IN THE COMMONWEALTH COURT OF PENNSYLVANIA

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

BRIEF IN SUPPORT OF APPLICATION FOR RELIEF TO MODIFY THE PLAN TO ELIMINATE THE PAYMENT OF AGENT COMMISSIONS ON COMPANY A POLICIES

A/76747774.5

TABLE OF CONTENTS

Page

INTRODUCTION 1

ARGUMENT 3

A. Company A's payment of commissions does not support any rehabilitation purpose 3

B. The agents do not have any property interest in property of the Companies 4

C. The agents' claim for commission should be placed in Company B with other general creditor claims 11

CONCLUSION 13

EXHIBITS 15

INTRODUCTION

Aetna Life Insurance Company, Anthem, Inc., Cigna Corporation, HM Life Insurance Company, Horizon Healthcare Services, Inc. d/b/a Horizon Blue Cross Blue Shield of New Jersey, QCC Insurance Company, United Concordia Life and Health Insurance Company, United Concordia Insurance Company and UnitedHealthcare Insurance Company (collectively, the "Health Insurers") through their undersigned counsel hereby submit this brief in support of their Application for Relief to Modify the Plan to Eliminate the Payment of Agent Commissions on Company A Policies under the proposed Second Amended Plan of Rehabilitation (the "Plan") for Penn Treaty Network America Insurance Company ("PTNA") and American Network Insurance Company ("ANIC" and, together with PTNA, the "Companies").

The Plan purports to establish an ongoing company ("Company A") and a company to be liquidated ("Company B"). Company A and Company B are comprised of the best and worst business of the Companies, respectively. Company B will be in formal liquidation proceedings. Plan § I.A. at 1. Company A may continue in rehabilitation proceedings or may exit proceedings through a sale to a third party or otherwise. Plan § I.A. at 1. The claims of policyholders in Company A will be paid in full in the ordinary course, while the claims of policyholders in Company B will be paid by the Life and Health Guaranty

Associations established pursuant to the laws of each state (the "Guaranty Associations") in accordance with their statutes.

The Plan also provides for the payment in full of agent commissions on policies in Company A. The receivership laws do not grant agents an interest in property of the estate, nor do the standard agreements entered into between the Companies and the agents create such an interest. The agreements of the agents with the Companies have been terminated and the agents are not required to provide any ongoing services to Company A or Company B. In the absence of an interest in property of Company A, or an ongoing relationship that provides value to Company A, the agents have nothing more than a general creditor claim against the Companies, and that claim should be junior in priority to the payment of all claims of policyholders and guaranty associations.

The Plan provides for the payment of agent commissions on policies that are the responsibility of Company A whether the policies were issued by PTNA or ANIC. Plan § I.H. at 11. The Companies currently pay approximately $14 million annually in agent commissions, though this amount is expected to decline over time as the business runs off. Plan § VI.G.2. at 96. Under the Plan, assuming that holders of non-Self-Sustaining (as defined in the Plan) policies do not modify their policies or pay additional premiums to have their policies placed in Company A, and holders of Self-Sustaining policies do not elect to have their policies placed in

Company B, there will be approximately 16,000 policies in Company A. The present value of expected future commissions on these policies is approximately $26 million. At the same time, the Plan does not pay the policyholders of Company B or the Guaranty Associations in full, and does not pay anything for the general unsecured claims against PTNA or ANIC. The Plan should be modified to eliminate provisions requiring the payment of agent commissions by Company A, but provide for any agent to file a secured claim against the estate if that agent's agreement creates an interest in the Companies' property.

ARGUMENT

A. Company A's payment of commissions does not support any rehabilitation purpose.

Paying the commissions on policies in Company A does not promote any rehabilitation purpose. The policies in Company A are being run off, and no new business is being solicited. Plan §§ IV.Q at 64, IV.AA. at 82. All of the agents were terminated by the rehabilitator in 2009, and have not been under any obligation to provide services since then. *See* PTNA Agent Termination Letter dated June 5, 2009 (attached hereto as Exhibit A)[1]; s*ee also* Plan § IV.T. at 68 (noting that the agents are no longer providing services at the request of the Rehabilitator). Such services are not necessary for the operation of Company A, just as they were not necessary for the operation of the Companies in rehabilitation.

[1] A similar termination letter was sent to the agents of ANIC in October 2009.

