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

HEALTH INSURERS' REVISED OBJECTION TO APPLICATION FOR APPROVAL OF SETTLEMENT AGREEMENT

I. 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 (the "Health Insurers") hereby object to the Verified Joint Application of the Commissioner, Penn Treaty American Corporation, Eugene Woznicki, and Broadbill Partners LP for Approval of Memorandum of Understanding filed with the Commonwealth Court of Pennsylvania on June 14, 2016 (the "Application"). The Application seeks approval of a settlement between Teresa Miller (in her capacity as statutory rehabilitator or upon the entry of liquidation orders in the matter as the liquidator, the "Rehabilitator") and Penn Treaty America Corp. ("PTAC") and certain of its affiliates (collectively, the "PTAC Group"). The terms of the settlement are set forth in the Memorandum of Understanding and Settlement dated June 14, 2016 (the "Memorandum of Understanding"). Under the Memorandum of Understanding, the Penn Treaty Network America Insurance Company ("PTNA") and American Network Insurance Company ("ANIC") estates will pay either $10 or $15 million to or for the benefit of PTAC.

II. SUMMARY OF OBJECTION

The Application seeks approval of a settlement under which the Rehabilitator wants to make a payment to the holders of equity in a company that is insolvent by four billion dollars. The settlement is supposed to obtain two benefits for the estate: (i) consent to a liquidation order and (ii) control of tax benefits. Both of these can be obtained without the consent or assistance of the equity, and without the payment of $10 million or $15 million.

The Health Insurers object to the Memorandum of Understanding and the Application for the following reasons:

1. The Memorandum of Understanding does not meet the stringent requirements imposed for settlements that make payments contrary to statutory priorities. The estate is not receiving fair value for the amounts it is paying, and the Rehabilitator did not pursue alternatives to the Memorandum of Understanding that would have avoided a payment to the equity.
2. The Application must also be denied because it fails to provide the Court with any basis on which to evaluate the Memorandum of Understanding. In order to approve a settlement, the Court must be able to weigh the competing contentions of the parties that are being settled. The terms of the Memorandum of Understanding are so

vague that they do not constitute an agreement that can be evaluated or approved by the Court. The Application contains no information about the disputes between the parties from which the Court could perform an evaluation.

3. There is no basis on which to condition the appellant's right to appeal on the posting of a bond where, as here, there is no need for a stay pending appeal.

In light of the foregoing, the Health Insurers respectfully request that the Application be denied.

III. ARGUMENT

A. Standard of Review.

In determining the standard of review for the Application, the Court must recognize that the proposed settlement provides for a payment to the sole shareholder in contravention of the insolvency priority scheme that places shareholders at the end of the line. *See* 40 Pa. Stat. Ann. § 221.44 (2016)(establishing priority scheme); *see also In re Jevic Holding Corp.*, 787 F.3d 173, 184 (3d Cir. 2015), as amended (Aug. 18, 2015), *cert. granted sub nom. Czyzewski v. Jevic Holding Corp.*, No. 15-649, 2016 WL 3496769 (U.S. June 28, 2016)(holding courts may approve settlements that deviate from the priority scheme only if they have "specific and credible grounds to justify the deviation").

The Rehabilitator cannot demonstrate the specific and credible grounds to deviate from the General Assembly's mandatory prioritization of creditors because there are other far less costly means to obtain the same benefits without having to make payments to the equity.

The Rehabilitator advocates for a standard of review that gives great weight to the Rehabilitator's judgment, but the cases cited by the Rehabilitator for this proposition do not support it. *See* Application, Paragraph 11. The Supreme Court's decision in this case deals only with "judicial review of a statutory Rehabilitator's decision to seek conversion under Section 518(a)," and does not address the standards applicable to approving a settlement. *In re Penn Treaty Network Am. Ins. Co.*, 119 A.3d 313, 322 (Pa. 2015). The *FGIC* case applied the "arbitrary and capricious" standard under New York law, but the settlement in that case was with an unrelated third party. *See In re Rehab. of Fin. Guar. Ins. Co.*, 975 N.Y.S.2d 712 (Sup. Ct. 2013) (The case on which *FGIC* relies, *Corocoran v. Frank B. Hall & Co., Inc.*, 149 A.D.2d 165 (1st Dept. 1989) does not deal with settlements at all, but only holds that the receiver has exclusive authority to bring certain actions.) The *Executive Life* decision specifically declined to reach the question of the Commissioner's discretion, stating:

> The powers of the Commissioner in this regard are, as in other respects, limited by the requirement of rationality, compliance with statute and prohibition against improper discrimination. We do not reach the question of precise delineation of the extent of the discretion

> of the Commissioner in this regard. We conclude only: (1) that the case for Class 5 priority of all ELIC GICs except the post-1988 Muni-GICs is so strong and the benefit to the estate from the settlements so great as clearly to justify the Commissioner's exercise of discretion to settle; and (2) that, at the other extreme, the record here fails to establish a rational basis for extending Class 5 priority by settlement to the post-1988 Muni-GICs.

