analyst, the "purchase price could be around \$2.7 billion....").

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF KINGS

Dr. Mark Castagna, Dr. Saul Modlin and Dr.
Irving Friedman, on behalf of themselves and
all others similarly situated,

Plaintiff,

-against-

Medical Liability Mutual Insurance Company,
John V. Capotorto, Mark J. Feldman, Timothy
F. Gabryel, Samuel M. Gelfand, Kira Geraci-
Ciardullo, Stanley L. Grossman, Leah S.
McCormack, Robert A. Menotti, Scott H.
Perra, James K. Reed, Malcolm D. Reid,
Malcolm J. Rothbard, Irene Snow, Anthony
A. Ascioti, Charles N. Aswad, Ann M.
Barbaccia, David W. Felton, John A.
Fracchia, Alvin Katz, Joseph R. Maldonado,
Jr., Joseph A. Mannino, Paul J. Okosky,
Kenneth D. Roberts, Salvatore Volpe, Murry
A. Yost, Jr., Margaret R. Albanese, Beth
Cady Burghardt, Duane M. Cady, Nameer R.
Haider, Richard L. Hehir, Richard H.S.
Karpinski, Edward D. Lewis, John W.
Lombardo, Andrew J. Merritt, Richard M.
Peer, David Sibulkin, Frederick W. Wetzel,
Jr., and Betsy Wright,

Defendants.

Index No.

CLASS ACTION COMPLAINT

Venue is Proper Under CPLR 503(a)

Plaintiffs Dr. Mark Castagna, Dr. Saul Modlin and Dr. Irving Friedman ("Plaintiffs"), by and through their attorneys, on behalf themselves, and all others similarly situated, as for a Class Action Complaint against the Defendants, allege on knowledge as to matters concerning themselves and, as to all other matters, upon information and belief, based on the investigation of counsel and review of relevant documents, the following:

NATURE OF THE ACTION

1. This action arises out of the proposed sale of the Medical Liability Mutual Insurance Company ("MLMIC") to the National Indemnity Company ("NICO") for an amount representing approximately \$1.7 billion less than what MLMIC is worth. The transaction, negotiated in secret by MLMIC's board of directors (the "Board"), is neither fair nor equitable to MLMIC's policyholders and will, if consummated, deprive them of fair value for their interests in MLMIC. NICO is a subsidiary of Berkshire Hathaway Inc., the conglomerate headed by Warren Buffet.

2. MLMIC's Board, all medical professionals without any apparent material experience in valuing companies of commensurate size, has approved the sale of MLMIC to NICO (the "NICO Transaction"). At present, Plaintiffs, as holders of medical malpractice policies issued by MLMIC, also have an ownership interest in MLMIC known as "Policyholder Membership Rights." As policyholders, Plaintiffs generally have rights similar to that of shareholders and are entitled to vote on the NICO Transaction.

3. Plaintiffs seek to enjoin a policyholder vote on the NICO Transaction and the transaction itself, unless and until further, complete, and frank disclosure regarding the NICO Transaction is made and a fair market value based price for MLMIC is negotiated and agreed to. In the alternative, Plaintiffs seek damages for injuries to themselves and other MLMIC policyholders (the "Policyholders") that will result from the NICO Transaction in its current form.

4. If the NICO Transaction is permitted to occur, MLMIC will be converted from a mutual company to a stock company and then immediately sold to NICO for \$2.502 billion in cash. If the NICO Transaction is approved and goes forward, at closing, MLMIC will issue an

“extraordinary dividend” to NICO in the amount of \$1.905 billion, representing almost the entire surplus built up by MLMIC in the course of its highly profitable operations.

5. Following the NICO Transaction, the Policyholders will have no input into how MLMIC is managed, who will manage it, or the amount of insurance premiums that will be charged. All of these decisions will be made by MLMIC’s new owners. Following the closing, MLMIC will not be operated for the benefit of Policyholders. It will be operated to maximize the profits of its ultimate shareholder – Berkshire Hathaway, which will likely result in much higher premiums.

6. As the Board has acknowledged in writing, the Board is a fiduciary in respect to Policyholders’ membership rights in MLMIC. The Board acted as fiduciary to the Policyholders in using confidential MLMIC financial information to negotiate the NICO Transaction. In connection with seeking approval of the plan for the transaction (the “Plan”), Defendants sent Plaintiffs and the other Policyholders a Policyholder Information Statement (the “Information Statement”), soliciting their votes in favor of the Plan. Moreover, the Board specifically provided Policyholders with investment advice as to the transaction, stating that it was the result of extensive negotiations and that Policyholders should vote in favor of it based upon the Board’s financial analysis. The Board has recommended the approval of the NICO Transaction to the Policyholders. The Board’s conduct in this regard, including their recommendation for approval, constitutes a breach of the fiduciary duty they owe to Plaintiffs and the Policyholders because, contrary to the false and misleading disclosures made by MLMIC and the recommendation itself, the NICO Transaction is not in the best interests of the Policyholders.

7. In addition to their claims against the Board for breach of their fiduciary duties, Plaintiffs seek an injunction and damages under New York’s General Business Law § 349

("GBL § 349") based on the false disclosure and deceptive practices being used by MLMIC to obtain the Policyholder's consent.

