

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

**RESPONSE OF THE HEALTH INSURERS TO
THE REHABILITATOR'S SUPPLEMENTAL
BRIEF REGARDING STANDARD OF REVIEW**

Since the last briefing in this matter, the Pennsylvania Supreme Court held that the abuse of discretion standard applies to the conversion of a rehabilitation proceeding to a liquidation proceeding. *In re Penn Treaty Network America Ins. Co.*, 94 MAP 2012, 2015 WL 4418522, at *4 (Pa. July 20, 2015). In light of that recent decision, the abuse of discretion standard will apply even to those aspects of the proposed Second Amended Plan of Rehabilitation (the "Plan") that contemplate the liquidation of Company B. However, the application of the abuse of discretion standard neither relieves the Rehabilitator of her burden to produce substantial evidence to support factual contentions nor impacts this Court's de novo review of legal issues. With these principles in mind, the Health Insurers herein respond to the Rehabilitator's Supplemental Brief Regarding Standard of Review (the "Supplemental Brief").

I. EXPLICATION OF THE STANDARD

A. Legal Issues

It appears that the Health Insurers and the Rehabilitator agree that the Court must review whether the Plan complies with applicable law without deference to the Rehabilitator. Supplemental Brief at 8-11, 19 (citing *Norfolk* and *Mutual Fire II* as recognizing that “a violation of law necessarily constitutes an abuse of discretion, and the Court always has the authority to determine whether a plan violates statutory or due process rights.”). The Plan raises a number of such legal issues that require this Court’s plenary review. The Rehabilitator identifies two that were raised by the Health Insurers in their Formal Comments: “(1) whether commissions may properly be paid to agents of Company A (ANIC), and (2) whether providing uncovered benefits to policyholders is permitted under Article V.” Supplemental Brief at 18. The Health Insurers, however, raised two more legal issues in addition to the two identified by the Rehabilitator.

First, the Health Insurers asserted that, under the Plan, creditors must fare at least as well as they would in a liquidation. Formal Comments of the Health Insurers filed February 13, 2015, at 16. The application of this test, referred to as the “best interest of creditors test,” is required by the United States Constitution. A plan that imposes harsher consequences than would be imposed through liquidation violates the Due Process clause of the Fourteenth Amendment. *See*

Neblett v. Carpenter, 305 U.S. 297, 305 (1938) (discussing the best interest of creditors test and rejecting appellants Due Process claims because the plan was as favorable to the objecting parties as a liquidation). The Pennsylvania Supreme Court recognized the application of the best interest of creditors test in *Foster v. Mutual Fire, Marine and Inland Ins. Co.*, 614 A.2d 1086, 1093 (Pa. 1992) (“*Mutual Fire II*”), *affirming sub nom., remanding in part, Grode v. Mutual Fire, Marine and Inland Ins. Co.*, 572 A.2d 798 (Pa. Commw. Ct. 1990). *See also Koken v. Fidelity Mutual Life Ins. Co.*, 907 A.2d 1149, 1155 (Pa. Commw. Ct. 2006) (“Under the Plan, contractholders, creditors and mutual members have received or will receive at least as much as they would receive in a forced liquidation, as is required if a rehabilitation plan is to be deemed fair and equitable.”). This Court has stated that *Mutual Fire II* does not stand for the proposition that every policyholder, or other creditor, must fare as well in rehabilitation as in liquidation. *Consedine v. Penn Treaty Network America Ins. Co.*, 63 A.3d 368, 451 (Pa. Commw. Ct. 2012) (the “May 2012 Order”). However, in its discussion of the application of the best interest of creditors test, the Court noted that the Rehabilitator had not submitted a rehabilitation plan, a “crucial distinction” from *Mutual Fire II*. A plan of rehabilitation is now before the Court. Therefore, the Court must determine whether the best interest of creditors test applies.

Second, the Rehabilitator has recognized that a plan cannot be confirmed if it does not treat “similarly situated creditors in the same fashion.” Supplemental Brief at 2-3. The Rehabilitator recognized that the assets are not sufficient to cover administrative expenses and policyholder claims in full. Supplemental Brief at 14.