Indeed, it is clear that the agents do not provide any service to policyholders. Plan § IV.T. at 68. Thus, the full payment of the agent obligations is not necessary to promote a successful rehabilitation of Company A.

B. The agents do not have any property interest in property of the Companies.

In prior litigation, the agents maintained that they have a property interest in the premiums collected on policies. *See* Objections of Affinion Group, et al. to the Application by the Rehabilitator of PTNA and ANIC for Approval of a Suspension of the Payment of Commissions to Insurance Agents (filed July 15, 2009) at 2, 4, 6. This is not supported by the agency agreements or the law of Pennsylvania. For example, one agency agreement provides as follows:

> The compensation to [the Field Marketing Organization] shall be in the form of commissions on business written by the FMO and its Sub-Agents in accordance with the commission schedules attached hereto, subject to all terms and conditions of this Agreement and the Company Rules and Regulations. The FMO's commissions shall be paid to the FMO *on the basis of collected premiums* on issued policies. Both during the term of the Agreement and after its termination, the Company shall use its best efforts to pay the FMO's commissions for each month on or before the 15th day following the close of that month. All of the FMO's first year and all renewal years commissions are fully vested immediately, and shall be the property of FMO.

Application for FMO Appointment and Contract, Penn Treaty Network American Insurance Company (attached hereto as Exhibit B) at Section 5(A); *see* Application for General Agent Appointment and Contract with Penn Treaty Network America Insurance Company (attached hereto as Exhibit C) at Section 5(A) (providing that

commissions are payable based on premium accepted or received by the Company); *see also id.* at Section 1(B) (expressly prohibiting the agent from collecting renewal premiums on behalf of Penn Treaty). These sections fall well short of creating any property interest by the agents in the premiums of the Companies. The italicized portion of the quotation above makes it clear that the collected premiums serve as a measuring device for the amount of commission to be paid rather than granting an interest in the premiums themselves. The final sentence of the paragraph only indicates that the agent's entitlement to be paid commission by the Companies is fully earned when the policy is sold, and that the commission receivable from the company is property of the agency. The word "premium" is not even mentioned in this sentence.

The provisions of the foregoing agreements should be contrasted with the provisions of the agency agreement at issue in *In re Professional Insurance Agents' Ass'n of Pa., Md. and De., Inc.*, Pa. Ins. Dept. Docket No. C89-11-12 (Jan. 31, 1991). There, the agreement stated:

> [(4.1)] . . . The full amount of all premiums collected by the Agent on policies of the Company, <u>less only the commissions payable to the AGENT with respect thereto</u>, in the amounts provided in the Schedule of Commissions, shall immediately become, be and remain trust funds in the custody of the Agent until actually paid to the GENERAL AGENT.

In re Professional Insurance Agents' at 10 (emphasis in original). This provision makes it clear that the insurance company only has a right to receive premium

from the agent after the agent receives its commission. The agreement says that the insurance company's right to the premium is "less only the commissions payable to the AGENT with respect thereto." The difference between the arrangement with the Companies' agents and the arrangement in *Professional Insurance Agents'* makes sense because it reflects the difference between the role of the agents for life and health insurance companies and agents for property casualty insurance companies. Agents for property casualty companies typically collect all premium, hold it in a trust account for some period, and then remit to the insurer. In contrast, the Companies did not rely on agents to collect their premium on an ongoing basis, and indeed the Companies' agency agreements expressly prohibit the agents from doing so. It is therefore not surprising that the financial arrangement is fundamentally different. The agents in the *Professional Insurance Agents'* decision had agreements that gave them an interest in the premium. Such arrangements are relatively common in property casualty settings, and are recognized by the courts, even as against insurance company receivers. *Kriedler v. Cascade National Ins. Co.,* 329 P.3d 928, 934 (Wash. App. 2014) ("As Cascade's fiduciary, Statewide was obligated to manage all premium receipts for the benefit of Cascade. *Outside of deducting the commission provided for by its agency agreement*, Statewide was not at liberty to dispose of premiums for its own benefit, not even to make up for amounts that Cascade had allegedly taken from it (or

failed to credit) in the past.") (emphasis added); *see also Bohlinger v. Mauyville Realty Co.*, 135 N.Y.S. 2d 865 (Sup.Ct. 1954). In contrast to agents in the foregoing cases, the Companies' agents did not have such provisions in their agreements.

