IN THE COMMONWEALTH COURT OF PENNSYLVANIA

In Re: Penn Treaty Network America Insurance Company in Rehabilitation	:	DOCKET NO. 1 PEN 2009
In Re: American Network Insurance Company in Rehabilitation	:	DOCKET NO. 1 ANI 2009

REPLY BRIEF OF REHABILITATOR TERESA D. MILLER TO THE HEALTH INSURERS' BRIEF REGARDING STANDARDS OF REVIEW APPLICABLE TO THE PROPOSED SECOND AMENDED REHABILITATION PLAN

I. INTRODUCTION

The Health Insurers' position regarding the standard of review applicable to a petition to approve rehabilitation plan overlooks one crucial, overriding point: The Pennsylvania Supreme Court's decision in *Foster v. Mutual Fire, Marine & Inland Insurance Co. ("Mutual Fire II")*, 614 A.2d 1086 (Pa. 1992), establishes the mandatory standard of review applicable to such a petition. Under *Mutual Fire II*, Article V of the Pennsylvania Insurance Department Act "explicitly defers all actions [regarding how to rehabilitate an insurer's business] to the skill of the Rehabilitator and implicitly recognizes her expertise in these matters," subject to review for abuse of discretion. 614 A.2d at 1091. That standard applies to the approach taken in the Second Amended Plan of Rehabilitation Plan ("Amended

Plan"). That plan provides for the rehabilitation of self-sustaining business from both Penn Treaty Network America ("PTNA") and American Network Insurance Company ("ANIC," and, collectively with PTNA "the Companies") by consolidating those policies in one company, ANIC, while consolidating non-self-sustaining business in the other company, PTNA, with the latter company to be liquidated after realignment of policies is complete.

The Health Insurers offer no basis to conclude that any portion of the Amended Plan is subject to *de novo* review. Indeed, they have not identified a single legal issue that they allege is subject to such review. Nor have they offered any basis for ignoring *Mutual Fire II*'s holding that the exercise of administrative judgment is reviewed for abuse of discretion, or for concluding that federal bankruptcy law warrants a departure from that standard. The position of the health insurers should be rejected, and the standard of review established by *Mutual Fire II* should be applied to the entirety of the Amended Plan.

II. ARGUMENT

A. The Health Insurers have not identified any legal issue that is supposedly subject to *de novo* review, and their suggestion that any part of the Amended Plan should be subject to such review is inconsistent with *Mutual Fire II*.

The Health Insurers state that "questions ... are reviewed *de novo*," yet their brief does not explain how that principle of appellate review would apply to an administrative action such as proposal of the Amended Plan, which requires an

executive official to exercise his or her judgment to determine what approach to take to rehabilitate a failing insurance company's business. *See* Response of Health Insurers, at 3. The Health Insurers do not identify a single provision of the Amended Plan that they believe should be subject to such review, and, even if they had, they offer no basis to conclude that such review would apply to the entirety of the Amended Plan. In fact, the only cases that they cite provide that issues of statutory construction receive such review. *See Hoffman Mining Co. v. Zoning Hearing Bd. of Adams Twp.*, 32 A.3d 587, 592 (Pa. 2011) (holding that interpretation of zoning statutes receives plenary review); *Holt's Cigar Co. v. City of Philadelphia*, 10 A.3d 902, 906 (Pa. 2011) (holding same with regard to criminal statutes). No such issues are present here.

This oversight reveals a critical flaw in their argument: Preparation of a rehabilitation plan is not a straightforward matter of interpreting a statute, construing a contract, determining the existence of a genuine issue of material fact, or engaging in some other analysis to which appellate courts routinely apply *de novo* review.[1] Instead, preparing a plan requires the Rehabilitator to exercise the authority granted by the legislature in Article V, specifically, to assess the financial

[1] Even if it did, the Rehabilitator's determination would still be entitled to deference under the Pennsylvania Supreme Court's holding that "courts ... afford great deference to the interpretation [of a statute] rendered by the administrative agency overseeing the implementation of such legislation." *Banfield v. Cortes*, --- A.3d ---, 2015 WL 668060, at *14 (Pa. 2015) (internal quotations omitted).

state of a company; determine whether rehabilitation is feasible; weigh whether rehabilitation actually furthers policyholders' interests; and, if it does, chart a path for reaching that goal. It also requires the Rehabilitator to evaluate whether policyholders as a whole would fare better through a liquidation proceeding, which provides access to guaranty association ("GA") protection not available in a rehabilitation proceeding. Those determinations are not legal holdings to which *de novo* review ordinarily applies. *Mutual Fire II* recognizes that these functions call for the exercise of administrative judgment, and that review for abuse of discretion is therefore appropriate. *Mutual Fire II* provides the appropriate standard of review.

B. Article V does not establish a more onerous standard of review for a conversion petition than for approval of a rehabilitation plan, and, even if it did, the former standard would not apply to the entirety of the Amended Plan.

