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Health Republic's Curious Liquidation: Part 2

Law360, New York (June 22, 2016, 11:18 AM ET) -- *The first part of this article, discussing the history of Health Republic and its liquidation, is available [here](#).*

The U.S. Bankruptcy Code provides for committees in both liquidation (Chapter 7) and reorganization (Chapter 11) proceedings.[1] In a Chapter 7 liquidation proceeding, the court *may* appoint a creditors' committee consisting of not more than 11 or fewer than three creditors, but the committee's members are usually not reimbursed for their time or expenses.[2]

In a Chapter 11 reorganization, the trustee *must* appoint a committee of unsecured creditors.[3] A Chapter 11 creditors' committee may consist of representatives from entities that hold the seven largest claims against the debtor. Creditors' committees are usually formed within a few weeks of the commencement of the case.



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The bankruptcy court may also appoint other committees, including multiple creditors committees or committees consisting of equity security holders. These committees may retain attorneys, accountants or other professionals to advise the committees, and the court may reimburse members of the committees subject to limitations in the Code.[4]

Under the McCarran-Ferguson Act, 15 U.S.C.A. § 1012(b), state insurance company insolvencies are conducted under the law of the state in which the insurance company is domiciled. These state laws are derived from model laws drafted by the National Association of Insurance Commissioners (NAIC). These model laws and state statutes do not specifically address the use of committees in insurance company insolvencies.[5] Nevertheless, committees have been effectively used in insurer receiverships in New York.

In the liquidation of Midland Insurance Co., which began in 1986 and continues today, Justice Michael Stallman, at the urging of the then-liquidator's outside counsel, brought together Midland's major policyholders and Midland's larger reinsurers to explore how to resolve asbestos-related claims and to structure a framework in which the liquidator could collect reinsurance for those claims.

In June 2006, four of Midland's major reinsurers and twelve of its Fortune 500 policyholders crafted a Case Management Order (CMO) that allowed Justice Stallman to address issues that stood in the way of collecting Midland's reinsurance, including what law should be applied to determine coverage questions and how reinsurers might participate in the liquidator's claims determinations.

The CMOs produced by these committees and so-ordered by Justice Stallman allowed the policyholders to move to resolve a choice of law dispute that eventually resulted in a Court of Appeals determination upholding Justice Stallman's ruling.[6]

Years before Midland, Supreme Court Justice Walter Schackman concluded that a cedants'/creditors' committee would help the liquidator of Constellation Reinsurance Co.

evaluate proposals to bring Constellation, a failed professional reinsurance company, out of liquidation.[7] Pursuant to that order, the creditors' (actually cedants') committee passed information back and forth between Constellation's cedants and the liquidator.[8]

The committee's membership fluctuated and at various times included representatives from reinsurance intermediaries, attorneys for cedant companies and nonlawyers from the cedants themselves. Neither of the committee members nor the committee's co-counsel were paid from Constellation's assets and the committee also paid for the cost of copies, postage and Federal Express.

In 1991, Zurich Reinsurance Co. of New York offered to buy Constellation pursuant to a 100 percent quota share contract. The committee gathered comments and obtained several changes to the proposal. At a hearing that approved the Zurich proposal and took Constellation out of liquidation, Justice Schackman noted that the committee's counsel and the committee itself had been "very helpful."

Policyholders' and creditors' committees have also played useful roles in insolvency proceedings in Pennsylvania (Mutual Fire)[9] and Missouri[10] (Transit Casualty). Although receivers in some jurisdictions have successfully prevented the formation of creditors' or policyholders' committees, or at least the formation of formally recognized committees whose members would be reimbursed by the estate for professional fees or other expenses, even those courts have left the door open to "unofficial or informal" committees of policyholders.[11]

Health Republic is not a typical insurance company receivership and cries out for committees of policyholders and medical providers to promote the transparency needed to understand how New York intends to step up and address the loss of taxpayer monies and the unpaid or unreimbursed losses sustained by more than 200,000 Health Republic policyholders and health providers.