The Court's decision in *Pennsylvania Assoc. of Life Underwriters v. Foster,* 645 A.2d 907 (Pa. Commw. Ct. 1994), *aff'd per curiam*, 668 A.2d 1113 (Pa. 1995), is not to the contrary. There, the court considered whether agents who had earned commissions that had been paid prior to the commencement of receivership proceedings were entitled to retain those payments or were obligated to turn them over to the receivership estate. The Court held that they were not obligated to turn them over to the estate. *Pennsylvania Assoc. of Life Underwriters*, 645 A.2d at 602. There is a vast difference between the facts of that case and this one. The agents in *Pennsylvania Assoc. of Life Underwriters* had not just earned commissions prior to the receivership. They had actually been paid those commissions. The question was whether those *payments* were property of the estate; the court concluded that they were not. *Id.* Here, the agents may have earned commissions on policies, but those commissions have not been paid. The issue presented is not whether paid commissions have to be turned over to the receivership estate, but whether the agents have the right to receive a payment of commissions from the receivership estate. These are different propositions. The

question of turnover turns on whether payments completed prior to the onset of receivership will be disturbed. The question of claim payment depends on issues of priority or a property interest in the premiums.

In prior litigation, the agents argued that they have a property interest in the premiums under Pennsylvania law regardless of the provisions of the agreement. There is no authority for this proposition under Pennsylvania law. To the contrary, the scant authority there is on the subject holds that agents are mere creditors of the insurer, and do not have a property interest in premiums. The case of *Foster v. Health Market, Inc.*, 604 A.2d 1198 (Pa. Commw. Ct. 1992), involved an allegation that the agents had received preference payments with respect to their earned commissions prior to the commencement of liquidation proceedings. Section 221.30 of the Act permits the liquidator to avoid as preferential only those payments made on account of an antecedent *debt*. The defendants in *Health Market* had contended that they were obligated to turn over only unearned commissions, and that all of their commissions were earned. Thus, in effect, their position was that there was no debt because they were owners of a portion of the premium rather than just creditors. The court rejected that argument, stating: "We conclude that it would be reasonable to infer that agents are creditors within the meaning of Section 503 and, therefore, that their commissions, if determined to be preferences, are recoverable pursuant to Section 530 of the Act." *Health Market*,

604 A.2d at 1203. The court thus rejected the concept that the agents had an actual interest in premiums which arose when the premiums were received by the insurance company. In an earlier Pennsylvania case, the Pennsylvania Superior Court rejected the proposition that an insurance agent is presumed to have a property interest in the premium used to measure his or her entitlement to compensation. *Holmes v. Wakelin*, 48 Pa. Super. 643, 647 (Pa. Super. Ct.1911).

The only authority to support the proposition that agents have an interest in commissions without regard to the agency agreement is found in the Oklahoma state courts. In *General American Life Ins. Co. v. Roach*, 65 P.2d 458 (Okla. 1937), the court considered a sale by a rehabilitator of a block of policies to another insurer. The assuming insurer agreed to pay only fifty percent of the commissions on the business. *General American*, 65 P.2d at 459-60. Citing various provisions of the agency agreement, the court decided that the intent of the parties was to create a property interest in the agents for their commissions. *Id.* at 460. However, the provisions cited are more consistent with the proposition that the agreement created nothing more than a debt from the insurer to the agent. In none of the provisions summarized by the court was there any grant of an interest in premium as there was in the *Professional Insurance Agents* decision. Thereafter, in *Cockrell v. Grimes*, 740 P.2d 746 (Okla. Civ. App. 1987), the Oklahoma appeals court decided, relying almost exclusively on the *General American* decision, that the

settled law of Oklahoma was that:

> As long as the insurance policies written by Cockrell are in effect and premiums are being paid on those policies, the commissions on those premiums is the separate, vested property of Cockrell and not the assets of the insolvent insurer.

Cockrell, 740 P.2d at 748. In so deciding, the court reversed the ruling of the trial court, which found that the agent was only a general creditor as to any renewal commissions and dismissed the agent's claims.

