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

ORDER

AND NOW, this _____ day of _____, 2015, upon consideration of Eugene J. Woznicki and Penn Treaty American Corporation's Application for Relief for an Order Rejecting the Rehabilitator's Plan or, in the Alternative, Requiring the Rehabilitator to Provide Certain Explanations in Advance of the Hearing, and all responses thereto, it is hereby **ORDERED** that the Application is **DENIED**.

BY THE COURT:

_____

MARY HANNAH LEAVITT, J.

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

THE POLICYHOLDERS COMMITTEE'S RESPONSE TO THE APPLICATION OF PTAC AND WOZNICKI FOR AN ORDER REJECTING THE REHABILITATOR'S PLAN, OR, IN THE ALTERNATIVE, REQUIRING THE REHABILITATOR TO PROVIDE CERTAIN EXPLANATIONS IN ADVANCE OF THE HEARING

The Policyholders Committee, by and through its undersigned counsel, hereby submits this Response to the Application of Eugene J. Woznicki and Penn Treaty American Corporation (collectively "PTAC") for an Order Rejecting the Rehabilitator's Plan or, in the Alternative, Requiring the Rehabilitator to Provide Certain Explanations in Advance of the Hearing (the "Application for Relief").

INTRODUCTION

PTAC's Application for Relief fails to state any compelling reason why this Court should take the extreme action of rejecting the Second Amended Plan without holding a hearing on the merits of the plan in accordance with §516(d) of Article V of the Insurance Department Act of 1921, 40 P.S. §221.16(d).

PTAC seeks to avoid a hearing on the merits of the Second Amended Plan by misrepresenting the mandates of the Court's May 3, 2012 Order, as well as the substantive components of the Second Amended Plan. PTAC also imposes unrealistic expectations on the rehabilitation process by insisting that the Court cannot approve or modify a plan until after all requisite regulatory approvals have been granted. For the reasons set forth below, the Committee asks that the Court reject PTAC's Application.

ARGUMENT

I. THE PENNSYLVANIA REHABILITATION STATUTE MANDATES THAT THE COURT PRESCRIBE NOTICE AND A HEARING

Section 516(d) of the Insurance Department Act of 1921, 40 P.S. § 221.16(d), states quite simply that the Court must prescribe notice and a hearing before disapproving a proposed plan of rehabilitation. Even if a party moves the Court to disapprove the plan on summary judgment, the Court must prescribe notice and a hearing. PTAC's application amounts to a motion for summary judgment because it asks the Court to reject the Second Amended Plan as a matter of law.

40 P.S. § 221.16 (d) sets forth the power of this Court in considering a proposed rehabilitation plan:

> The rehabilitator may prepare a plan for the reorganization, consolidation, conversion, reinsurance, merger or other transformation of the insurer. Upon

> application of the rehabilitator for approval of the plan, and after such notice and hearing as the court may prescribe, the court may either approve or disapprove the plan proposed, or may modify it and approve it as modified.

40 P.S. §221.16(d). Authorizing the Court to prescribe the appropriate notice and hearing is not the same as authorizing the Court to disapprove a plan without notice and a hearing.

The Court clearly cannot approve or modify a rehabilitation plan without providing widespread notice or holding a hearing because approving a rehabilitation plan which modifies the contractual rights of policyholders and other creditors without notice and an opportunity to be heard would violate their rights to due process. Commonwealth ex rel. Chidsey v. Keystone Mut. Cas. Co., 373 Pa. 105, 119, 95 A.2d 664, 671 ("The fundamental requirements of due process in a proceeding affecting property interests are (1) a notice of proceedings appropriate to the nature of the case and adequate to safeguard the rights of the parties, and (2) an opportunity to be heard."). Similarly, disapproving a plan also affects property interests and other rights of the policyholders and creditors because the estate's assets continue to be consumed instead of funding a plan of rehabilitation, and because disapproval constitutes a rejection of the proposed treatment of policyholders and creditors.

For these reasons, due process requires both widespread notice to policyholders and creditors and a hearing before disapproving a proposed plan of rehabilitation. Such notice has not been prescribed or given to policyholders and creditors regarding PTAC's Application, and thus persons whose property interests may be affected by PTAC's Application will not have had the opportunity to be heard. Although there is a link to PTAC's Application on Penn Treaty's website, there is nothing to indicate the nature and importance of the Application or its effect, if it is granted. For that reason, the link by itself is not adequate notice of what is in effect a motion to disapprove the Second Amended Plan on summary judgment.

Even if the rehabilitation statute permitted the Court to summarily disapprove the Second Amended Plan without first prescribing notice and a hearing – which it does not – dismissal would not be appropriate here because there are issues of fact which require a hearing.