8. Finally, Plaintiffs assert a claim of negligent misrepresentation against each member of the Board of Directors based on false and misleading statements made in the materials used to solicit the Policyholder's approval.

PARTIES

9. Plaintiff Mark Castagna, a dentist, has been, at all relevant times, a Policyholder of MLMIC.

10. Plaintiff Saul Modlin, a cardiologist, has been, at all relevant times, a Policyholder of MLMIC.

11. Plaintiff Irving Friedman, a cardiologist, has been, at all relevant times, a Policyholder of MLMIC.

12. Defendant Medical Liability Insurance Company ("MLMIC") is a mutual insurer with its principal offices at Two Park Avenue, New York, New York 10016.

13. Defendants John V. Capotorto, M.D., Mark J. Feldman, D.M.D., Timothy F. Gabryel, M.D., Samuel M. Gelfand, M.D., Kira Geraci-Ciardullo, M.D., Stanley L. Grossman, M.D., Leah S. McCormack, M.D., Robert A. Menotti, M.D., Scott H. Perra, James K. Reed, M.D., Malcolm D. Reid, M.D., Malcolm J. Rothbard, M.D., Irene Snow, M.D., Anthony A. Ascioti, M.D., Charles N. Aswad, M.D., Ann M. Barbaccia, M.D., David W. Felton, John A. Fracchia, M.D., Alvin Katz, M.D., Joseph R. Maldonado, Jr. M.D., Joseph A. Mannino, M.D., Paul J. Okosky, M.D., Kenneth D. Roberts, Salvatore Volpe, M.D., Murry A. Yost, Jr., M.D., Margaret R. Albanese, M.D., Beth Cady Burghardt, M.D., Duane M. Cady, M.D., Nameer R. Haider, M.D., Richard L. Hehir, M.D., Richard H.S. Karpinski, M.D., Edward D. Lewis, M.D.,

John W. Lombardo, M.D., Andrew J. Merritt, M.D., Richard M. Peer, M.D., David Sibulkin, M.D., Frederick W. Wetzel, Jr., D.D.S., and Betsy Wright (the “Director Defendants” and, collectively with MLMIC, the “Defendants”), each were members of MLMIC’s board of directors at the time the Plan was approved.

CLASS ACTION ALLEGATIONS

14. Plaintiffs bring this action as a class action pursuant to Article 9 of the New York Civil Practice Law and Rules.

15. The members of the class consist of all owners of policies issued by MLMIC who are entitled to vote on the proposed NICO Transaction.

16. Excluded from the Class are: MLMIC and its successor and assigns; the executive officers and directors of MLMIC and their immediate family members and affiliates; any entity owned or controlled by any of the above; and the legal representatives, heirs, successors, or assigns of any of the above.

17. The members of the Class are so numerous that joinder of all members is impracticable. There were approximately 18,000 Policyholders outstanding as of March 2018. While the exact number of Class members is unknown to Plaintiffs at this time, and can only be ascertained through appropriate discovery, Plaintiffs believe that the proposed Class contains those approximate 18,000 Policyholders. Class members may be identified from records maintained by MLMIC and may be notified of the pendency of this action by mail, using the form of notice similar to that customarily used in similar type actions.

18. Plaintiffs’ claims are typical of the claims of the members of the Class, as all members of the Class are similarly affected by the wrongful conduct in violation of the law that is complained of herein.

19. Plaintiffs will fairly and adequately protect the interests of the members of the Class and have retained counsel competent and experienced in class actions and complex litigation. Plaintiffs have no interests antagonistic to, or in conflict with, those of the Class.

20. Common questions of law and fact exist as to all members of the Class and predominate over any questions solely affecting individual members of the Class. Among the questions of law and fact common to the Class are: whether the Director Defendants breached their fiduciary duties to the Class; whether the Defendants violated GBL § 349 or committed other violations of the law by their acts, as alleged herein; whether the statements made in the Information Statement provided to Policyholders misrepresented material facts about the business, operations, financial results and value of MLMIC; whether the Information Statement misrepresented whether the transaction was fair and reasonable to Plaintiffs and to what extent the members of the Class have sustained damages and the proper measure of damages.

21. A class action is superior to all other available methods for the fair and efficient adjudication of this controversy since joinder of all members is impracticable. Furthermore, as the damages suffered by individual Class members may be relatively small, the expense and burden of individual litigation make it impossible for members of the Class to individually redress the wrongs done to them. There will be no difficulty in the management of this action as a class action.

SUBSTANTIVE ALLEGATIONS

The Company

22. MLMIC was organized as a mutual insurance company approximately 40 years ago. It insures over 13,000 physicians, 3,000 dentists, dozens of hospitals, and thousands of other healthcare professionals and facilities for losses resulting from medical malpractice.

MLMIC's currently-owned assets, chiefly investment grade financial instruments, have a value in excess of \$5.378 billion.

23. In its current mutual company form, MLMIC's Policyholders are owners, with full voting rights to elect the company's Board of Directors. By statute, the management of the business and affairs of a domestic mutual insurance corporation *is vested in a board of directors*. It is only through its board of directors that a mutual insurance company can initiate the regulatory process of approval by applying to the New York Superintendent of Insurance (the "Superintendent") for permission to convert to a stock company.

