IN THE COMMONWEALTH COURT OF PENNSYLVANIA

ROBERT L. PRATTER, ACTING INSURANCE COMMISSIONER OF THE COMMONWEALTH OF PENNSYLVANIA, **Plaintiff,** **v.** **PENN TREATY NETWORK AMERICA INSURANCE COMPANY,** **Defendant.**	:	**DOCKET NO. 5 M.D. 2009**
ROBERT L. PRATTER, ACTING INSURANCE COMMISSIONER OF THE COMMONWEALTH OF PENNSYLVANIA, **Plaintiff,** **v.** **AMERICAN NETWORK INSURANCE COMPANY,** **Defendant.**	:	**DOCKET NO. 4 M.D. 2009**

ORDER

AND NOW, this ___ day of _________, 2010, in consideration of the Motion in Limine of the Rehabilitator to Preclude Intervenors' Arguments Concerning Post-August 1, 2009 Rate Increase Efforts ("Motion") and any response thereto, it is hereby

ORDERED that the Rehabilitator's Motion is GRANTED, and accordingly, the Intervenors are precluded from asserting at the liquidation hearing in this matter (i) that the Rehabilitator violated the terms of the Rehabilitation Orders entered by the Court on January 6, 2009 by terminating efforts to file for additional rate increases or (ii) that the Commissioner was

obligated to pursue such rate increases notwithstanding being advised that the financial condition of PTNA and ANIC was drastically worse than had been reported by the companies prior to rehabilitation.

BY THE COURT:

____
MARY HANNAH LEAVITT

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

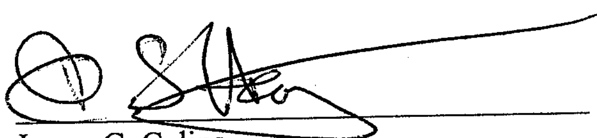
ROBERT L. PRATTER, ACTING INSURANCE COMMISSIONER OF THE COMMONWEALTH OF PENNSYLVANIA, Plaintiff, v. PENN TREATY NETWORK AMERICA INSURANCE COMPANY, Defendant.	:	DOCKET NO. 5 M.D. 2009
ROBERT L. PRATTER, ACTING INSURANCE COMMISSIONER OF THE COMMONWEALTH OF PENNSYLVANIA, Plaintiff, v. AMERICAN NETWORK INSURANCE COMPANY, Defendant.	:	DOCKET NO. 4 M.D. 2009

MOTION IN LIMINE OF THE REHABILITATOR TO PRECLUDE INTERVENORS' ARGUMENTS CONCERNING POST-AUGUST 1, 2009 RATE INCREASE EFFORTS

Petitioner Robert L. Pratter, Acting Insurance Commissioner of the Commonwealth of Pennsylvania (the "Rehabilitator"), in his capacity as Rehabilitator of Penn Treaty Network America Insurance Company ("PTNA") and American Network Insurance Company ("ANIC") hereby moves this Court to preclude Intervenors Penn Treaty American Corporation and Eugene Woznicki from asserting at the liquidation hearing in this matter that the Rehabilitator violated the Rehabilitation Orders or must pursue rate increases thereunder notwithstanding the financial

condition of the companies. The reasons and grounds for this motion are set forth in the accompanying Memorandum of Law submitted in support hereof and the exhibits set forth in the accompanying Appendices, which are incorporated by reference as if set forth fully herein.

Respectfully submitted,



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Dated: November 12, 2010

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

ROBERT L. PRATTER, ACTING INSURANCE COMMISSIONER OF THE COMMONWEALTH OF PENNSYLVANIA, **Plaintiff,** **v.** **PENN TREATY NETWORK AMERICA INSURANCE COMPANY,** **Defendant.**	:	**DOCKET NO. 5 M.D. 2009**
ROBERT L. PRATTER, ACTING INSURANCE COMMISSIONER OF THE COMMONWEALTH OF PENNSYLVANIA, **Plaintiff,** **v.** **AMERICAN NETWORK INSURANCE COMPANY,** **Defendant.**	:	**DOCKET NO. 4 M.D. 2009**

MEMORANDUM OF LAW OF THE REHABILITATOR IN SUPPORT OF HIS MOTION TO PRECLUDE INTERVENORS' ARGUMENTS CONCERNING POST-AUGUST 1, 2009 RATE INCREASE EFFORTS

INTRODUCTION

Petitioner Robert L. Pratter, Acting Insurance Commissioner of the Commonwealth of Pennsylvania, in his capacity as Rehabilitator of Penn Treaty Network America Insurance Company and American Network Insurance Company (the "Rehabilitator" or "Commissioner"), submits this memorandum of law in support of his motion to bar Intervenors Penn Treaty American Corporation and Eugene Woznicki (collectively "Intervenors") from asserting at trial that (i) the Rehabilitator violated the terms of the Rehabilitation Orders entered by the Court on

January 6, 2009 by terminating efforts to file for additional rate increases or (ii) that the Commissioner was obligated to pursue such rate increases notwithstanding being advised that the financial condition of PTNA and ANIC was drastically worse than had been reported by the companies prior to rehabilitation.

