The INSURANCE RECEIVER

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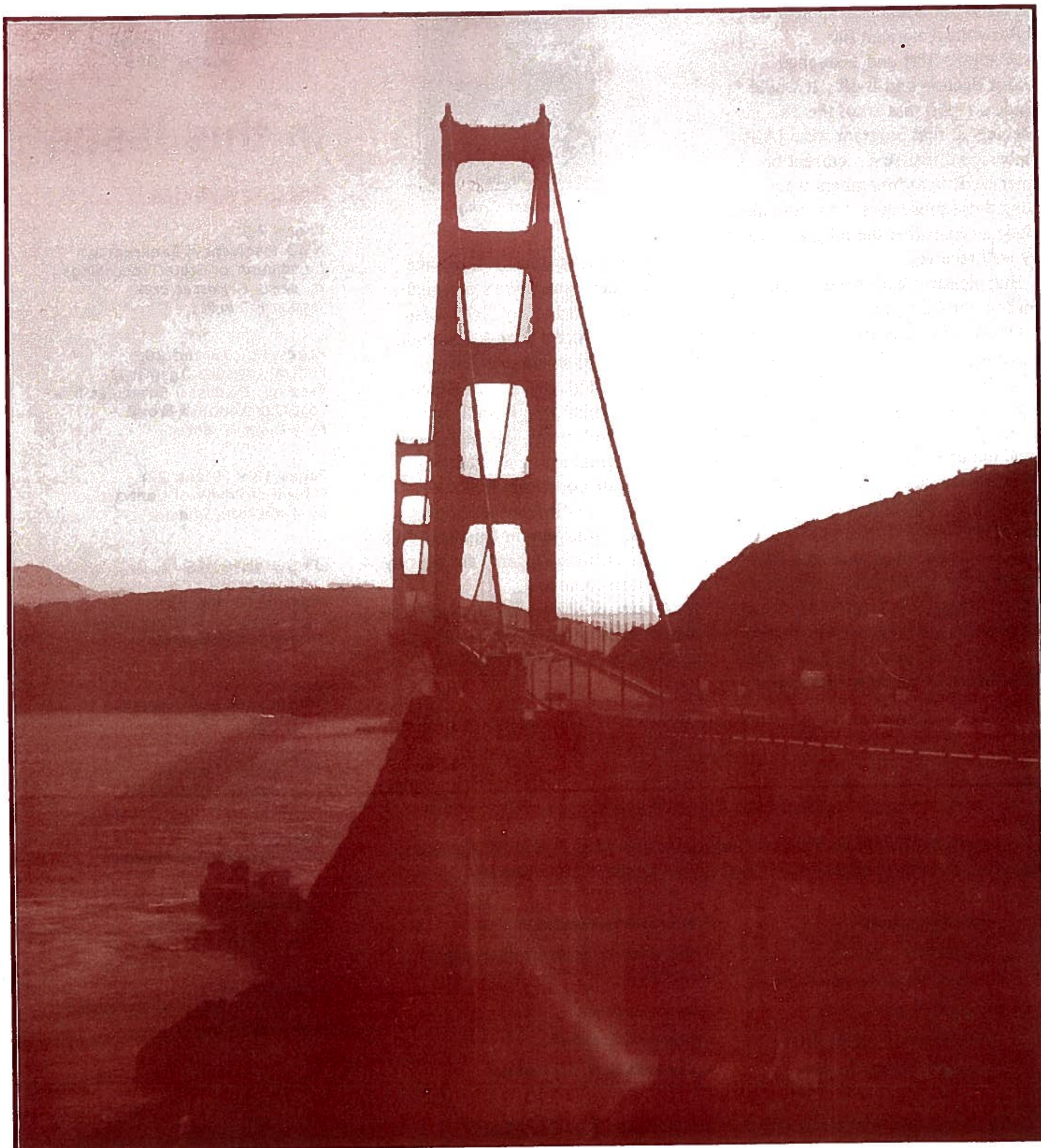

President's Message

By Robert Craig, Lamson, Dugan, & Murray

Normally this column would be devoted to bringing everyone up to speed on the recent Insurer Insolvency seminar in San Francisco sponsored jointly by the American Bar Association's Tort and Insurance Practice Section and IAIR. It would include a report that 20 of the 28 presenters at that program were IAIR members and that seven current or former IAIR board members were among those presenters. It would also include a report that the program was very well received.