24. Here, the Board has acted affirmatively to approve the NICO Transaction and has unreservedly recommended it as fair and reasonable to the Policyholders based upon what the Board described as an extensive review of MLMIC's financials and the market for medical malpractice insurers. Before doing so, it was the duty of the Board to determine whether the Policyholders would be better off continuing to own MLMIC, to sell it on the terms agreed to with NICO, or to attempt to negotiate another transaction. Here, that duty has been breached.

25. As a mutual insurance company, MLMIC is owned and must be operated for the benefit of the Policyholders. As stated in a MLMIC newsletter published in the spring of 2016:

Our competitors often promise low initial premiums to attract business, but MLMIC continually operates without a profit motive. Instead, we work to provide much needed relief to our policyholders, while maintaining financial stability. MLMIC remains a mutual insurer, owned by our policyholders, and we are committed to policyholder-first service. Over the years, MLMIC's financial strength has allowed us to pay more than \$300 million in dividends to our policyholders, an accomplishment unmatched by other insurers.

MLMIC Newsletter, Volume 15, No. 2, Spring 2016.

26. Each Policyholder has an ownership interest in MLMIC known as "Policyholder Membership Rights," which provides a Policyholder with the right to: (i) vote on matters

submitted to a vote of the members; and (ii) receive a distribution of profits in the form of a dividend.

27. MLMIC has, in fact, consistently touted its strong financial performance year after year. This performance has resulted in its ability to issue dividends out of surplus to its Policyholders. Over the course of its existence, through 2017, MLMIC has declared in excess of \$500 million in dividends. Prior to announcing Board approval of the NICO Transaction, MLMIC has never made any disclosure suggesting financial instability or an inability to continue as a viable mutual insurance company. MLMIC has been consistently profitable.

The Proposed Transaction

28. According to the Information Statement, the Berkshire Hathaway Group (“BHG”) first approached MLMIC in 2015 about a possible acquisition of MLMIC by The Medical Protective Company (“TMPC”), an affiliate of BHG.

29. No disclosure to the Policyholders was made at that time regarding the terms of the proposed TMPC–MLMIC transaction. Policyholders did not learn of the amount of consideration that TMPC would have paid to acquire MLMIC in 2015. No disclosure was ever made to Policyholders about the proposed TMPC transaction until after the Board approved the NICO Transaction in 2018. MLMIC did not disclose to Policyholders the basis upon which, in 2015, an executive committee of the Board chose to reject the TMPC proposal. Only presently, in current disclosures about the NICO Transaction, are Policyholders told that the executive committee had unspecified “concerns” concerning the TMPC proposal and specifically about “potential changes to the operations of MLMIC following the sale.” If such concerns were real – they are also likely present with regard to the NICO Transaction, as NICO and TMPC are both controlled by BHG. The disclosures in the Information Statement suggesting such issues have

been resolved are inadequate and materially misleading. Policyholders are legally entitled to disclosure of the terms and conditions of the TMPC proposed transaction. They are also entitled to an explanation of what terms have changed with respect to the proposed NICO Transaction. The only disclosure made so far is that the current Board and officers will, pursuant to the NICO Transaction, remain in office after the transaction is completed at undisclosed compensation rates. As fiduciaries, the Director Defendants are required to disclose the course of negotiations and why they negotiated to remain as directors with the successor insurer-NICO. Plaintiffs are entitled to disclosure of the terms of these directorships to determine whether these directors have an undisclosed conflict of interest.

30. According to the Information Statement, the NICO Transaction was proposed after rejection of the TMPC proposal. As noted above, at the time this offer was being made, MLMIC was still touting the benefit to Policyholders of MLMIC being a mutual insurer owned and operated for Policyholders and the continued ability of MLMIC to maintain financial stability while providing “relief” to Policyholders in the form of dividends and/or lower premiums.

31. An asserted feature of the proposed NICO Transaction is that it supposedly would permit MLMIC to “continue to run with the same board of directors, committees, endorsed partners, staff and operating practices.” No further disclosures have been made regarding promises, agreements or commitments that may have (or may not have) been made by BHG with regard to the continuation of management personnel in their positions or future operations. The disclosure suggests that, in approving the NICO Transaction, the Board acted to entrench itself without any protection for Policyholders. It is notable that MLMIC has not disclosed the existence of any legally binding agreements that exist in order to effectuate this continuity of

management or that describe the manner in which MLMIC will operate after the transaction is completed. Nor do the disclosure materials explain how, in the absence of elaborate and legally binding documentation, management and staff could enforce such a commitment.

32. In fact, the supposed commitment by BHG to “run with the same board of directors, committees, endorsed partners, staff and operating practices” appears to be smoke and mirrors: a mere pretext for the unexplained abandonment by MLMIC of the mutual insurer form after 40 years of successful operation which assures the current Board with potentially lucrative positions going forward in a for-profit insurance business.

33. The supposed advantages of the NICO Transaction are vague and far from compelling. Unexplained is what economic or other factors have changed since 2015 when MLMIC management continued to extol the benefits of a mutual insurance ownership structure.

34. Looking beyond the decision to end the mutual insurance structure, the Information Statement is entirely deficient in explaining why the Board has agreed to sell MLMIC for an amount that is barely in excess of its net worth adjusted book value.