In re Executive Life Ins. Co., 32 Cal. App. 4th 344, 370 (1995), as modified on denial of reh'g (Mar. 15, 1995) (emphasis supplied). The court in *Liquidation of International Underwriters Insurance Company* approved a settlement between the receiver and a receiver of another estate, but did not indicate in the ruling what standard of review had been applied. *See In re Liquidation of Int'l Underwriters Ins.* 1998 WL 928383 (Del. Ch. Dec. 30, 1998). Furthermore, the settlement at issue did not involve payments outside the priority scheme. Id.

The Rehabilitator cites with approval a Third Circuit decision in a bankruptcy case that sets forth the standard advocated by the Health Insurers. *In re Jevic Holding Corp.*, 787 F.3d 173 (3d Cir. 2015), as amended (Aug. 18, 2015), cert. granted sub nom. *Czyzewski v. Jevic Holding Corp.*, No. 15-649, 2016 WL 3496769 (U.S. June 28, 2016)("*Jevic*").[1] *Jevic* involved a bankruptcy court order approving the dismissal of a Chapter 11 case pursuant to a settlement agreement

[1] Jevic is now on certiorari to the U.S. Supreme Court, presumably for the purpose of resolving the split among the Circuit Courts on the question of whether settlements that violate the absolute priority rule can be approved at all. *See Matter of AWECO, Inc.*, 725 F.2d 293, 298 (5th Cir. 1984), holding that a settlement that violated the absolute priority rule could not be approved.

that made partial payments to some creditors but not others. *Jevic*, 787 F.3d at 184. The court observed that settlements, like other aspects of reorganization cases, must be "fair and equitable." *Id.* at 183. The court noted that the fair and equitable test includes the "absolute priority rule by requiring that a plan of reorganization pay senior creditors before junior creditors in order to be 'fair and equitable' and confirmable.'" *Id.* at 182. Recognizing that settlements are not plans of reorganization, and that failure to adhere to the bankruptcy priorities was not dispositive of whether a settlement is fair and equitable, the Court held that "bankruptcy courts may approve settlements that deviate from the priority scheme of § 507 of the Bankruptcy Code only if they have 'specific and credible grounds to justify [the] deviation.'" *Id.* at 184 (citing *In re Iridium Operating LLC*, 478 F.3d 452, 466 (2d Cir. 2007)). In disputing the conclusion reached by the dissenting judge (who would have disapproved the settlement), the court wrote, "[t]here is no support in the record for the proposition that a viable alternative existed that would have better served the estate and the creditors as a whole." *Id.* at 185. The rule adopted in *Jevic* has been used by other courts as well and should be applied in the instant matter. *See, e.g.*, *In re Iridium Operating LLC*, 478 F.3d 452, 466 (2d Cir. 2007); *In re Energy Future Holdings Corp.*, 2016 WL 2343322 (3d Cir. May 4, 2016).

B. The Memorandum of Understanding Clearly Violates the Statutory Priority Scheme.

The Court should reject the Application because the Memorandum of Understanding would require a payment to the equity holder, $10 or $15 million to PTAC, that clearly circumvents the statutory distribution scheme. Under Section 221.44 of the Pennsylvania Insurance Code, "the claims of shareholders or other owners" are the last claims to be paid. 40 Pa. Stat. Ann. § 221.44(i) (2016). The proposed settlement would require such claims to be paid ahead of claims made by those holding senior interests.

While there is a circuit split on the standard of approval for settlements that violate the statutory priority scheme, under either standard the Application must be rejected. The Fifth Circuit flatly rejects settlements which prioritize junior interests (i.e. the payment to equity) over senior interests because they cannot satisfy the "fair and equitable" standard for approval of settlements. *See Matter of AWECO, Inc.*, 725 F.2d 293 (5th Cir. 1984)(holding "[t]he words 'fair and equitable' are terms of art—they mean that 'senior interests are entitled to full priority over junior ones.'"). The Third Circuit standard articulated in *Jevic* requires "specific and credible grounds" for deviation from a statutory priority scheme. In the instant matter, there are viable alternatives to the settlement that do not result in paying $10 or $15 million to the shareholder in order obtain the same

benefits, and the Application and Memorandum of Understanding do not provide the Court with a choate transaction or a set of defined disputes that can actually be evaluated by the Court. The Application, therefore, does not provide specific or credible grounds for deviating from the statutory priority scheme. Applying either the Fifth Circuit or Third Circuit standard, the Application should be denied.