As is demonstrated below, the Rehabilitation Order's terms do not so provide—in fact just the opposite conclusion is reached from a plain reading and application of the operative facts to the Rehabilitation Order. As detailed *infra*, the Rehabilitator has made diligent efforts to rehabilitate the companies and actively pursued rate increases until it became clear that their financial condition was drastically worse than previously reported and that further rate increase filings would prove futile and therefore wasteful.

Indeed, Intervenors' own actuarial evidence further demonstrates the severity of the insolvency and the reasonableness of the Rehabilitator's conclusion that neither PTNA and ANIC can be successfully rehabilitated under Pennsylvania law. As such the Intervenors should be precluded from introducing such evidence at the time of trial and the Commissioner submits the following in support thereof.

FACTUAL BACKGROUND

A. The Rehabilitation Orders and the Condition of the Companies.

On January 6, 2009 this Court entered Orders placing PTNA and ANIC in rehabilitation. In pertinent parts, the Rehabilitation Orders provided as follows:

> *The Rehabilitator shall take such actions as are necessary to correct the condition of the Company that prompted the Board of Directors request for and consent to the rehabilitation of the Penn Treaty.*

(PTNA Rehabilitation Order ¶ 5; ANIC Rehabilitation Order ¶ 5).

The Rehabilitation Orders did not require the Rehabilitator to take steps which had no reasonable chance of correcting a hopeless condition. Prior to the initiation of this proceeding the condition of PTNA and ANIC was described as problematic, as set forth in the correspondence to the Commissioner by counsel for the Intervenors. (See Exhibit 5). At first the negative surplus of PTNA was described as totaling $100-$120 million, a sum viewed as manageable by the Commissioner and ANIC had a positive surplus. (Ex. 6, DiMemmo Dep. at 75:13-75:20; Exhibit 7 at 2). By April, it was estimated that PTNA had a negative surplus of $227 million dollars, more than twice what PTNA's management portrayed just months earlier. However, with certain adjustments in operations PTNA's financial difficulties were viewed by the Rehabilitator as potentially surmountable and ANIC still showed a very small positive surplus.

Undeniably, matters were determined to be far worse by the fall of 2009. By then the PTNA's negative surplus was estimated to be more than $1 billion dollars and ANIC had a negative surplus of over $40 million. Even the Intervenors' expert has concluded that the negative surplus far exceeds what was described as the condition of the company at the time of the execution of the Rehabilitation Orders. (See Exhibits 8 and 9, Calculation 2).

B. The Rehabilitator's Good Faith Efforts to Correct the Condition of the Companies.

From the outset, the Rehabilitator undertook extensive efforts to explore any possible way to rehabilitate PTNA and ANIC, including sale of some or all of the companies' business, reinsurance, rate increases, expense reductions, and possible benefit limitations which would not be more harmful to policyholders than liquidation. (Ex. 6, DiMemmo Dep. at 29:21-30:14, 146:24-152:2, 157:24-159:3, 215:6-218:24, 226:13-229:3:, 231:10-15). The Rehabilitator also

undertook to have up-to-date actuarial analyses done to determine the adequacy of the companies' reserves and their true financial condition to determine whether and to what extent the companies were capable of being rehabilitated.

There can be no serious dispute that the Rehabilitator actively filed and pursued rate increases until it became apparent in the summer of 2009 that PTNA was hopelessly insolvent and incapable of rehabilitation. (Ex. 6, DiMemmo Dep. at 146:24-151:20, 158:3-16). Intervenors' own witness, William Hunt, who was at PTNA through March 2009, has testified that he agrees that the Rehabilitator made diligent efforts to obtain rate increases for PTNA and ANIC from January through July 2009. (Ex. 11, Hunt Dep. 256:2-258:4, 264:10-19).