From there she reasoned:

The Plan therefore provides for administrative expenses to be reimbursed from the Companies’ estates, and for all other assets to be channeled to policyholder claims – either through the protection of state guaranty associations (“GAs”) or through provision of benefits in excess of GA limits. There is no improper classification of creditors – or abuse of discretion – in that approach.

Id. This statement glosses over the problem of discrimination between the guaranty associations, on the one hand, and the policyholders designated to Company A, on the other hand. Under the Plan’s asset allocation methodology, Company A policyholders will receive a massively disproportionate percentage of the estates’ assets in relation to the size of their anticipated claims. It will be for the Court to decide as a matter of law whether such inequitable treatment of similarly situated creditors is lawful without deference to the Rehabilitator’s position that such treatment does comply with applicable law.

B. Factual Issues Require Presentation of Substantial Evidence By The Rehabilitator

Where a factual – as opposed to a legal issue – is presented, the application of the abuse of discretion standard does not relieve the Rehabilitator from the

obligation to put on a *prima facie* case in support of the Plan. It requires that the Plan be supported by “substantial evidence,” which is “such relevant evidence that a reasonable mind might accept as adequate to support conclusion.” *Pennsylvania State Police, Bureau of Liquor Control Enforcement v. Boots & Bonnet, Inc.*, 630 A.2d 541, 543 (Pa. Commw. Ct. 1993). It must be “something more than a scintilla creating a mere suspicion of the existence of fact, and must be such relevant evidence as a reasonable mind might consider adequate to support a conclusion.” *See Barnes v. Com., Dep't of Justice*, 452 A.2d 593, 595 (1982). The Rehabilitator erroneously contends that parties opposing the Plan must show “egregious error or oversight by the Rehabilitator.” Supplemental Brief at 16. This attempt by the Rehabilitator to lower the burden of proof is not supported by the case law cited by the Rehabilitator or by any Pennsylvania case law. The case law clearly states “an administrative agency abuses its discretion when its ‘findings of fact are not supported by substantial evidence.’” *See Koken v. Fid. Mut. Life Ins. Co.*, 803 A.2d 807, 812 (Pa. Commw. Ct. 2002) (internal citations and quotations omitted). The burden to provide substantial evidence to support the Rehabilitator’s contentions remains with the Rehabilitator, and the Court is, in turn, required to determine whether the Rehabilitator has offered that substantial evidence.

For example, the Rehabilitator must present substantial evidence that the Plan satisfies the three-part test articulated by *Mutual Fire II*. This Court has stated

that a “rehabilitation plan is permitted to impair the contractual rights of some policyholders in order to minimize the potential harm to all of the affected parties.” *Penn Treaty*, 63 A.3d at 452. Under this Court’s view of the three-part test adopted in *Mutual Fire II*, once the Court determines a substantial impairment exists, such impairment may be constitutionally permissible if: “(1) the rehabilitator has acted for a legitimate and significant public purpose and (2) the adjustment of contractual rights is reasonable and of a nature appropriate to that public purpose.” *Id.* To that end, the Court must be ever mindful that one of the primary goals of Article V is ‘the protection of the interest of insured, creditors, and the public generally...’ Section 5019(c) of Article V, 40 P.S. Sec. 221.(c). *Id.* at 453. The Rehabilitator must present substantial evidence to support each prong under the *Mutual Fire II* test: that the impairment of creditor’s rights is not “substantial,” or, if it is, that the Rehabilitator’s actions are for a legitimate and significant public purpose, and that the adjustment of contractual rights is reasonable and of an appropriate nature to attain that public purpose.

The Rehabilitator will also need to offer substantial evidence that the Plan can actually be implemented if confirmed - another factual issue requiring the presentation of substantial evidence. Thus far, the Rehabilitator has offered the following testimony on the issue of licensing needed to implement the Plan:

I have had many discussions with the regulators and Guaranty Associations about this concept, and although

no regulator is able to make any commitment before there's a final plan approved by this court, I'm hopeful that we can achieve that. There have been questions for some states, Your Honor. There's some question as to whether the statute provides sufficient authority for the special license, and then for some Guaranty Associations, there is the question of whether they prefer that ANIC be liquidated rather than to have the special treatment for Penn Treaty. I'm gonna work my way through that as best as I can.