C. The Payments to the Shareholder Exceed the Benefits of the Memorandum of Understanding.

The Application cites six benefits to the proposed settlement. The Health Insurers address them in order.

1. Tax Issues

The first two benefits are "Preservation of Tax Benefits" and "Joint Submission of the PLR Request to the IRS." PTAC currently controls the filing of the tax return that includes PTNA. For this reason, it is currently blocking PTNA from seeking a private letter ruling from the IRS ("PLR") until PTNA pays it to unlock the stranglehold.

The bargain envisioned by the Memorandum of Understanding allows PTNA to file a private letter ruling request, and gives PTNA the right to approve future tax returns, but the price of $10 million (and possibly $15 million) cannot possibly be justified for at least two reasons. First, the settlement payment is payable whether or not the PLR actually is successful – resulting in the possibility

that the estate pays up to $15 million (and in the process upsetting the order of priorities) for no tax benefit whatsoever. Second, the supposed "tax benefit" of the settlement could be achieved without the agreement.

With respect to the first point, if the PLR is denied, the most that the estate could possibly owe is approximately $20 million – effectively a 20% alternative minimum tax on 10% of the approximately $1 billion of reserve recapture taxable income that the estate might recognize in the absence of a PLR.[2] In this scenario, the settlement provides no tax benefit. Consequently, the estate is agreeing to pay as much as $15 million for the *mere possibility* of avoiding a $20 million liability.

With respect to the second point, the result proposed to be achieved by the Memorandum of Understanding could be achieved without any payment to PTAC. The current roadblock created by PTAC results from PTNA being part of a consolidated taxpayer group with PTAC – that is, being an 80%-plus owned subsidiary of PTAC. PTNA would be deconsolidated from PTAC if PTAC's ownership were to fall below 80%, either as a result of a transfer of shares or the issuance of new shares. The Rehabilitator has authority to issue enough shares of PTNA to break the consolidation and exit the consolidate group. 40 P.S. §221.16(b) ("He shall have all the powers of the directors, officers and managers,

[2] A 20% alternative minimum tax may be imposed on 10% of the estate's income because only 90% of alternative minimum taxable income may be offset by the estate's otherwise-sufficient alternative tax net operating losses. *See* 26 U.S.C. Section 56(d)(1)(A)(i).

whose authority shall be suspended, except as they are redelegated by the rehabilitator.") It is the Health Insurers' expectation, as they have discussed with the Rehabilitator, that PTNA would experience no material adverse federal income tax consequences if it ceased to be a member of that group: it would retain the net operating losses attributable to its operations (as opposed to PTAC's operations), and PTAC should not experience impairment in its asset basis or other tax attributes, either. If PTNA were no longer part of PTAC consolidated taxpayer group, it would be able to file the PLR request without PTAC's joinder or consent. In addition, if the PLR were denied, PTNA would continue to have access to the net operating losses generated by its operations (as distinct from PTAC's operations). Finally, the deconsolidation would leave PTAC in a position where it would still be able to take its worthless stock deduction, which is exactly the tax benefit that it preserves for itself under the Memorandum of Understanding. *See* Memorandum of Understanding Section D. 3.

PTNA has more than enough authorized but unissued shares to accomplish a sale that would break consolidation. The PTNA's Certificate of Incorporation, Article 5 authorizes 320,000 shares of common stock. (Amendment December 14, 1999 (Exhibit A, pg. 11). Of that amount, only 240,000 shares have been issued, leaving 80,000 shares (or 25% of the capital stock) unissued. (See, Return of Increase or Decrease of Stated Capital dated August 25, 1989 (Exhibit A, pg. 16)).

The Rehabilitator could issue the shares to any entity, including to a trust set up for the benefit of policyholders, and thereby avoid having to make a payment to equity. The Health Insurers would even be willing to discuss a purchase of the unissued shares, as long as it would avoid having to make a payment to the equity. Such a transaction would put money into the estate rather than taking money out of the estate. Under any arrangement where issuance of stock resulted in deconsolidation, PTNA could decouple with PTAC at no cost and thereby control its own destiny. Such an arrangement would not harm PTAC because PTAC could retain its worthless stock deduction. This is the course that should have been, and should be, pursued because deconsolidation would avoid a $10 or $15 million settlement payment to PTNA's sole shareholder. Because there is a readily available alternative to a payment to equity, there are no specific and credible grounds for violating the statutory priority scheme, and the Application should be denied.