It was only when the Rehabilitator concluded based on the information he received from the up-to-date actuarial analysis that rehabilitation was futile and that such rate increase filings would not be approved that new rate increase filings were stopped. (Ex. 6, DiMemmo Dep. at 57:7-58:11, 64-66, 71, 75-76, 144-47, 178-179, 183). Even then the Rehabilitator continued to pursue pending rate increase filings in some fifteen states, succeeding in obtaining rate increases in some states, and implemented almost all additional rate increases which were approved. (Exhibit 10; Ex. 6, DiMemmo Dep. 64:2-65:22, 290:23-291:22). Rate increases were not pursued or implemented only in a very small number of states with a low share of premium because those states at the time had low $100,000 guaranty association limits. (Ex. 6, DiMemmo Dep. at 287:1-290:4, 294:11-295:14; Exhibit 10 at 28).

The information provided to the Rehabilitator during the late spring and throughout the summer of 2009 proved devastating. The condition of the companies went from problematic to beyond repair. As a result no new rate increase filings began for PTNA after July 31, 2009. The Rehabilitator's conclusion that further rehabilitation efforts and rate increase filings were futile is

thoroughly reasonable. The Rehabilitator's actuary has concluded that even with further rate increases of over thirty-five percent in the next ten years beyond those approved to date, PTNA would still have a negative surplus of over $2 billion and the much smaller ANIC had a negative surplus of over $100 million, and the companies would not be able to pay all of their obligations. (Ex. 12 at 12-14, 27-29). Moreover, the severity of PTNA's and ANIC's insolvency has been confirmed by the actuary retained by the National Organization of Life and Health Guaranty Associations ("NOLHGA"), an organization of guaranty associations whose financial interests are adversely affected by liquidation and negative surplus projections and who have no incentive to seek liquidation or overstate the companies' degree of insolvency. (Ex. 13 at 7-9).

The absence of new rate increase filings was not kept secret from Intervenors, but was disclosed to them over ten months ago. On December 8, 2009, the Rehabilitator provided to Intervenors a summary of all rate increase efforts in 2009 which includes the dates of all rate increase filings. (Exhibit 14; Exhibit 10). A simple examination of that document discloses that the latest date of any new rate increase filing was July 24, 2009. (See Exhibit 10). Intervenors were thus fully aware from December 2009 on that no rate increases had been filed after July of 2009. In addition, updated information was provided to Intervenors at their request in April 2010 which showed continuation of pre-July 2009 rate increase proceedings but no new filings. (Exhibit 15; Exhibit 16).

Notwithstanding these facts, Intervenors are now contending that the Rehabilitator must pursue rate increases even where he has concluded that there is no basis to believe that such rate increases could be granted which would return PTNA or ANIC to solvency. Intervenors base this contention on the claim that the Rehabilitator is required by the Rehabilitation Orders to seek rate increases and that Intervenors' actuary's opinion allegedly shows that the companies are

capable of rehabilitation through rate increases. (*See, e.g.*, Ex. 6 , DiMemmo Dep. at 68:23-71:23; Ex. 17, Robinson Dep. at 277:1-292:12). Both of these contentions are without merit. As is demonstrated below, the Rehabilitator is under no obligation to waste PTNA's and ANIC's assets on actions that would be futile and that he has reasonable cause to believe the companies cannot be rehabilitated.

Secondly, not only is Intervenors' actuarial analysis at best a disputed issue of fact, the validity and credibility of which is to be resolved at the liquidation hearing, but Intervenors' own actuary's analysis shows that PTNA and ANIC are both far more insolvent than projected at the time of the Rehabilitation Order and preliminary April 2009 rehabilitation plan filing. (Ex. 9 at 10). Indeed, Intervenors' actuary has admitted that under many of his projections, PTNA remained insolvent and could not pay all policyholder claims. (Ex. 19. Volkmar Dep.at 124:4-132:5). Even many of the projections submitted by Intervenors as supporting rehabilitation, which include draconian and unachievable rate increases, show that PTNA has a negative surplus for the next 30 years. (Ex. 2, Attachment 6, pp. 32-34, 38-40, 44-46, 50-52, 56-58, 62-64, 68-70, 74-76).

ARGUMENT

A rehabilitator is not obligated to pursue a rehabilitation plan which he has in good faith concluded is futile and cannot return the insurer to solvency. Koken v. Legion Insurance Co., 831 A.2d 1196, 1230, 1245 (Pa. Cmwlth. 2003), aff'd sub nom. Koken v. Villanova Insurance Co., 583 Pa. 400, 878 A.2d 51 (2005). "[S]omething more than blind hope is needed to continue a rehabilitation and avoid a liquidation." Koken v. Legion Insurance Co., 831 A.2d at 1230.