The Oklahoma decisions are outliers. For example, in *Roush v. National Old Line Ins Co.*, 453 F. Supp. 247 (W.D. Okla. 1978), the Oklahoma District Court, recognizing the rule in Oklahoma, concluded that Texas law applied to an agency commission arrangement, and concluded that the agent did not have a property interest in premium being collected. In *Liberty National Ins Co. v. Reins Agency Inc.*, 307 F.2d 164 (9th Cir. 1962), the court let stand the determination of an Idaho court cutting off commissions of agents on a block of business where the rehabilitator continued to collect premiums, stating that "[a]gents do not have a vested interest in future insurance premiums against insolvency receivers or against rehabilitators." *Liberty National*, 307 F.2d at 167. The court noted that the policyholders do not have an interest in specific assets of the estate either, and they, unlike agents are the principal beneficiaries of insurance receivership proceedings. *Id.* at 167-68. Further, in *Palmer v. Peoria Life Ins. Co.*, 34 N.E.2d 829 (Ill. 1941),

the court rejected *General American,* writing:

> The appellants never had any interest in or lien upon any premium ever paid by any policyholder and the only relationship which those premiums bear to the compensation of the agents, is that they were used as a unit of measuring and determining those commissions.

Palmer, 34 N.E.2d at 832. Still other cases are in accord. *See id.* at 832-33 (citing cases).

C. The agents' claim for commission should be placed in Company B with other general creditor claims.

The Plan provides for the deferral of payments to agents for commissions with respect to Company B policies until all claims of a higher priority, including costs and expenses of administration and claims arising under the Companies' insurance policies have been paid in full. Plan § IV.T at 67. It is not expected that these claims will be paid. The Plan provides that all pre-rehabilitation debt of ANIC (which will become Company A), and claims against ANIC with a lower priority than that of policyholders, will be transferred to Company B and managed in the course of liquidation. Plan § IV.T at 68. There is no legal or equitable basis on which to treat the commission claims related to Company A policies differently than the other agent claims or general creditor claims.

It appears to be undisputed that claims for commissions by agents in liquidation cannot be paid in full until all policyholder claims are paid. Section 221.44, which provides for the priority of claims in liquidation, states that "[e]very

claim in each class shall be paid in full or adequate funds retained for such payment before members of the next class receive any payment." 40 P.S. § 221.44. Class B provides for the payment of claims of policyholders under policies, while Class E provides for the payment of claims of general creditors. Claims of agents cannot be assigned to Class B or the class senior in priority to it, Class A. In both of the Mutual Fire and Fidelity Mutual plans, the liquidation priority scheme was followed. *Grode v. Mutual Fire, Marine and Inland Ins. Co.*, 572 A.2d 798, 807 (Pa. Commw. Ct. 1990) ("*Mutual Fire I*"); *Koken v. Fidelity Mutual Life Ins. Co.*, 803 A.2d 807, 811 (Pa. Commw. Ct. 2002). As set forth above, there is no legal or equitable basis on which to elevate the agents' claims above those of the policyholders. The agents have no interest in property of the estate, they are not providing ongoing service to the rehabilitated company, and their claims have only general creditor status in liquidation. As such, they should not be paid on a more advantageous basis than the policyholders and guaranty association creditors of Company B. As the court stated in *Mutual Fire I,*

> If, after all, insurance is to perform its function of risk assumption and distribution of loss, then those statutes which govern it must first protect the insuring public, particularly in situations where the insurer becomes incapable of covering the risks it contracted to assume.

Mutual Fire I, 572 A.2d at 807.

Paying the commissions of agents in Company A reduces the recovery of policyholders and guaranty associations in Company B, which is inequitable under

the facts of this case. Unquestionably, both Companies are insolvent. The Plan creates Company A out of a subset of policies of the Companies that are Self-Sustaining. The transfer of these policies to a separate stand-alone entity deprives other policyholders and the guaranty associations of any positive contribution that they might make to improving the solvency of the Companies in liquidation. As discussed above, agents are just unsecured creditors of the Companies, and in liquidation are clearly junior to the claims of policyholders. The creation of a solvent company out of the assets of two insolvent companies at the expense of some policyholders and all guaranty associations might be justifiable (under some circumstances) in order to benefit a subclass of policyholders, but it would not be justifiable to benefit agents whose claims are in all respects junior to those of policyholders.