2. Liquidation Issues

The next three benefits identified by the Rehabilitator are (i) "Resolution of All PTAC Intervenors' Objections, Consent to Liquidation, and Expedited Proceedings," (ii) "Elimination of Cost of Agent Commissions and Premium," and (iii) "Reduction of the Burden on State Insurance Guaranty Associations." The second and third benefits derive from the entry of a liquidation order and are not

otherwise related to the Memorandum of Understanding.[3] The entry of the liquidation order is not a matter that is seriously in doubt in the wake of the Pennsylvania Supreme Court's ruling in July of 2015. *In re Penn Treaty Network Am. Ins. Co.*, 119 A.3d 313, 319 (Pa. 2015) ("Grounds for liquidation existed, because both [PTNA and ANIC] indisputably were and are insolvent […]"). The Court held that the Rehabilitator was entitled to deference in her conclusion that further efforts at rehabilitation would increase the risk of loss or be futile. The Court noted that "the matter of insolvency has never been in question relative to the Companies . . .." *Id.* At 321. The Rehabilitator has been attempting rehabilitation for four years. The first rehabilitation plan was extensively amended to a second plan which is no longer being actively prosecuted by the Rehabilitator. On these undisputed facts, it cannot be seriously maintained that there would be a basis on which to challenge the Rehabilitator's judgment to seek liquidation.

3. Mutual Releases and the Prospect of Litigation

The Application cites the prospect for a "conclusion of litigation on all contested issues between the Commissioner and PTAC Intervenors that currently exists and that could arise in the future." *See* Memorandum of Understanding, Section I,5(f). While peace undeniably has a value, there is currently no war.

[3] It should be noted that the Health Insurers are the parties that will bear the burden of the assessments from the state insurance guaranty associations. Their opposition to the Application should, by itself, cast serious doubt on the value of the reduction at issue.

There are no active pending actions before this or any other court in which the Rehabilitator and PTAC are contestants. The Second Amended Rehabilitation Plan was opposed by PTAC (and also the Health Insurers), but confirmation of that plan has not been pursued for several months. As discussed above, opposition to liquidation is implausible. In addition, the Application fails to describe what issues might cause the parties to be at odds or what they are releasing each other from that is worth $10 or $15 million. The liquidation and tax issues are certainly not worth these sums.

The Rehabilitator posits that PTAC will pursue litigation on these issues regardless of their merits, and the implication is that the estate will need to continue to pay PTAC's fees. The Court has cited both Section 518(a) of Article V of The Insurance Department Act of 1921 ("Article V"), 40 P.S. § 221.18(a), and, alternatively, Section 506(c)(i) of Article V, 40 P.S. § 221.6(c)(i), in making such awards. The Health Insurers maintain that neither section would require reimbursement of PTAC's fees and expenses in connection with a contest over a liquidation petition or tax attributes in this proceeding.

Fees and expenses spent in connection with any dispute over tax benefits would clearly not be reimbursable by the estate under either statute. The position being asserted by PTAC and its shareholders is solely for their benefit and not that of PTNA. In fact, it is directly contrary to the interest of PTNA. In such a dispute,

they would not be acting as the directors or managers of PTNA, and therefore would have no entitlement to recovery for their endeavors.

With respect to the defense of a liquidation petition, only Section 518(a) would apply, and that section commends reimbursement to the Court's discretion. Given the overwhelming case to be made for liquidation, and the Court's close supervision of the rehabilitation process over the last four years, a substantial award in the defense of a liquidation petition would be unjustified.

Section 506(c)(i), which has a more liberal standard for reimbursement, should not apply. This section should be read to deal only with the defense of cases first being initiated by the insurance department. Read otherwise, there would be two provisions of Article V that deal with the exact same topic and have different standards. Well established principles of statutory interpretation counsel against such a result. *See* 1 Pa. Stat. and Cons. Stat. Ann. § 1921 (2016) ("Every statute shall be construed, if possible, to give effect to all of its provisions"); *Matter of Employees of Student Servs., Inc.*, 432 A.2d 189, 195 (1981)("Whenever possible each word in a statutory provision is to be given meaning and not to be treated as a surplusage.")