The Need for Transparency and Committee Involvement

Health Republic policyholders include many energetic and alert writers, assistants and part-time employees who can add value and shine light on the liquidation. Health Republic health providers are, in many cases, represented by in-house or outside counsel, as well as trade associations, but thus far have been only observers in the Health Republic liquidation. The health providers (and their counsel) should bring their resources and considerable talents to the Health Republic liquidation.

Here are a few of the areas that the committees could explore:

1. Timeline. The New York Senate Insurance Committee and others have asked about the delay in liquidating Health Republic, but regardless of the explanation, how long will the Health Republic liquidation take? Committees are needed to press for a timetable and an end-game for the liquidation.

2. Proofs of Claim. Policyholders have been promised an "explanation of benefits" with respect to their unreimbursed claims, but nothing has been announced with respect to filing proofs of claim. "Deadlines are set for filing proofs of claim in order to encourage all claimants to file promptly, making possible an early partial distribution of the insurer's assets." [12]

Committees should have input with respect to the filing of proofs of claim. Committees should also participate in the drafting of any case management orders.

3. Assets and Liabilities. Nothing has been posted on the NYLB or Health Republic websites with respect to Health Republic's assets and liabilities. The New York State Senate has passed a measure that would create a special "Health Republic Insurance of New York Fund" that would collect monies from certain fines, tobacco settlements, lotteries and other fees and authorize the superintendent of the DFS to distribute that money pursuant to "terms to be set forth in a future chapter of the law," but the bill

provides that these monies may only be distributed after distribution of all assets in connection with a [Health Republic] liquidation proceeding.[13] This measure passed in the Senate, but no similar action has been taken in the Assembly.

Committees could ask about measures like these and give both health providers and policyholders a voice with respect to how the lack of a guaranty fund for Health Republic will be addressed, both in the liquidation court and in the New York Legislature. And committees certainly should be heard with respect to the posting of reports on Health Republic's remaining assets.

4. Administrative Expenses. At this point, it is unknown how much in Health Republic assets has been spent from October 2015 to date on outside vendors and counsel working, presumably, at the direction of the DFS.

At the May 10 liquidation hearing, counsel for the then-acting superintendent stated that there exists a reinsurance arrangement, pharmacy rebates and "certain amounts that Health Republic is entitled to receive from federal programs" that may be collected.[14] Counsel also promised that "financial statements" would be prepared "during the liquidation" to "apprise the court of the liquidator's progress," but no dates were offered as to when these reports will be made available. Committees could monitor and comment on these reports.

5. Recoupment. Actions have been commenced in other states to recover monies from the federal government on behalf of failed Co-ops. *Complaint, Health Republic Insurance Company [of Oregon] v. United States of America*, No. 16-259 C (Ct. Fed. Cl. Feb. 24, 2016). This action seeks to recover monies allegedly promised by the federal government under the reinsurance and risk-sharing provisions of the Affordable Care Act. Health Republic (Oregon) shut down in October 2015, but continued paying claims and has not yet been liquidated. Another Oregon Co-Op, Oregon's Health Co-Op, survived the reduced amount of federal risk-sharing monies and continues in operation.[15]

In Iowa, Commissioner Nick Gerhart took over CoOpportunity Health Inc., an Iowa Co-Op, in December 2014 and placed the company in liquidation in February 2015. Unlike New York, the Iowa liquidation order provided a claims procedure and the federal government has already filed a proof of claim against the CoOpportunity estate. Commissioner Gerhart seeks a declaration that the federal government is not entitled to priority claim status in the government's efforts to recoup solvency loans that Gerhart claims are subordinated to policyholder claims. *Gerhart v. U.S. Department of Health and Human Services*, No. 16-cv-00151 (S. D. Iowa May 3, 2016).

Committees of Health Republic policyholders and health providers should be given standing to address how claims on behalf of and against the Health Republic estate will be handled and to explore whether New York's acting superintendent will commence similar actions.

As one attorney with experience working for and with the liquidators of insolvent insurers put it while advocating for policyholder committees: "The desirability of creditors' committees is manifest. After all, it is the creditors who paid good money for bad insurance. They are the only ones who are hurt by the insolvency." [16] In Health Republic's case, the need is even *more* manifest.