Robert Craig

But, please indulge the deviation from my normal format.

On Tuesday, December 14, 1999 my partner and friend, Mike Dugan, died quite unexpectedly and quite young. While many of you may not have known Mike, many others of you around the country did. Mike served as Nebraska's Director of Insurance from 1983 to 1987 and was very active in the NAIC.

We all know the joys of trying to carry on a discussion in the halls of an NAIC meeting; folks walking up trying to catch a few minutes of your time or that of whomever you're talking with. With Mike, carrying on a discussion was all but impossible. Seemed like everyone there was Mike's personal friend and wanted to say "Hi." Ben Nelson, Nebraska's former governor, was just quoted saying that Mike "never knew a stranger." Tom Bond, former Commissioner from Texas spoke at Mike's wake. He mentioned that it was great to see the standing room only support from the local community for Mike and his family, continuing "What you in Omaha should know is that Mike Dugan's community is the entire country."

A number of people commented on Mike's license plate: "8GRTKDS." Should have read "1GRTFRND."

A SPECIAL THANK YOU

We would like to thank those companies that served as Patron Sponsors of our quarterly reception held in San Francisco during the NAIC Meetings:

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San Francisco Meeting Recap

By Mary Cannon Veed

Characteristics of the San Francisco NAIC? Two I can think of: a sort of watchful calm looking forward to the impact of S.B. 900 and the resolution of the solvency predicament in health care, and a sly grin that life remains placid enough, for now, to enjoy the pleasures of Union Square at Christmastime (or more exactly, at Hanukkah).

One highlight of the weekend was IAIR's co-sponsorship of the ABA-TIPS National Institute on Insurer Insolvency. This is at least the fifth biennial iteration of this warhorse. Over the years, they have always been interesting, and several have been watersheds. This one was certainly the former; whether it was the latter won't be clear until we see which way the waters part. It did, at least, have its share of arresting moments.

One came from my friend and former partner, Ellen Robinson, whose thoroughly researched and thoughtful paper posited that insurance company directors owe fiduciary duties to policyholders as well as shareholders. The premise makes sense, although, in spite of all that thorough research, the precedent is a little thin. It is one of those situations where you can carry the day if you have a good strong public policy argument behind you, and won't get to first base if you don't. The public policy seems obvious: policyholders ought to be able to enforce their legitimate expectation that the management of their insurer will do its skillful utmost to keep its promises to them, right? But that isn't quite the simple proposition it seems. Isn't this a claim that can just as well be brought by the liquidator, on behalf of the company itself? And doesn't the policyholders' claim fit exactly into the mold of the derivative claim, belonging equally to all creditors rather than differentially to individuals? Does the availability of a direct policyholder action (which may or may not be controlled by the liquidator) make us any richer or happier in this situation than if the liquidator simply brought an action on behalf of the remains of the company, to whom the directors unquestionably owe fiduciary duties? In fact, if competing lawsuits erupted against a single set of defendants (presumably possessing a limited pool of assets and liability insurance policies, and owing a single amount of damages no matter how often they got sued), the ensuing complexity and duplication might enrich only the much-maligned lawyers.

There may be one reason why a policyholders' suit might work better than one brought by the estate, and that is when the hypothetical interests of the policyholders and the corporation diverge. In *Cenco v. Seidman & Seidman*, for instance, the 7th Circuit refused to permit stockholders of a company whose officers had inflated its balance sheet through an inventory scam to recover from its auditors. At least part of the rationale for the claim was that the officers' fraud had been in favor of the company instead of against it — the inflation made it possible for the company to use its inflated stock to acquire other companies and thus get richer, or at least less insolvent.[1] In that case, it would have been superficially difficult to say that the company, as such, was damaged by the fraud, but easy to see that its creditors were. This is an instance when a case brought by creditors might work better than one brought by stockholders, but it is probably not superior to a case brought by a receiver. It is conventionally said that a receiver is subject to any defense available against the company. However, courts since Cenco, including the 7th Circuit, have consistently refused to apply it to bankruptcy trustees and receivers of insurers and banks, basically because adequate protections exist to prevent the guilty parties receiving the proceeds, and because barring suits really would provide windfalls to the sloppy and fraudulent defendants. *F.D.I.C. v. O'Melveny & Myers* 61 F.3d 17 (9th Circ. 1995); *In Re Jack Greenberg, Inc.*, 240 B.R. 486 (E.D.Pa. 1999); *Schacht v. Brown* 711 F.2d 1343 (7th Cir. 1983)(Ellen had a hand in that, too).[2] Ellen Robinson and Judge Richard Posner make a formidable combination, but with respect, I think they're probably wrong here. A rationale that permits (or requires) creditors to pursue cases that could just as well be brought by receivers is not good policy.