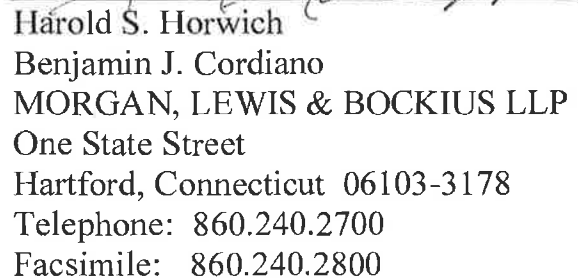
CONCLUSION

For the reasons set forth above, the Health Insurers respectfully request that the Court enter an order modifying the Plan to provide that all claims for agent commissions with respect to the policies of the Companies, whether they are Company A or Company B policies, should be treated as general creditor claims against Company B unless an agent can prove that such agent's particular agreement creates an interest in property of the estate.

Respectfully submitted,

Dated: April 2, 2015

MORGAN, LEWIS & BOCKIUS LLP

By: 

Harold S. Horwich
Benjamin J. Cordiano
MORGAN, LEWIS & BOCKIUS LLP
One State Street
Hartford, Connecticut 06103-3178
Telephone: 860.240.2700
Facsimile: 860.240.2800

John P. Lavelle, Jr.
MORGAN, LEWIS & BOCKIUS LLP
1701 Market Street
Philadelphia, PA 19103
Telephone : 215.963.5000

Attorneys for Aetna Life Insurance Company, Anthem, Inc., Cigna Corporation, HM Life Insurance Company, Horizon Healthcare Services, Inc. d/b/a Horizon Blue Cross Blue Shield of New Jersey, QCC Insurance Company, United Concordia Life and Health Insurance Company, United Concordia Insurance Company and UnitedHealthcare Insurance Company

EXHIBITS

EXHIBIT A

800.362.0700
www.penntreaty.com

June 5, 2009

RE: Notice of Contract and Appointment Termination

Dear Agent,

As you are aware, Penn Treaty Network America Insurance Company ("PTNA") ceased selling new business in October 2008 and was placed into rehabilitation on January 6, 2009 by Order of the Commonwealth Court of Pennsylvania. As a result of these events, we are terminating all PTNA producer contracts and appointments, and this letter shall serve as your written notice of termination of your PTNA producer contract. Please be advised that such termination is 'without cause' and shall be effective based on the timing set forth in your contract (generally, 30 days after the date of this letter; 90 days in New Jersey and Oregon).

We appreciate your past service to PTNA and wish you the best in your future endeavors.

Sincerely,

Robert L Robinson, CLU, ChFC
Chief Rehabilitation Officer

Penn Treaty Network America Insurance Company (In Rehabilitation)
(Penn Treaty Network America Life Insurance Company in California)

3440 Lehigh Street :: Allentown, PA 18103

CERTIFICATE OF SERVICE

I certify that on April 2, 2015, I caused a true and correct copy of the foregoing document to be served on the following persons by email at the email addresses indicated below:

Patrick H. Cantilo
Special Deputy Rehabilitator
Cantilo & Bennett, LLP
11401 Century Oaks Terrace, Suite 300
Austin, TX 78758
phcantilo@cb-firm.com

Stephen W. Schwab
DLA Piper LLP
203 North LaSalle Street
Suite 1900
Chicago, IL 60601-1293
stephen.schwab@dlapiper.com

Charles T. Richardson
Caryn M. Glawe
Faegre Baker Daniels
1050 K Street NW, Suite 400
Washington, DC 20001-4448
crichardson@faegrebd.com
caryn.glawe@faegrebd.com

James R. Potts
Cozen O'Connor
1900 Market Street
Philadelphia, PA 19103
jpotts@cozen.com

Thomas A. Leonard, Esq.
Richard Limburg, Esq.
Obermayer, Rebmann, Maxwell & Hippel LLP
One Penn Center – 19th Floor
1617 John F. Kennedy Blvd.
Philadelphia, PA 19103
thomas.leonard@obermayer.com
richard.limburg@obermayer.com

Carl Buchholz
DLA Piper LLP
One Liberty Place
1650 Market Street
Philadelphia, PA 19103-7300
carl.buchholz@dlapiper.com

Douglas Y. Christian
Benjamin M. Schmidt
Ballard Spahr LLP
1735 Market Street
51st Floor
Philadelphia, PA 19103
christiand@ballardspahr.com
schmidtb@ballardspahr.com

Paul M. Hummer
Saul Ewing LLP
Centre Square West
1500 Market Street, 38th Floor
Philadelphia, PA 19102-2186
phummer@saul.com

Andrew Parlen
O'Melveny & Myers, LLP
1625 Eye Street, NE
Washington, DC 20006
aparlen@omm.com

Benjamin J. Cordiano