35. Notably, the Board apparently has failed to commission, on behalf of Policyholders, an independent current appraisal of MLMIC and a study of how Policyholders will be impacted by the conversion of MLMIC from a mutual insurer, owned by its Policyholders, to a for-profit enterprise owned by BHG. Despite having no deal-making experience, the medical professionals on the Board do not appear to have obtained such a routine fairness opinion.

36. The only appraisal of MLMIC that has been made available to Policyholders in connection with the NICO Transaction is an appraisal commissioned by the New York State Department of Financial Services (the “DFS”) and performed by Ernst & Young (the “EY”

Report”). The EY Report does not purport to be a complete valuation of MLMIC and expressly states that Policyholders and the Board cannot rely upon it. The EY Report makes clear that Ernst & Young did not do any review of cash flow projections related to future performance of MLMIC’s business. However, the EY Report itself demonstrates that the compensation proposed to be paid by NICO for MLMIC is grossly inadequate. In fact, an examination of the EY Report demonstrates that the economics of the NICO Transaction are a disaster. Despite the EY Report, the Defendants have continued to maintain their position that the consideration is fair and reasonable to Plaintiffs.

37. The EY Report provides data from public companies comparable to MLMIC and transactions comparable to the NICO Transaction. That data shows that similar insurance companies are valued by the financial markets at prices equal to an *average* of 1.8 times “tangible book value.” Here, the Board, supposedly acting as fiduciaries of the Policyholders, is recommending a price that is barely more the tangible book value of MLMIC. At a price calculated at 1.8 times tangible book value, Policyholders would receive \$4.26 billion dollars *or \$1.737 billion more than the \$2.502 billion agreed to by the Board*. The Board does not dispute this average market multiple of book value, and has provided no analysis of why a multiple of 1.0 is fair to Policyholders.

38. The EY Report makes clear that a multiple to current book value is the most accurate method of determining fair value. Defendants have not disclosed if they used this method or how they calculated book value or multiples thereto. Absent disclosure of the method by which the Defendants determined the fairness of the transaction, Plaintiffs cannot fairly evaluate it. As fiduciaries, the Director Defendants are required to disclose this information.

39. As of March 31, 2018, MLMIC had invested assets of \$5.3 *billion*. MLMIC’s

only material liabilities are its obligations to pay the claims of Policyholders – medical doctors and other healthcare providers that pay premiums to protect themselves from malpractice liability. MLMIC’s liabilities have been estimated at \$3.13 billion using actuarial methods claimed to be appropriate and in conformity with generally accepted accounting principles. Policyholders have no visibility into the basic assumptions underlying this estimate. However, assuming the estimated \$3.13 billion is reasonable, MLMIC is swimming in excess capital. As noted in the EY Report, “MLMIC holds a substantially higher level of capital in comparison to its private and public peers[.]” In fact, according to this report, “[a]s compared to the peer group, MLMIC holds the highest level with respect to the premiums written.” This appraisal shows that *\$2.250 billion of MLMIC’s invested assets represent “surplus.”* Upon the closing, NICO will obtain a dividend of \$1.902 billion. The Board has failed to disclose why this amount cannot be returned to Policyholders rather than used by MLMIC to fund a NICO dividend. If such a dividend was declared in favor of Policyholders, Policyholders would obtain most of the economic benefit of the NICO Transaction but would continue to own MLMIC, which remains highly profitable.

40. Rather than return surplus to Policyholders, the Board has decided to, in effect, allow BHG to use the MLMIC surplus to fund the acquisition of MLMIC. Because NICO is receiving an extraordinary dividend in the amount of \$1.902 billion, the cash needed to fund the \$2.502 billion consideration agreed to by the Board is approximately \$600 million. In effect, NICO is purchasing MLMIC for \$600 million, while MLMIC has earned more than \$700 million of profit over the last 4 and one-half years. There is no basis for this purchase price and Defendants offer none. Looking at the NICO Transaction in its entirety, the Board has effectively agreed to sell \$5.3 billion in investment grade assets to BHG along with a highly

profitable business for (i) the assumption by NICO of liabilities in the amount of approximately \$3.226 billion and (ii) approximately \$600 million in cash. On its face, this transaction is not in the best interest of Policyholders.

41. MLMIC has a proven track record of generating profits and surplus from premiums and investments. According to the EY Report, since 2007, MLMIC experienced approximately \$1.6 billion in favorable surplus development.

42. In the first quarter of this year MLMIC made \$77 million in profits, and increased its surplus by \$45 million. If MLMIC's performance stays on track, within a few years MLMIC will generate enough cash (all of which will be retained by NICO or its affiliates) so that BHG will have acquired MLMIC for *nothing*. Meanwhile, the stream of dividends that has flowed to Policyholders will stop permanently.

The Plan's Approval

43. On May 31, 2018, the Board found the NICO Transaction to be "in the best interest of the Policyholders" and unanimously approved the Plan. According to the Information Statement, the terms of the Plan were initially agreed upon in October 2016, after a sales process which began in 2015. The Board specifically recommended that Policyholders vote in favor of the NICO Transaction.