PTAC's own Application for Relief identifies unanswered factual questions concerning whether the Rehabilitator will be able to obtain necessary regulatory approvals and satisfy other contingencies. Those questions are more properly the subject of discovery by PTAC than a motion for summary judgment.

More fundamentally, the current and projected financial condition of the Companies must be proven before the Court gives serious consideration to

rejecting the Rehabilitator's Second Amended Plan in favor of any of PTAC's suggested alternatives. In advocating for the adoption of a rehabilitation plan focused on **involuntary** benefit reductions and premium rate increases across the board – as opposed to the "business division" approach proposed in the Second Amended Plan – PTAC aims to place the burden of at least a $3 billion deficit on the policyholders. The only way for such a plan to succeed is by causing large numbers of policyholders to lapse, thereby wiping out much of the Companies' liabilities at no cost. PTAC has not offered an actuarial opinion or any other evidence, much less any undisputed evidence, that benefit cuts and premium increases alone can fairly restore ANIC and PTNA to solvency given their current financial condition. The April 30, 2013 Plan on which PTAC relies so heavily was never proven feasible. On the contrary, the Rehabilitator represented that the Plan likely would not be successful and that rehabilitation was a remote possibility: "While the Plan does provide the potential for the future restoration of full policy benefits to any policyholders remaining at that time and the payment of all other creditor claims in full, *the Rehabilitator does not anticipate at this time and based on current information that this is likely to occur.* Therefore, *the Rehabilitator is not anticipating that the company will be able to exit rehabilitation* and recommence issuing new business." See p. 20 of the April 30, 2013 Plan (emphasis supplied).

In seeking the wholesale rejection of the Second Amended Plan, PTAC seeks relief far beyond its interest as the sole shareholder of PTNA. That shareholder interest currently has no value. Because PTNA and ANIC face a "combined deficit of more than $3 billion, so that they have less than $1 in assets for every $4 that they should hold as reserves for their policies and other liabilities," it is a virtual certainty that PTAC will never see a single penny from ANIC and PTNA. (Second Amended Plan, at p. 26). PTAC has not presented any scenario under which its stock in PTNA has any value. Meanwhile, PTAC proposes no contribution of any kind on its part toward the rehabilitation of PTNA and ANIC. That speaks volumes about PTAC's lack of actual belief in its preferred form of rehabilitation and raises the question: to what extent should PTAC be able to benefit financially from its preferred form of rehabilitation, if such rehabilitation were achieved entirely through modification of benefits and premiums without any financial assistance from PTAC?

Thus, even assuming that the Pennsylvania rehabilitation statute permits the Court to dismiss the Second Amended Plan on summary judgment without first prescribing notice and a hearing – which it does not – there is no basis for doing so under the circumstances of this case where the existence of unresolved factual questions requires that the Court hold an evidentiary hearing. Accordingly, the

Court should deny PTAC's Application for Relief in all respects, or hold it under consideration pending the scheduled hearing on the Plan.

II. THE SECOND AMENDED PLAN SUBSTANTIALLY COMPLIES WITH THE COURT'S MAY 3, 2012 ORDER

PTAC's argument that the Second Amended Plan violates the Court's May 3, 2012 Order is without merit.

PTAC suggests that the Second Amended Plan violates the May 3, 2012 Order because benefit reductions and premium rate increases are not the central focus of the plan. (See, e.g., PTAC Application for Relief, at pp. 2-3: "The [R]ehabilitator is contemptuous of this Court and its Orders. The Court should order appropriate action by way of a modified plan that focuses on the first phase of the Rehabilitator's 2013 plans – benefit reductions – to be followed by premium rate increases..."). PTAC's assertion is incorrect in two key respects.

First, the Court's May 3, 2012 Order does not require that benefit reductions and premium rate increases be the central feature of the plan. On the contrary, the Court's May 3, 2012 Order does not contain any mandates concerning the substantive components of the plan, other than directing that Rehabilitator to submit a plan that "address[es] and eliminates the inadequate and unfairly discriminatory rates for the OldCo business" – which the Second Amended Plan does by dividing PTNA and ANIC into self-sustaining and non-self-sustaining blocks and requiring non-self-sustaining policyholders to voluntarily modify their

benefits and premiums if they elect to be included in Company A and avoid liquidation.

Thus, contrary to PTAC's argument, both benefit reductions and premium rate increases are in fact a central component of the Second Amended Plan. However, unlike PTAC's proposal – which is premised upon **involuntary** benefit reductions and premium rate increases – the Second Amended Plan makes benefit reductions and premium increases voluntary for non-self-sustaining policyholders. The **involuntary** benefit cuts and premium rate increases advocated by PTAC eliminate policyholder choice and thus are likely to result in substantial policyholder lapses.