Futility of rehabilitation exists and the rehabilitator is justified in ceasing efforts to rehabilitate and develop a rehabilitation plan where the rehabilitator determines that the insurer's

reserves had been severely understated and its insolvency is so severe that rehabilitation is not feasible. Koken v. Legion Insurance Co., 831 A.2d at 1245. As this Court explained in Legion,

> This is not to say that futility can be established only where there is a proposed plan of rehabilitation. There will be cases where the rehabilitator discovers that the insurer's finances are in total disarray, loss reserves against claim liabilities are drastically understated and investments chimerical. Evidence of this type would also establish futility.

Koken v. Legion Insurance Co., 831 A.2d at 1245 (emphasis added).[1] This is such a case. Following PTNA's and ANIC's placement in rehabilitation, the Rehabilitator, in order to determine whether rehabilitation was feasible and what would be necessary to rehabilitate the companies, had current actuarial claims and surplus projections done. Those studies revealed that PTNA's and ANIC's reserves were in fact "drastically understated" and that, properly reserved, the amount of the companies' negative surplus (over $1 billion for PTNA and over $40 million for the much smaller ANIC, even with continuing rate increases) is so great that neither rate increases nor any other legally permissible rehabilitation alternatives could bring the companies back to solvency or allow the companies to pay all of their obligations. Even the Intervenors' actuary agrees that the situation is far more bleak than the Commissioner was told prior to rehabilitation.

Nothing in the Rehabilitation Orders is to the contrary. The Rehabilitation Orders do not require that the Rehabilitator seek rate increases regardless whether such rate increases could rehabilitate PTNA or ANIC or could be obtained. Rather, they direct the Rehabilitator to rehabilitate the companies and take actions to "correct the condition" that led to rehabilitation. (Rehabilitation Orders ¶¶ 3, 5). The Rehabilitator fully complied with these directions, exploring alternatives to rehabilitate the companies and actively seeking rate increases until the

[1] None of the Intervenors' experts appear familiar with this definition.

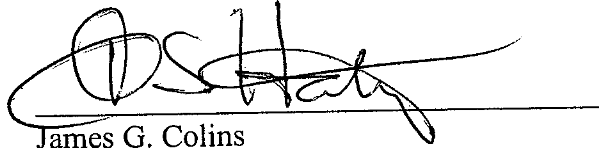
extent of the companies' insolvency demonstrated that rehabilitation was futile. Rate increase filings which are incapable of restoring PTNA or ANIC to solvency, and incapable of even allowing them to pay all of their policyholder obligations, do not constitute rehabilitation of the companies or correction of their condition. And no good faith argument can be leveled that the "condition of the Company" is anything but on virtual "life support" given the magnitude of present negative surpluses projected by both the Rehabilitator's actuarial expert witnesses and (once their draconian and unrealistic rate increases are stripped away) Intervenors' own experts.

Because the Rehabilitator is not obligated under the Rehabilitation Orders or the governing statutory scheme to seek such rate increases, assertions to this effect create an unnecessary and wasteful sideshow. The issue is simple—is the Court going to accept the opinions of Milliman and DaVinci, both of which fully support the Rehabilitator's conclusion that the situation is hopeless as PTNA and ANIC are confronting enormous surplus deficits and will run out assets long before paying all claims; or defer to Mr. Volkmar's view that extreme rate increases many times greater than states have been willing to grant PTNA and ANIC are feasible; and which he claims despite his own dire projections might allow the companies to satisfy all of their obligations.

Wasting time on baseless allegations and assertions of purported violations of this Court's Orders is not warranted as not even a *prima facie* basis for such an allegation can be offered. Instead the Court needs to focus its efforts on the severity of the issues at hand—to wit whether further efforts to rehabilitate PTNA's and ANIC would be futile. Koken v. Legion Insurance Co., 831 A.2d at 1230, 1245. As a consequence the Commissioner requests the Court

preclude the Intervenors from asserting that the Rehabilitator violated the Orders or must pursue rate increases thereunder notwithstanding the condition of the companies.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I, Virginia Lynn Hogben, hereby certify that on November 12, 2010, I served the foregoing Motion in Limine of the Rehabilitator on the following person by the following means:

Via Hand Delivery:

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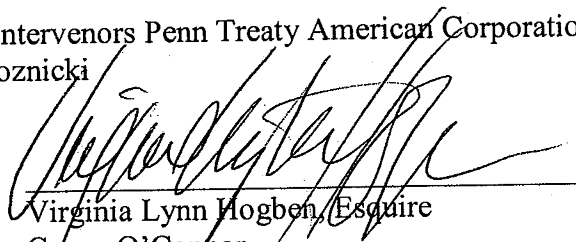

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