The more liberal entitlement to reasonable costs and fees – without discretion of the Court – provided in Section 506(c)(i) makes sense in the circumstance of defending against the commencement of a delinquency

proceeding. At this stage, no judicial determination has been made that the insurer is in troubled financial or other condition that justifies the institution of a delinquency proceeding against it, and the management and board of directors remains in control of the company. Until such a determination is made, the insurer should be entitled to use its funds to defend against the institution of delinquency proceedings. This is the outcome provided by Section 506(c)(i).

Section 518(a) addresses an entirely different circumstance. That section is expressly limited to fees and costs in connection with the defense of a liquidation petition once a rehabilitation proceeding is already pending.[4] In that case, there has been a judicial determination – entry of the final order of rehabilitation – that the circumstances warrant abridging the rights of the management and board of directors. Once that determination has been made, the statutory Rehabilitator is entitled to exercise the rights of the insurer's directors, officers and managers, whose authority is suspended, and a comprehensive regime is imposed to protect "the interests of insureds, creditors, and the public generally." 40 P.S. §§ 221.1(c), 221.16(b). As part of that regime, the directors may still take action to defend against a petition for liquidation, but fees and costs may be awarded only for

[4] It is well settled that in construing statutes, the specific is favored over the general. *See Kingsley v. Wes Outdoor Advert. Co.*, 262 A.2d 193, 195 (1970)(holding that the provisions of a specific statute will prevail over a general statute). Thus, principles of statutory interpretation further support the application of Section 518(a) to any fee application in connection with the defense of a liquidation petition in a pending rehabilitation proceeding.

"reasonably necessary" actions "as justice may require." This limitation makes sense in the context of conserving the insurer's limited assets consistent with the regime imposed by Article V.

Any fee application filed by PTAC in connection with the defense of a liquidation petition in this case could only be granted, if at all, for very limited sums. In order for the Court to approve a liquidation petition, it must determine that PTNA and ANIC are insolvent and that further attempts to rehabilitate them would be futile or would substantially increase the risk of loss to creditors, policyholders and the public generally. That standard has been met, and no reasonable arguments can be made to the contrary. The Court already determined that the companies are insolvent. *See Consedine v. Penn Treaty Network Am. Ins. Co.*, 63 A.3d 368, 441 (Pa. Commw. Ct. 2012), as amended (Jan. 18, 2013), aff'd but criticized sub nom. In re Penn Treaty Network Am. Ins. Co., 119 A.3d 313 (Pa. 2015)(holding "[PTNA and ANIC] are insolvent"). The Rehabilitator has been diligently pursuing rehabilitation for over four years with no fewer than four intervening interested parties, including the Health Insurers, to no avail. Justice no longer requires the payment of substantial PTAC fees.

The settlement advocated by the Rehabilitator does not meet the strict standards required for approval of a settlement that violates the statutory priority rules. PTAC's consent to liquidation is not needed because the issue of liquidation

here is not materially in doubt. PTAC's joinder in a request for a PLR is not needed because the Rehabilitator can break consolidation and chart its own course (without paying PTAC and without even injuring PTAC's tax position). The costs of meritless litigation by PTAC are not so substantial (certainly not $10 or $15 million) since the estate should not be required to reimburse any material portion of PTAC's fees.

D. The Application and Memorandum of Understanding Do Not Support the Proposed Payments.

In order for the Court to consider the settlement proposed by the Application, it would need to scrutinize the compromise involved and evaluate that compromise against the merits of the claims being settled. But the Memorandum of Understanding is too vague to permit the required scrutiny and evaluation. The Application provides no details as to the merits of the issues being compromised. What is clear is that these are not issues that are otherwise in front of the Court.

In *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson,* 88 S. Ct. 1157 (1968) ("*TMT Trailers*"), the Supreme Court set out the role of the court in reviewing compromises. This standard was adopted in *Jevic* (on which the Rehabilitator relies). The Court wrote:

> The fact that courts do not ordinarily scrutinize the merits of compromises involved in suits between individual litigants cannot affect the duty of a bankruptcy court to determine that a proposed compromise forming part of a reorganization plan is fair and equitable. *In re Chicago Rapid Transit Co.*, 196 F.2d 484 (C.A.7th

> Cir. 1952). There can be no informed and independent judgment as to whether a proposed compromise is fair and equitable until the bankruptcy judge has apprised himself of all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated. Further, the judge should form an educated estimate of the complexity, expense, and likely duration of such litigation, the possible difficulties of collecting on any judgment which might be obtained, and all other factors relevant to a full and fair assessment of the wisdom of the proposed compromise. Basic to this process in every instance, of course, is the need to compare the terms of the compromise with the likely rewards of litigation.