The Health Insurers claim that the Court's May 3, 2012 Order previously determined the standard of review applicable to a petition to convert a rehabilitation proceeding to a liquidation under § 518(a) of Article V, and that such a standard should govern the entirety of the rehabilitation plan. *See* Response of Health Insurers, at 4-6. That position misses the point of both the Court's December 19, 2014 Order requesting briefing on the applicable standard of review, and the overriding rehabilitation approach set forth in the Amended Plan.

From the outset of this receivership, the Rehabilitator has maintained that § 518(a)'s emphasis on the Rehabilitator's "reasonable cause to believe" and *Mutual Fire II* collectively establish a deferential standard that authorizes the Rehabilitator to pursue a conversion petition whenever, in the exercise of her discretion, she determines that the facts at issue support a well-founded, good-faith belief that continued rehabilitation would substantially increase the risk of loss or would be futile. 40 P.S. § 221.18(a). That is the position the Rehabilitator took during the hearing on the liquidation petitions, has taken in her appeal to the Pennsylvania Supreme Court, and continues to take with regard to the pending Amended Plan. Notwithstanding the Court's May 3, 2012 Opinion, the Rehabilitator maintains that *Mutual Fire II* provides the appropriate standard of review applicable to the petition to approve the Amended Plan.

Even if a different standard were appropriate, the Health Insurers suggest that it should apply to the entirety of the Amended Plan because "the centerpiece of the Plan is the conversion of the PTNA rehabilitation proceeding to liquidation." *See* Response of Health Insurers, at 6. That statement mischaracterizes the Amended Plan. ***The central components of the plan are division of the Companies' business into self-sustaining and non-self-sustaining blocks, rehabilitation the self-sustaining policies, and empowerment of policyholders to choose how their policies will be treated.*** Policyholders with non-self-sustaining

policies will be given the opportunity to elect between liquidation and reformation of their policies to make them self-sustaining. That choice is designed to rehabilitate self-sustaining business from *both* Companies while giving policyholders who prefer to receive a combination of benefits from the GAs and the uncovered benefits provisions of the Amended Plan the ability to select that coverage. Liquidation of PTNA will not occur until a future time after policyholders have completed their elections. The Amended Plan therefore contemplates the liquidation of a future iteration of PTNA that differs significantly from the present version of the company, in that all of its future policyholders will have chosen liquidation as furthering their best interests and who will have placed their policy with PTNA precisely because they wish to participate in liquidation.

Under these circumstances, even if the standard of review under § 518(a) differed from *Mutual Fire II* (and the Rehabilitator does not believe that it does), that standard should apply, at most, to the provisions of the Amended Plan that contemplate liquidation of a future iteration of PTNA for which the futility of continued rehabilitation will be facially evident. After realignment of the Companies' policies is complete, PTNA will lack sufficient assets to cover the claims of the policyholders that have elected to place their policies with that company, and rehabilitation of PTNA would therefore substantially increase the risk of loss or be futile. The Amended Plan therefore satisfies any standard that

applies under § 518(a). The Health Insurers' argument poses no obstacle to approval of the plan.

C. Federal bankruptcy law does not support a different or higher standard of review.

Lastly, the Health Insurers claim that Chapter X of the Bankruptcy Code of 1898 and Chapter 11 of the current Code suggest that review of a rehabilitation plan should not be subject to a deferential standard of review, and that the burden should be placed on the Rehabilitator to obtain approval of the plan rather than on parties challenging the plan to establish abuse of discretion. Bankruptcy law, however, provides only a tenuous analogy to a receivership proceeding and, even if it applied with greater force, would not support the outcome for which the Health Insurers advocate.

As an initial matter, the Pennsylvania Supreme Court has recognized that "the Bankruptcy Act of 1898, rather than the [current] Bankruptcy Code of 1978, is most germane to the interpretation" of Article V, as the 1898 Code was in effect when the General Assembly enacted Article V. *Ario v. Ingram Micro, Inc.*, 965 A.2d 1194, 1203 (Pa. 2009). Current Chapter 11 (upon which the Health Insurers rely) is therefore of limited relevance in the insurance receivership context. That relevance diminishes further when one considers that the purpose of Chapter 11 is to *facilitate a voluntary compromise among a debtor and its creditors*, with an agreed plan ultimately being submitted to the court and the debtor bearing the

burden of showing that the Plan is feasible pursuant to established statutory standard. *See* 11 U.S.C. § 1129(a)(7)(A) (providing that creditors must generally approve a plan for it to be confirmed); *In re WR Grace & Co.*, 729 F.3d 332, 348 (3d Cir. 2013) (stating that a debtor has the burden of demonstrating that confirmation of a reorganization plan is not likely to be followed by a liquidation). Nothing could be further from the present case.