44. In July 2016, an application to request permission to convert MLMIC to a stock insurance company was filed with the Superintendent. That application described a formula for the post-closing adjustment of cash consideration. According to the Information Statement, this feature of the proposed Plan was inconsistent with the Section 7307 of Insurance Law. To comply with the comments of the Superintendent, MLMIC then amended the proposal to provide for fixed cash compensation of \$2.502 billion. This amendment apparently actually reduced the

cash compensation even though, since the time of the first proposal, MLMIC has continued to generate material surpluses, alone warranting a significantly higher price. Indeed, according to press reports (based on an internal report by MLMIC's financial advisor to its clients), the initial purchase price was approximately \$2.7 billion.¹

45. Whether or not the Plan meets the requirements of the Superintendent under the Insurance Law is not determinative of whether the NICO Transaction is in the best interest of the Policyholders. The Insurance Law provides that the Superintendent may *refuse* to approve a plan of conversion of a mutual company into a stock company upon determining that it is not "fair and equitable." There is nothing in the statute, however, that remotely supports the notion that this approval supplants the duty of the Board to act, in the first instance, consistent with their fiduciary duties and GBL § 349. There is no issue more central to the business and affairs of MLMIC than a change of ownership that assures that MLMIC will no longer be operated for the exclusive benefit of its members and which ends Policyholders' rights to future dividends based on existing and future surplus. Moreover, under New York law by offering advice with respect to the financial benefits of the transaction, the Director Defendants have assumed a fiduciary duty.

46. On or about July 18, 2018, MLMIC and the Board mailed or caused to be mailed the Information Statement soliciting Plaintiffs and the other Policyholders to vote in favor of the Plan. For the Plan to be approved, the New York Insurance Law requires approval by two-thirds of voting Policyholders participating in the vote.

47. No vote by Policyholders should go forward. Policyholders have not been provided with complete information by Defendants and the Policyholders are not in a position to

¹ See Bloomberg News, July 18, 2016, "Buffett Buys \$1.8 Billion 'Gem' of a Medical Insurer in N.Y." (noting that, according to a KBW analyst, the "purchase price could be around \$2.7 billion....").

make an informed decision about the NICO Transaction.

48. The Information Statement describes as an “advantage” of the NICO Transaction that Policyholders “will have the opportunity to receive an allocable share of the Cash Consideration in exchange for their Policyholder Membership Rights.” In a similar vein, Defendants state in the Information Statement that, if the NICO Transaction is not consummated, “there can be no assurance that MLMIC will be able to find an equivalent strategic acquirer willing to pay an equivalent or more attractive price than what would be paid in the NICO Transaction.” These are misleading statements, since the Policyholders would, if they retained their Policyholder Membership Rights, likewise have the opportunity to receive distributions from current and future surplus. These distributions could meet or exceed the \$2.502 billion of cash consideration that NICO has agreed to pay. As shown, NICO is largely funding its acquisition of MLMIC assets using the MLMIC surplus, not NICO funds. The Information Statement fails to explain why, even if MLMIC was unable to find a “strategic acquirer” equivalent to BHG, Policyholders would be worse off continuing as owners of MLMIC.

49. Absent from the Board’s discussion in the Information Statement is any explanation of why the transaction is fair to Policyholders given that the EY Report shows fair value should be approximately 1.8 times tangible book value or \$1.7 billion more than the cash consideration offered. Absent from the Board’s discussion is a comparison of the economic benefits to the Policyholders of retaining their membership interests or a comparison of the cash compensation to be paid to Policyholders if the NICO Transaction is approved versus the dividends available to Policyholders in the event the NICO Transaction is rejected.

50. Also absent from the Information Statement is whether the Board made any efforts to find an alternative strategic acquirer and whether the terms which MLMIC’s

management or directors insisted upon (including their retention on the board) caused potential acquirers to decline to make a proposal to acquire MLMIC.

The Cash Consideration is Not Fair and its Adequacy is Not Supported By Substantial Evidence

52. MLMIC apparently failed to obtain an independent appraisal of its value prior to entering into the NICO Transaction. Instead, the only valuation analysis is the EY Report.

53. The EY Report does not support the decision of the Board to sell MLMIC for \$2.502 billion in cash consideration.

54. Although the EY Report goes through several approaches to valuation, according to the EY Report and industry experts, the “NAV” or “net asset value” approach is the least subjective and most accurate valuation approach. Ernst & Young identifies the primary weakness of this method as its failure to “capture the going concern value of a business” or the “profitability of the business and its ability to generate future cash flow.” In other words, the NAV approach may *undervalue* assets by failing to capture the value of staying in business.

55. The NAV approach values MLMIC by calculating adjusted book value – the difference between the fair value of its assets and the fair value of its liabilities. As noted, the assets of MLMIC are relatively simple to value as they consist mostly of marketable securities and cash and thus have readily observable market values. As of the date of the most recent financial information available, MLMIC had cash and invested assets with a fair market value of \$5.872 billion.

56. Evaluating MLMIC’s liabilities, however, is more complex in that it requires, *inter alia*, an actuarial analysis of the liabilities represented by outstanding policies.

57. According to the EY Report, the aggregate range of value for MLMIC based on this adjusted book value approach spans \$450 million – between \$2.450 billion and \$2.880

billion. The cash consideration to be paid for MLMIC is nowhere near the midpoint of this range. In fact, the proposed cash consideration for the NICO Transaction is only \$52 million more than the low end of the range. In considering this fact, it is critical to emphasize that this approach does not even purport to capture future profits from operating MLMIC for the benefit of the Policyholders, and thus materially understates value.