TMT Trailers at 1163. The Application should be denied because it fails to provide the Court with the means by which to evaluate the compromise embodied in the Memorandum of Understanding.

i. The Settlement is too vague to evaluate its value to the estate.

The operative terms of the Memorandum of Understanding are so vague that the Court cannot determine whether the estate is receiving any value for the payment that it is making. The issues left open are the fundamental aspects of the agreement.

The entire point of the Memorandum of Understanding is to enable the Rehabilitator to file a private letter ruling, but no one appears to have worked out what the PLR request will say. The Agreement states:

> PTAC and the Commissioner will seek a Private Letter Ruling from the Internal Revenue Service ("IRS"), office of the Assistant Commissioner, with ruling requests substantively as set forth in the pre-submission request that the Commissioner submitted to the IRS and to PTAC in March 2015, or as otherwise modified in accordance

> with the terms hereof, to present the facts and circumstances of liquidation as provided and as described in a draft statement agreed to by the Parties.

Memorandum of Understanding Section B (1). The pre-submission request submitted to the IRS and to PTAC in March 2015 (a copy of which is attached as Exhibit B) related specifically to the terms of the Second Amended Plan of Rehabilitation. The request depends entirely on the terms of the Plan including the creation of Company A and Company B, the bifurcation of liabilities between an entity being liquidated and an entity that was being rehabilitated and elections by policyholders. The PLR that would have to be filed under the present circumstances will be materially different from the pre-submission request drafted in connection with the Plan because the settlement contemplates that both PTNA and ANIC will go into liquidation, and policyholders are not receiving any choices to move their policy from one company to the other. The "draft statement" that will support the PLR will also have to be materially different for the same reasons. Yet these items are not submitted with the Application and appear to be items that will have to be worked out by the Rehabilitator and PTAC after the settlement is approved and after the first $5 million of the settlement payment is made. *See* Memorandum of Understanding at Section 1.G.(a). Likewise, the Memorandum of Understanding contemplates that the "Parties will enter into tax cooperation, non-interference and other agreements complementary and ancillary to, and consistent

with the terms of, this MOU (*i.e.*, the Definitive Agreements)." Memorandum of Understanding at Section 1.B.(5). These appear to be the agreements that should be approved by the Court, since they are the documents that will actually embody the terms of the parties' agreements.

Finally, there is a provision in the Memorandum of Understanding for the payment of an additional $5.0 million into an insolvent subsidiary of ANIC under circumstances that cannot be divined from the Memorandum of Understanding. Section H.2. of the Memorandum of Understanding states:

> 2. SALE OF AINIC: Nothing in this MOU shall preclude the Parties from separately negotiating for or effecting a sale of the stock of AINIC to PTAC. Without limiting the generality of the foregoing, unless AINIC's assets or business have been sold to a third party, the Parties shall negotiate in good faith and consistent with the prior negotiations over a $5 million capital contribution by ANIC to AINIC in exchange for a surplus note (which the Commissioner has informed PTAC must be in a face amount of $25 million), but at all times exclusively repayable from fifteen percent (15%) of AINIC's distributable surplus and with a liquidation distribution rights that shall not be superior to common stock and limited to 15% of distributable assets. Such capital contribution and surplus note shall be subject to the approval by the New York Department of Financial Services and the retention of AINIC of its book of business.

This provision would increase the consideration paid by fifty percent, yet it is not even mentioned in the Application and it is impossible to know under what circumstances it will be paid. The Memorandum of Understanding requires the parties to "negotiate in good faith and consistent with the prior negotiations over a $5 million capital contribution by ANIC to AINIC…." There is no indication of

what "prior negotiations" were. Furthermore, the consideration is a surplus note that has "a liquidation distribution rights [sic] that shall not be superior to common stock and limited to 15% of distributable assets." There is no explanation in the Memorandum of Understanding or the Application why a surplus note would be junior to equity in liquidation or what prospects there might be for the payment of such a note in the absence of liquidation. The Health Insurers understand from the Rehabilitator (a) that AINIC is an insolvent New York domiciled long term care insurance company, (b) that the Rehabilitator permitted management to "operate" AINIC during these proceedings, and (c) that management took substantial fees and expenses out of AINIC even though PTNA performed substantially all of the administrative services for it. The terms of this arrangement are so vague as to be unintelligible. There is also no explanation of the arrangement or justification for it in the Application. In fact, it is not even mentioned.