The debtor's role a Chapter 11 proceeding differs markedly from that of a statutory rehabilitator in an insurance receivership. The two are not analogous in any way. Unlike a debtor focused on negotiating with its creditors, the Rehabilitator's function in a receivership as set forth in Article V is primarily one of consumer protection. The General Assembly has entrusted the Rehabilitator, as an executive official of the Commonwealth government, to administer the estate for the benefit of policyholders and to give their interests precedence over those of other creditors. *See Foster v. Peat Marwick Main & Co.*, 587 A.2d 382, 385 (Pa. Commw. Ct. 1991) (holding that Article V gives the rehabilitator broad powers to legal action necessary to protect policyholders). That legislative delegation of authority is appropriate due to the "skill, judgment, and expertise" that the Rehabilitator holds the "highly specialized industry [of] insurance." *Mutual Fire II*, 614 A.2d at 1092. The Rehabilitator's duty to protect policyholders places her in a wholly different position from that of an ordinary debtor primarily concerned

with self-preservation. The Rehabilitator's primary concern is to propose a rehabilitation plan that protects policyholders who would otherwise lack the resources, sophistication, or bargaining power to protect their interests, even if doing so comes at the expense of the insurer's interests. *See Grode v. Mut. Fire, Marine, & Inland Ins. Co. ("Mutual Fire I")*, 572 A.2d 798, 801 n.5 ("[T]he equitable purpose of rehabilitation and liquidation is to protect first of all consumers of insurance."). Imposition of a Chapter 11-style burden of proof is not appropriate in light of the Rehabilitator's statutory consumer-protection mandate.

Nor does the former Chapter X of the 1898 Code support a higher burden. The Health Insurers rely on *In re Van Sweringen Corp.*, 155 F.2d 1009 (6th Cir. 1946), for the proposition that certain questions of law pertaining to reorganization plans under the former Chapter X were not subject to deferential review, as if to suggest that courts paid no deference to the entirety of those plans. *See* Response of Health Insurers, at 8. In actuality, however, the class of legal issues subject to *de novo* review in *Van Sweringen* was narrow and consisted solely of a determination of whether the plan was "fair and equitable" to creditors. *Id.* at 1013. At the time, the phrase *fair and equitable* was a term of art referring to the requirement of prioritization of secured claims over those of unsecured creditors or equity holders. *See Case v. L.A. Lumber Prods, Inc.*, 308 U.S. 106, 115 (1939) (holding that the phrase *fair and equitable* was a term of art for the "'familiar rule'

that 'the stockholder's interest in the property is subordinate to the rights of creditors"). Thus, the passage of *Van Sweringen* cited by the Health Insurers simply stands for the proposition that a court should review *de novo* whether a plan satisfies the statutory priority of distribution.

The same principle did not apply to issues requiring the exercise of discretion under Chapter X. In fact, *Van Sweringen* acknowledged that the business judgment standard applied to discretionary determinations such as which lease provisions the debtor should assume under a reorganization plan. 155 F.2d at 1015. Regarding the plan at issue in that case, the court acknowledged that the trustee "exercise[d] sound business judgment in considering" those matters, and that approval of the plan was appropriate. *Id.* A Rehabilitator must exercise the same type of discretion when formulating a plan of rehabilitation for a failing insurance company, and Chapter X therefore supports application of an abuse of discretion standard to the petition to approve the Amended Plan.

III. CONCLUSION

For the reasons set forth above and at greater length in her Brief in Support, the Rehabilitator respectfully requests that the Court enter an order finding that:

(1) Section 516(d) applies to review portions of the Amended Plan that provide for rehabilitation of ANIC (including policies issued by PTNA), which are reviewed for abuse of discretion;

(2) Section 518(a) applies to portions of the Amended Plan that contemplate liquidation of PTNA (including policies issued by ANIC), which applies as follows:

(a) The Rehabilitator must possess reasonable cause to believe that continued rehabilitation would substantially increase the risk of loss to policyholders, creditors, or the public or would be futile, and such a determination is reviewed for abuse of discretion;

(b) The Rehabilitator must produce *prima facie* evidence of the statutory ground for liquidation;

(c) Upon such a showing, the burden shifts to the party contesting the petition to disprove the ground for liquidation or to establish an abuse of discretion.

(3) All objections to the Amended Plan, including any objection to the liquidation of PTNA, must be presented at the plan-approval hearing.

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CERTIFICATE OF SERVICE

I certify that I will cause a Notice of Filing of the foregoing Reply Brief in Support of the Application for Relief to Establish Standard of Review Applicable to the Proposed Rehabilitation Plan to be served on all parties listed on the Master Service List by electronic mail or facsimile, or by U.S. Mail where no electronic mail address or facsimile number was available, and that, on March 9, 2015, I served the foregoing Application for Relief, upon Intervenors Penn Treaty American Corporation and Eugene J. Woznicki as follows:

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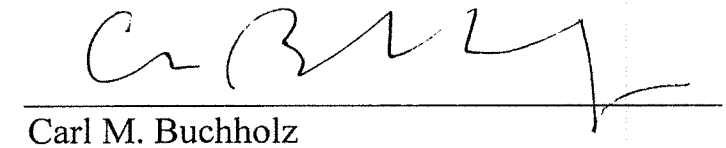

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