Health Republic has no guaranty funds to pay policyholders or providers. Nor are there any private investors; all of Health Republic's capital came from federal taxpayers. And most of Health Republic's policyholders and health providers are New York residents. For that reason, the Health Republic liquidation poses a fraction of the difficulties posed by the failures of large 50-state multiline insurers like Midland or Union Indemnity.

Policyholders shouldn't be shunted to a third-party website and provided almost no information on their claims other than being told that an explanation of benefits may be headed their way one of these days. The Health Republic liquidation should be conducted in the open so that

additional monies will not be wasted by outside vendors whose work remains unevaluated and largely unknown.

While advocates for committees in U.S. insurer liquidations have argued that only creditors can push for such committees, in this case Superintendent Vullo should take the lead. Health Republic's policyholders and health providers should not be kept in the dark with only a website and a few FAQs to guide them. Health Republic should be wound up quickly and with as much policyholder and health provider participation as possible.

And if the federal government intends to seek a priority claim status in the Health Republic Liquidation, let's find that out sooner rather than later. Committees would bring light and energy into the Health Republic liquidation, which was adjourned on May 10 without date, and help avoid having New Yorkers suffer a second Health Republic debacle, this one during its liquidation. [17]

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[1] 11 U.S.C.A. § §705, 1102.

[2] 11 U.S.C.A Section 705.03[3].

[3] 11 U.S.C.A. § 1102.

[4] See generally COLLIER BANKRUPTCY MANUAL (co-chief editors Alan N. Resnick and Henry J. Sommer), chs. 705, 1102, 1103 (2008).

[5] See D. Hartz, Creditor Committees, Constituencies, and Constitutions, The Insurance Receiver, Vol. 9, No. 4 (Winter 2000).

[6] In re Liquidation of Midland Insurance Company, 16 N.Y. 3d 536, 542 (2011) ("Consequently, during the spring of 2006, the parties negotiated and agreed upon a proposed case management order * * * The CMO set forth a procedure to resolve the legal disputes between the parties"); see also, Veach and Milrad, Threshold Choice-of-Law Analysis Required for Each Midland Policy, Mound, Cotton, Wollan & Greengrass Newsletter, Vol. 18, Issue # 3 (2011); see also, T. McCarthy, Creditors' Committees in U.S. Insolvencies – the Wave of the Future (Only if Creditors Demand it!) at 18, Insurance Receiver, Vol. 9, No. 3 (2000) (McCarthy, Creditors' Committees).

[7] In re Liquidation of Constellation, Index No. 43178/1986 at 7 (1990).

[8] J. Veach, Creditors' Committees: The Constellation Story, Insurance Receiver, Vol. 10, No. 1 (Spring 2001) at 18-21.

[9] Foster v. The Mutual Fire, Marine and Inland Insurance Company (appeal of the cedent's committee), 544 PA 387, 404 (1996) (Supreme Court agreed with committee's argument that fee petitions should not be filed under seal).

[10] McCarthy, Creditors' Committee at 18 discussing ad hoc committee of guaranty associations established during the Transit Casualty Insurance Company liquidation, as well as a proposed creditors' committee.

[11] In Re Liquidation of Integrity Ins. Co, 231 N.J. Super 152, 161, 555 A.2d 50 (Ch. Div. 1988).

[12] APPLEMAN § 45.09[4] at 45-52.

[13] NY LEGIS 54 (2016) Sess. Law News of N.Y. Ch. 54 (S. 6406-C, Part LL amending NY State Finance Law § 99 (McKinney's).

[14] May 10th Liquidation Hearing Trans. at 18.

[15] N. Budnick, Health insurer beats odds with luck, caution.

[16] McCarthy, Creditors' Committees at 18.

[17] For an outrageous example of all that can go wrong in an insolvency proceeding in which outside vendors played a huge role, but no policyholders' or creditors' committees participated, see B. Coffin and others, *The Complete ELNY Saga: 21 Years of Mismanagement, Corruption, Broken Promises, and Shattered Lives*, HealthPro; P. Bickford, *The Elephant in the Courtroom*, AIRROC MATTERS, Summer 2012 at 6.

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