Transcript of Proceedings dated July 13, 2015, at 165 (statement of Patrick Cantilo). In the Health Insurers' Response to Intervenors' Application For An Order Rejecting The Plan Or Alternative Relief (filed April 22, 2015), the Health Insurers cited applicable provisions of law in the nine relevant states that provide that Company A and Company B would not be eligible for licenses. The Rehabilitator has asserted that those are not the relevant statutes, but has not cited any different statutes that purportedly control. Transcript of Proceedings dated July 13, 2015, at 170. The Health Insurers suggested that the Rehabilitator obtain conditional commitments from other regulators with respect to licensing. Health Insurers' Response to Intervenors' Application, at 5-6. The Rehabilitator responded that it was not possible for her to obtain such conditional commitments. The Health Insurers submit that in order for the Rehabilitator to submit "substantial evidence" on the issue of licensing, which is required in order to show that the Plan can actually be implemented if confirmed, she will need to cite statutes that do authorize the issuance of limited licenses (and demonstrate that the issuance of

such limited licenses is sufficient to ensure that guaranty association coverage will be available to the policyholders) and introduce substantial evidence that Company A and Company B will meet the requirements of those statutes.

Additionally, the Rehabilitator is required to present substantial evidence regarding its compliance with this Court's May 2012 Order. That Order requires that the Plan address and eliminate "inadequate and unfairly discriminatory premium rates." May 2012 Order at 461. This Court, in turn, must determine whether the Rehabilitator has presented substantial evidence to show the Plan complies with the May 2012 Order.

II. REVIEW OF THE PLAN

The Rehabilitator posits that the Court's review should proceed in two phases. According to the Rehabilitator, the Court must determine: first, whether the "core aspects of the Plan fail to comply with applicable law or are otherwise flawed" and second, whether "particular provision(s) of the Plan challenged by interested parties constitute an abuse of discretion." Supplemental Brief at 24.

This broad proposed formulation is overly generalized. The Health Insurers urge this Court to apply the following more specific standards:

A. Issues of Law

The Plan presents a finite number of legal issues that should be resolved as follows:

- i) The Penn Treaty Liquidating Trust – The Court must determine as a matter of law the validity of the provisions establishing the trust, which will pay policyholder claims exceeding the applicable guaranty association limits.
- ii) Payment of Commissions on Company A policies – The Court must determine as a matter of law the validity of the Plan’s provisions providing for payment of agent commissions on Company A policies once the terms of the agency contracts are introduced into evidence.
- iii) Application of the Best Interest of Creditors Test – The Court must determine as a matter of United States constitutional law whether the best interest of creditors test applies to the Plan.
- iv) Treatment of Similarly Situated Creditors – The Court must determine as a matter of law whether the Plan’s unequal treatment of Company A and Company B policyholders is lawful.

B. Issues of Fact Requiring Presentation of Substantial Evidence By The Rehabilitator

The Plan presents numerous issues of fact that require the Rehabilitator to present substantial evidence to support her contentions and a determination from the Court regarding whether any such evidence presented is “substantial.” The following is a sampling of some such factual issues:

- i) Application of the *Mutual Fire II* Three-part Test – The Court must determine whether the Rehabilitator has presented substantial evidence to establish that the Plan satisfies the three-part test articulated by *Mutual Fire II*.
- ii) Compliance with May 2012 Order – The Court must determine whether the Rehabilitator has presented substantial evidence that the Plan complies with this Court’s May 2012 Order and that the Plan adequately addresses the historical problem of inadequate and unfairly discriminatory premium rates.
- iii) Feasibility – The Court must determine whether the Rehabilitator has presented substantial evidence to demonstrate that the Plan can actually be implemented if confirmed, including substantial evidence on the issue of licensing in the nine relevant states and the requested rulings from the Internal Revenue Service regarding the Plan’s tax treatment.

III. CONCLUSION

For the reasons set forth above, the Court must consider the key questions of law which affect vital portions of the Plan without deference to the Rehabilitator. As to factual issues, the Rehabilitator is still required to submit substantial evidence to support provisions of the Plan.

Respectfully submitted,

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