58. The EY Report also considers the prices at which publicly owned insurance companies trade in financial markets and analyzes the price to book value and price to tangible book value represented by the market capitalization of such companies. This analysis shows that, in 2017, the market capitalization of Ernst & Young's "selected guideline public companies" (*i.e.*, comparable companies) represented an average price to tangible book value (P/TBV) ratio of 1.8 and a median price to tangible book value (P/TBV) ratio of 1.7.² As shown, using the Ernst & Young book value comparable analysis the fair value of MLMIC is **\$1.7 billion more than the cash consideration**. The EY Report demonstrates that the cash consideration is indisputably inadequate and unfair. Moreover, the Defendants have offered no analysis of why the Ernst & Young valuation is so much higher than the cash consideration. Nor have they alleged the E&Y analysis is inaccurate in any respect. As fiduciaries, the Director Defendants were required to fully advise Plaintiffs as to the accuracy or inaccuracy of the EY Report and have failed to do so. They here not even provided a copy of the report to Policyholders. The Director Defendants have failed to fulfill their fiduciary obligations of full and complete disclosure with respect to the transaction.

59. Pursuant to New York Insurance Law § 7312(k), Defendants were required to

² Indeed, recent market studies suggest higher multiples are appropriate. In Deloitte's "2018 Insurance M&A Outlook," at p.5, Deloitte observed that average M&A multiples to book value for property and casualty insurers during 2017 were 2.08 and the mean multiple was 1.97. The multiple negotiated by Defendants here was half the industry average.

provide notice to the Policyholders about the demutualization and their right to vote on the Plan. In order for such notice to be adequate and effective, it could not include material misstatements or contain material omissions.

The Board Otherwise Failed To Comply With Its Duties

60. Before accepting and recommending the NICO proposal to buy MLMIC at scarcely more than the tangible net worth, the Board was obligated, but failed, to take reasonable measures to ascertain the value of MLMIC. Remarkably, in considering the sale of a company with in excess of \$5 billion of marketable assets, the Board apparently did not obtain an appraisal or fairness opinion from a qualified valuation firm. Given that the Director Defendants are medical professionals with no experience in valuing companies, the failure to obtain a fairness opinion was a breach of their duties.

61. Why has the Board agreed to sell MLMIC for an amount that is well below its fair market value? Why, given the profitable success of MLMIC in creating surplus and distributing that surplus as dividends to Policyholders, would MLMIC now agree to a sale that would end MLMIC's 40-year history of being operated for its members? The answers to these questions remain unknown because the Board's negotiations were held in secret and its disclosures have been misleadingly selective and incomplete.

62. The purported rationale for the NICO Transaction contained in the "disclosure" materials made available to Policyholders consists of meaningless generalities and falls far short of justifying the transaction. From materials provided by MLMIC, Policyholders learned that following a "presentation" to the Board, the contents of which are not disclosed or described with any detail, the Board "concluded" that the offer by BHG was "within a range of acceptable values." This "range of acceptable values" has not even been disclosed. Nor do the disclosure

materials explain how the range of acceptability was defined by the Board.

63. Also undisclosed is whether the offer from BHG was at the low or high end of the range. Additionally, minimal insight is given to any of the issues, other than price, that were relevant to the Board's decision.

64. The disclosure materials provided by MLMIC do not contain an adequate explanation as to why the Policyholders are supposedly better off after their voting rights and rights to dividends in respect to MLMIC equity are eliminated and MLMIC is owned by NICO; nor do they disclose whether premiums will likely go up after the acquisition. MLMIC has successfully operated for years as a member-owned institution, providing medical malpractice insurance at competitive rates – a fact it has repeatedly touted in reports to policyholders. It has also been consistently profitable.

65. Similarly unhelpful is the “background” to the transaction provided by the disclosure materials. With typical vagueness, the disclosure materials assert that MLMIC “negotiated” with BHG. No information is provided as to the subject of that negotiation. Policyholders are told that “MLMIC was able to negotiate a ‘higher consideration,’” though it appears, based on prior public statements of MLMIC’s financial advisor, the actual consideration may have gone down approximately \$200 million from a prior offer. Since there is no disclosure of the opening bid *or* the amount of the increase in the consideration *or* the range of reasonable values, this so-called “disclosure” is materially inadequate and is, in fact, deceptive.

66. The Board's breach of duty is not limited to having agreed to this transaction without disclosing the essential information necessary for evaluation. In addition, the Board of MLMIC apparently has shut the door to more favorable deals. It has, inexplicably, agreed with BGH that it will not solicit alternative suitors or transactions. It has agreed that, even if

unsolicited, it will not change its recommendation in favor of the NICO Transaction unless the failure to effect a change of recommendation “would reasonably be likely to result in a breach of its fiduciary duties to policyholders.”

67. The Board has also agreed not to “shop” MLMIC and not to provide non-public information to any other potential acquirer. It has agreed to pay a break-up penalty in the event it changes its recommendation in favor of an alternative transaction, even if that transaction is materially more favorable to Policyholders.