Moreover, as stated in objections to the April 30, 2103 Plan, there is no policy provision permitting the Companies, and no statutory provision authorizing the Rehabilitator, to reduce benefits from one policy year to another or at any other time. Any unilateral reduction of benefits would be a breach of the policies. Moreover, cutting benefits to match premiums for underpriced products on a state by state basis is functionally the same as increasing premiums to match claims on underpriced products on a state by state basis. Both are ways of matching the product and the price. Increasing premiums to reduce the funding gap on anticipated claims requires the approval of state insurance regulators. Reducing the same funding gap by reducing benefits and rendering the policies less valuable

should be subject to approval by state insurance regulators as well. If regulations for approval of benefit cuts are lacking, it is because no insurer sells a product that permits the insurer to reduce policy benefits. No consumer would ever purchase a policy that allows the insurer to cut benefits unilaterally. It is not right or just to do through a rehabilitation plan what cannot be done directly through the state insurance regulators to whom the regulation of the pricing of insurance products is entrusted by statute. Moreover, any plan premised on across-the-board benefit reductions potentially raises impairment of contract issues under both federal and state law.

Further, assuming policy benefits are modified and reduced during rehabilitation and the company subsequently enters liquidation, it would be grossly unfair for policyholders to lose full guaranty association benefits because their benefits were reduced for purposes of a failed rehabilitation. By contrast, because any benefit reductions and premium rate increases under the Second Amended Plan will be voluntary, the Second Amended Plan avoids unfairly stripping policyholders of their right to full guaranty association coverage, as well as the practical obstacles and lead times of obtaining regulatory approval in each individual state.

III. THE NEED FOR REGULATORY APPROVALS AND THE EXISTENCE OF OTHER CONTINGENCIES ARE NOT GROUNDS FOR DENYING THE PLAN

PTAC argues that the Court should reject the Second Amended Plan because of the potential nonoccurrence of certain contingencies, including the need to obtain certain regulatory approvals. However, PTAC's argument ignores the practical reality of implementing an insurance rehabilitation plan, as well as the practical impact that the Court's approval of the Second Amended Plan will have on obtaining the requisite approvals from regulators throughout the country.

PTAC's argument – that the Plan is speculative and/or cannot be timely implemented because it cannot be assumed that certain contingencies will be met – is flawed because it improperly presumes that the Rehabilitator would be able to obtain the requisite regulatory approvals and satisfy the other contingencies without first obtaining this Court's approval of the plan. For instance, it is unreasonable to expect that the Rehabilitator would be able to obtain commitments from the regulators in each state to restore the insurance licenses of ANIC without having an approved plan of rehabilitation in place. Conversely, the Court's approval of a plan of rehabilitation will go a long way toward helping the Rehabilitator obtain state-by-state regulatory approval. PTAC's expectation that the Rehabilitator should have already resolved each and every contingency is unreasonable and is not a basis for denying the Second Amended Plan.

Further, PTAC's suggestion that the Rehabilitator should submit a plan focused on **involuntary** benefit reductions and premium rate increases undermines its argument that the Plan is overly dependent on obtaining regulatory approvals. The Committee submits that a plan incorporating premium rate increases would require regulatory approvals on a state-by-state basis. (See Second Amended Plan, at p. 38: "[O]btaining premium rate increases would require the approval of the Insurance Regulatory Authority in the state in which the policy was issued."). As noted above, cutting benefits is the functional equivalent of raising premiums and, thus, should also be subject to regulatory approval. Thus, PTAC's proposal actually would impose additional regulatory hurdles and uncertainty that the Second Amended Plan avoids.

IV. IF PTAC HAS QUESTIONS "REGARDING UNCERTAINTIES OF THE PLAN," IT SHOULD SERVE THE REHABILITATOR WITH DISCOVERY REQUESTS

As an alternative form of relief, PTAC asks that the Court order the Rehabilitator to "immediately state his position regarding uncertainties of the Plan." (PTAC Application for Relief, at p. 13). The Court should deny PTAC's request because discovery is ongoing and if PTAC has questions concerning the plan it can serve the Rehabilitator with discovery requests. Accordingly, there is no basis for PTAC's alternative request for relief, and the Court should deny PTAC's Application in its entirety.

CONCLUSION

For all of the forgoing reasons, the Court should enter an Order denying PTAC's Application for Relief.

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CERTIFICATE OF SERVICE

I certify that on April 22, 2015, I caused a true and correct copy of the foregoing Response to be served on the following persons by email at the email addresses indicated below:

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