The Rehabilitator is asking the Court to approve terms that are either indefinite or unintelligible. This is fundamentally at odds with the Court's obligation to weigh the consideration being received under the Memorandum of Understanding against the alternatives to the Memorandum of Understanding.

ii. The Application fails to describe any disputes being settled.

The Application does not describe any of the disputes between the parties, and therefore also fails to evaluate the merits of any party's legal position. While

it extols the value of a peaceful resolution, it provides no basis on which the Court could determine that there are disputes that need to be settled (as discussed above, there are none currently pending). The only pending dispute concerns the Second Amended Plan of Rehabilitation, but that plan is no longer being pursued. In other words, the matters that are being settled are not otherwise before the court.

The decisions in which courts have considered the merits of a settlement are replete with legal and factual analysis of the disputes. *In re Executive Life Ins. Co.*, cited with favor by the Rehabilitator, is a good example. There, the court conducted an extensive analysis of the statutes involved in the dispute as well as their legislative history. The court also examined the terms of the policies that were at issue in the dispute. On the basis of that analysis, the court approved one of the settlements before it and disapproved the other. *See generally* In re Executive Life Ins. Co., 32 Cal. App. 4th 344, as modified on denial of reh'g (Mar. 15, 1995).

In *TMT Trailers*, the U.S. Supreme Court reversed and remanded the approval of a settlement, stating:

> The record before us leaves us completely uninformed as to whether the trial court ever evaluated the merits of the causes of actions held by the debtor, the prospects and problems of litigating those claims, or the fairness of the terms of compromise. More than this, the record is devoid of facts which would have permitted a reasoned judgment that the claims of actions should be settled in this fashion. In reaching this conclusion, however, it is necessary to emphasize that we intimate no opinion as to the actual fairness of the proposed compromises. To the

> contrary, it is clear that the present record is inadequate for assessing either, and that a remand is necessary to permit further hearings to be held. Only after further investigation can it be determined whether, and on what terms, these claims should be compromised.

TMT Trailers at 1171-72. The same is true here: the Application is utterly devoid of any information from which the Court could conclude that the Memorandum of Understanding was appropriate. As such, the Application should be denied.

E. Chapter 17 of the Pennsylvania Rules of Appellate Procedure Does Not Support Conditioning Appeal on the Posting of a Bond.

Paragraphs 29-32 of the Application request that the Court enter an order conditioning the right to any appeal on the posting of a $36 million bond. This is directly contrary to Pennsylvania law. Unless a statute requires otherwise, a bond is only required of an appellant if the appellant seeks a supersedeas or other stay pending appeal. The Health Insurers do not intend to seek supersedeas or other stay. It is unnecessary here since the Memorandum of Understanding itself preserves the status quo pending resolution of an appeal. (See Section I.A.1. -- Definition of "Effective Date").

The Application relies on Chapter 17 of the Pennsylvania Rules of Appellate Procedure (titled "Effect of Appeals; Supersedeas and Stays"), which sets out the requirements for collateral if the appellant is seeking a stay pending appeal. If the appellant does not seek a stay, the chapter does not apply. Pennsylvania Rules of Appellate Procedure Section 1733(a), relied on by the Rehabilitator, provides:

> An appeal from an order which is not subject to Rule 1731 (automatic supersedeas of orders for the payment of money) shall, unless otherwise prescribed in or ordered pursuant to this chapter, operate as a supersedeas only upon the filing with the clerk of the court below of appropriate security as prescribed in this rule. Either court may, upon its own motion or application of any party in interest, impose such terms and conditions as it deems just and will maintain the res or status quo pending final judgment or will facilitate the performance of the order if sustained.

The first sentence of this paragraph makes it clear that the appeal order acts as a stay only when a bond is filed. The second sentence (relied on by the Rehabilitator) needs to be understood in the context of the first sentence and the Chapter as a whole. It provides a court flexibility in determining what collateral or other interim measure is required to support an order by the court staying the effect of the order. If the court is not being asked by the appellant to enter an order maintaining the status quo, this provision should not apply. It is not the intention of the Health Insurers to seek a stay if the Application is granted because the status quo is unlikely to shift while the appeal is pending.