68. Absent full and frank disclosures, Policyholders can only speculate regarding the motives of the Board for agreeing to sell MLMIC for materially less than what it is worth, for proceeding in such an opaque manner, and for apparently failing to obtain an independent formal appraisal or fairness opinion.

69. Part of the story may be that BHG has simply duped the Board, who are physicians and not businesspeople expert in the methodologies of actuarial analysis and the market for insurance company assets.

70. Part of the story behind the proposed transaction may be that the Board has been improperly enticed by BHG’s agreement (presumably at the Board’s request or insistence) that the Board and management stay on to run MLMIC when it is no longer a mutual insurance company. Entrenchment of management is a well-known improper inducement. According to statements from MLMIC, BHG has agreed that current management and staff will keep their positions. However, neither the promises made nor the financial inducements offered are disclosed. This is a material omission in the disclosure material.

71. The Board’s approval of the NICO Transaction was the product of a flawed and inadequate process, undertaken in secret and without participation by representatives of the

Policyholders' interests. The Board failed to take appropriate and necessary steps to make an informed decision and also deliberately withheld from Policyholders information necessary to allow Policyholders to make an informed decision. Based upon the financial information available, Defendants had no basis to recommend this transaction.

FIRST CLAIM FOR RELIEF

(Breach of Fiduciary Duty Against the Director Defendants)

72. Plaintiffs restate and reallege the foregoing paragraphs, which are incorporated by reference as if set forth fully herein.

73. The Director Defendants owe duties of good faith, loyalty, and due care to the Plaintiffs and other Policyholders.

74. The Director Defendants assumed a fiduciary duty to Plaintiffs by using confidential information to negotiate the NICO Transaction and by providing Policyholders with financial advice concerning the transaction based upon this confidential information.

75. In approving the NICO Transaction and recommending approval of the NICO Transaction to the Plaintiffs and other Policyholders, the Director Defendants breached their fiduciary duties to the Policyholders, because the NICO Transaction is, in fact, contrary to the interests of the Policyholders. The Director Defendants also breached their fiduciary duty by failing to make full and fair disclosure concerning the NICO Transaction to Plaintiffs, and failing to make a full and fair examination of the benefits of the NICO Transaction to Plaintiffs.

76. The Director Defendants are interested in the NICO Transaction and, upon information and belief, will receive personal financial benefits not received by the Policyholders.

77. The Director Defendants' breach of fiduciary duty has resulted in and will result in further damages to the Plaintiffs and other Policyholders.

SECOND CLAIM FOR RELIEF

(Negligent Misrepresentation Against the Defendants)

78. Plaintiffs restate and reallege the foregoing paragraphs, which are incorporated by reference as if set forth fully herein.

79. The Director Defendants, by virtue of their positions as directors at MLMIC, have a duty to disclose complete and accurate information regarding the NICO Transaction to the Plaintiffs and other Policyholders. In their capacity as directors and in recommending the NICO transaction, they have established a special relationship of trust and confidence with Plaintiffs.

80. The Defendants sent, or caused to be sent, the Information Statement to Plaintiffs and the other Policyholders.

81. The Information Statement, which was meant to provide notice to the Policyholders of the demutualization and solicit their votes, contains material misstatements and omissions, including that the supposed advantages of the NICO Transaction outweigh the complete loss of the Policyholders' ownership interests and their surrender of ownership. As such, the Information Statement wrongfully misleads the Policyholders regarding the NICO Transaction.

82. The Plaintiffs and other Policyholders reasonably relied upon the Information Statement provided by the Defendants in evaluating the NICO Transaction.

83. Defendants' misrepresentations contained in the Information Statement have resulted in and will result in further damages to the Plaintiffs and Policyholders.

THIRD CLAIM FOR RELIEF

(N.Y. Gen. Bus. Law § 349 Against Defendants)

84. Plaintiffs restate and reallege the foregoing paragraphs, which are incorporated by reference as if set forth fully herein.

85. Defendants, as a mutual insurance company and the directors thereof, are engaged in consumer-oriented conduct within the meaning of GBL § 349.

86. GBL § 349, declares unlawful deceptive acts or practices in the conduct of any business, trade or commerce and creates a private right of action for damages resulting therefrom. The Information Statement contains false, misleading and incomplete information, including the statement that the transaction was in the Policyholders' best interests and that Defendants had reasonable basis for this statement. In proceeding with secret negotiations with BHG and in preparing and causing to be used incomplete, misleading and false information about the proposed transaction for the purpose of soliciting approvals defendants have violated GBL § 349.

87. The Information Statement is false and misleading. Its use in connection with the NICO Transaction accordingly gives rise to Plaintiffs' claim under GBL § 349 against Defendants.

88. Defendants, by distributing the false and misleading Information Statement regarding the NICO Transaction, have engaged in deceptive practices prohibited by GBL § 349.

89. Plaintiffs and the other Policyholders are and will be injured by Defendants' deceptive practices.

90. Plaintiffs disclaim any right to punitive, exemplary or similar damages under GBL § 349. Plaintiffs disclaim any right to any penalties provided for under GBL § 349.

JURY TRIAL DEMAND

A trial by jury is hereby demanded on all issues triable by jury.