The Rehabilitator advocates a reading of this section that would allow the Court to require a bond as a condition to exercising a right of appeal. This would overrule Pennsylvania Rule of Appellate Procedure 341, which states, "Except as prescribed in paragraphs (d) and (e) of this rule, an appeal may be taken as of right

from any final order of a government unit or a trial court."[5] The Rule does not condition the appeal as of right on the posting of a bond. This is confirmed by a leading treatise on Pennsylvania practice, which states, "The failure to file a required appeal bond does not result in dismissal of the appeal because the bond acts merely as a supersedeas. However, where such a bond is not filed, an execution may be issued to collect the judgment of the court below, even though an appeal has been taken." 16 Standard Pennsylvania Practice 2d § 85:158 The Darlington Treatise, 20A West's Pa. Prac., Appellate Practice § 1733:1, states that the authority granted to the court by Section 1733(a) is with regard only "to the terms and conditions, if any, that may be attached to an order granting supersedeas."

In fact, even where supersedeas is requested, a bond is not always required. The Rule accords a Court "broad discretion regarding the terms and conditions, **if any**, that **may** be attached to an order granting a supersedeas." Darlington, et al., Pennsylvania Appellate Practice § 1733:1 (emphasis added). As the leading Pennsylvania appellate practice treatise explains, "There are many instances … where security, or other conditions, are neither necessary nor appropriate. The logical interpretation of the rule is that if the court, in the exercise of its discretion,

[5] Subsection (e) refers to Pennsylvania Rule of Appellate Procedure 1101. This Rule and Rule 1102 make it clear that matters originally commenced in the Commonwealth Court are appealable as of right.

conditions the grant of a supersedeas upon the posting of security, or imposes other conditions, the supersedeas is not effective until the security is posted, or the other conditions are satisfied." *Id.* *See also* 16 Standard Pennsylvania Practice 2d § 85:158.

Because the right to take an appeal is a Constitutional right, the imposition of restrictions around that right are to be narrowly construed. Pa. Const. art. V, § 9. There are instances under Pennsylvania law where a statute specifically conditions an appeal on the appellant posting a bond. *See e.g.* 35 Pa. Stat. Ann. § 691.605 (requiring persons who wish to appeal assessment of a civil penalty by the Department of Environmental Resources to post bond or deposit a certain amount in escrow); *see also* 53 Pa. Stat. Ann. § 11003-A (allowing landowner whom appellant seeks to prevent from use or development of certain land, to petition the court to order appellants "to post bond as a condition to proceeding with the appeal"). The present matter is not a situation for which the legislature has created statutory authority to condition the appeal (as opposed to the stay) on the posting of a bond. The purposeful omission of such pre-conditions is significant and shows that the legislature did not intend to grant the court broad authority to require a bond as a condition to taking an appeal, but only as a condition to obtaining a stay pending appeal. See *Fonner v. Shandon, Inc.*, 724 A.2d 903, 907 (1999) (reiterating "where a section of a statute contains a given

provision, the omission of such a provision from a similar section is significant to show a different legislative intent").

If the Court were to determine that it could impose a bond requirement as a condition to taking an appeal, then the Court would have to also enter a stay once the bond was posted. This is required by Pennsylvania Rule of Appellate Procedure 1733(a).

Finally, the bond amount requested by the Rehabilitator bears no rational relationship to the supposed injury that the estate might suffer. In particular, tying the amount of the bond to the projected amount of the alternative minimum tax is indefensible. The estate's tax position is not in jeopardy as a result of an appeal. The parties are still bound by the Memorandum of Understanding if there is an appeal, and there is no reason to believe that success on the PLR or the amount of the alternative minimum tax would change any as a result of the passage of time.

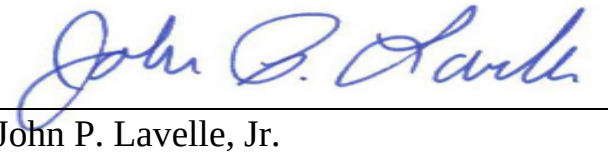
IV. CONCLUSION

The Application should be denied and that the Memorandum of Understanding should not be approved. The Rehabilitator has not presented specific and credible grounds to justify the deviation from the statutory priorities. There are viable alternatives to the payment of $10 or $15 million to the equity under the Memorandum of Understanding, and these should be pursued. Moreover, the Memorandum of Understanding is so vague that the Court cannot

reasonably be expected to evaluate its merits. The Application fails to identify or examine the disputes between the parties, so the Court cannot evaluate the merits of the settlement as against alternatives. As such, the Rehabilitator cannot meet the strict standards required for approval of a settlement that violates statutory priorities. Finally, the Rehabilitator's request to require the posting of a bond as a condition to an appeal is directly contrary to Pennsylvania law.

Dated: July 14, 2016

MORGAN, LEWIS & BOCKIUS LLP

By: 

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