WHEREFORE, Plaintiffs demand judgment, as follows:

- i. Declaring this case to be a proper class action, certifying the Class, appointing Plaintiffs as Class representatives and their counsel as Class Counsel;
- ii. Enjoining MLMIC from submitting the NICO Transaction and the Plan for a vote by the Policyholders unless and until full and complete disclosure is made regarding the value of MLMIC and the impact on the Policyholders of the proposed NICO Transaction;
- iii. Awarding actual damages to the Policyholders based on the breach by the Board of its fiduciary obligations;
- vi. Awarding actual damages for Defendants' negligent misrepresentations regarding the NICO Transaction;
- v. Awarding actual damages for violations of GBL § 349;
- vi. Awarding Plaintiff and the Class the costs and disbursements of the action, including a reasonable allowance for Plaintiffs attorneys' and experts' fees; and
- vii. Granting such other and further relief as is just and proper under the circumstances.

BROWN RUDNICK LLP

By: /s/ Sigmund S. Wissner-Gross
Sigmund S. Wissner-Gross
May Orenstein

Seven Times Square
New York, NY 10036
Tel.: (212) 209-4800
Fax: (212) 209-4801
swissnergross@brownrudnick.com
morenstein@brownrudnick.com

BLACKNER STONE & ASSOCIATES

By: /s/ Richard L. Stone

Richard L. Stone

123 Australia Avenue
Palm Beach, FL 33480
Tel.: (561) 804-9569
Fax: (561) 659-5754
rstoneesq@aol.com

Attorneys for Plaintiffs

Dated: August 16, 2018

Presentation to Superintendent of Financial Services

Proposed Plan of Conversion of Medical Liability Mutual Insurance Company

August 23, 2018



Superintendent Should Not Approve Proposed Transaction in Current Form for Several Reasons

- First, as alleged in Castagna v. Medical Liability Mutual Insurance Company, et al., the disclosure in the policyholder information statement is inadequate, misleading and confusing and does not provide an adequate basis for the Superintendent and the policyholders to make a decision on the proposed transaction.
- Second, the transaction does not comply with Section 7307 of New York Insurance Law since it is not fair, equitable and in the best interests of policyholders and public from an economic point of view.

The Policyholder Information Statement and Other Disclosures Are An Inadequate Basis for Superintendent's Decision and Misleading to Policyholders

- A. The background to the proposed transaction and the process by which the cash consideration was determined are inadequately discussed and confusing.
- B. It is unclear what prior transactions were considered by the Board and what prior consideration was offered by NICO or NICO affiliates.
 - The disclosure does not state the amount of the deal consideration previously offered in 2016, and initially accepted by the Board in July 2016, more than two years ago.
 - The only public information about this deal is contained in a Bloomberg article which states that such July 2016 consideration was likely about \$2.7 billion dollars – \$200 million more than the current offer.
 - The Superintendent and policyholders need to have a clear explanation of the prior offer and its terms in order to evaluate the fairness of the current offer.
 - **In the two year period since this prior offer, MLMIC has earned at least \$268 million dollars, and added almost \$250 million dollars to surplus.**
 - Thus, the current offer should be higher than the prior offer, not lower. In any event, there is insufficient information from which to evaluate the two respective offers.



The Policyholder Information Statement and Other Disclosures Are An Inadequate Basis for Superintendent's Decision and Misleading to Policyholders (cont'd)

- C. The role Keefe Bruyette & Woods ("KBW") played in the process is unclear.
- The E&Y report states that KBW evaluated in March 2016 the "fairness" of the original "offer." However, the policyholder information statement, to the contrary, states that KBW only examined various valuation methods and did not offer a valuation or fairness opinion of its own.
 - While it is difficult to understand how the MLMIC Board could have approved the transaction without a fairness opinion, the exact role and advice of KBW in the transaction must be fully understood in order to determine the fairness of the deal. This is especially important as the E&Y report states that it cannot be relied upon by policyholders or the MLMIC Board.

The Consideration Is Not Fair and Equitable to Policyholders, Nor In Their Best Interests

- A. The E&Y report makes clear that the NAV or Book Value Method is the most accurate method for evaluating the fair value of MLMIC.
- Page 20 of the E&Y report indicates that the E&Y medium case value for MLMIC as of 12/31/17 was approximately \$2,667,000,000. This is \$167 million dollars more than the consideration offered. Stated differently, the proposed transaction price is less than the adjusted book value.
 - Moreover the NAV/Book Value has gone up through the first six months of 2018 by \$107 million dollars, currently equaling \$2,774,000,000.
- B. Based on the E&Y report, MLMIC is being paid, at a minimum, \$277 million dollars less than current book value or less than 90% of book value.
- The E&Y report shows that this is materially less than that average multiple to book for similar transactions, which is at least 1.5 according to E&Y.
 - Plaintiffs' own expert analysis is in agreement that the multiples to book for similar transactions are much higher.



The Consideration Is Not Fair and Equitable to Policyholders, Nor In Their Best Interests (cont'd)

- Moreover the E&Y report offers no explanation whatsoever as to why it employed such a low multiple (.9) in determining fair value, though the median in multiple similar transactions was significantly higher (1.5).
- Before approving the transaction, the basis for the purchase price must be further analyzed and examined. Approval at this point would be premature based upon the lack of information in the record.