The session was distinguished by a couple of other daring assertions, notably from David Spector (who is still mad about Hopewell, and not shy about saying so) and, orally at least, from Bob Mangino, and some less daring but quite useful material on ERISA and health care regulation from Betty Cordial, Jack Blaine and Gale

(Continued on page 4)

1 This is one of Judge Posner's wobblier efforts — he was preoccupied, apparently, by the fact that the managers were among the stockholders likely to benefit from the class action, although by no means the only ones, and he ended up, in effect, imputing the bad conduct of the crooked management to the victims of the fraud who were induced to part with their own companies in exchange for its stock.

2 The same could have been said for Cenco, too — a third-party claim against the responsible managers would certainly have resulted in offset in excess of their class action shares. Or see the end-run practiced by the creditors of Phar-mor, victims of a similar bubble: Phar-Mor, Inc. v. Coopers & Lybrand (In re Phar-Mor, Inc. Securities Litigation), 900 F.Supp. 784 (W.D.Pa.1995).

IAIR Roundtable Schedule

NAIC Meeting - March 11-15, 2000
Chicago, Illinois
IAIR Roundtable
March 11, 1:00 - 4:00 p.m.

NAIC Meeting - June 10-14, 2000
Orlando, Florida
IAIR Roundtable
June 10, 1:00 - 4:00 p.m.

NAIC Meeting - September 9-13, 2000
Dallas, Texas
IAIR Roundtable
September 9, 1:00 - 4:00 p.m.

The Insurance Receiver

is intended to provide readers with information on and provide a forum for opinion and discussion of insurance insolvency topics. The views expressed by the authors in *The Insurance Receiver* are their own and not necessarily those of the IAIR Board, Publications Committee or IAIR Executive Director. No article or other feature should be considered as legal advice.

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SAN FRANCISCO MEETING RECAP

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Pearce. A thoroughly worthwhile package.

The downside to the ABA/TIPS session was the cancellation of the formal IAIR meetings, including the postponement of its Annual Meeting, which will now take place in Tucson in January. We do tend to forget we're having annual meetings until the last minute, but I do think it's important that they be seen to be accessible and fair. Shipping the AGM off to Tucson makes it an expensive form of democracy. I haven't even figured out who is slated for the Board, or whether any controversy exists or ought to (this issue of the Receiver will no doubt fill us both in). But I would suggest two things: that anyone who isn't going to Tucson pay special attention to their proxy materials, and that anyone who is running engage in some mail, email, or phone communication with the rest of us, beyond just showing up for the meeting, to obviate any appearance of an exclusive or closed election. Whoever gets elected, however, their first order of business should be to resolve not to cancel any more meetings.

Returning to the main business of the NAIC, the most notable event was the absence of controversy over Gramm-Leach-Bliley, a/k/a HR 10, a/k/a S. 900. It has, of course, become law. It does, as you know, create the potential for economic overlap between the banking and insurance industries. It contains traffic rules meant to keep bank and insurance regulators from clipping each others' bumpers, but it is unlikely that they will work infallibly, or even smoothly, in the heavy traffic likely to surround a combined bank/insurer failure or near miss. The most painstaking, and critical, phase of this new joint venture, will be the resolution of the plethora of small questions that will inevitably arise. Until we try one, though, it's hard to predict whether catastrophic collisions will occur.

This uneasy collaboration between state and federal government is becoming a recurrent theme in the NAIC. Time was, insurance commissioners carefully avoided involvement in federal activity, both because federal government was somebody else's political turf, and because in theory their bailiwicks were unaffected by it. But insurance is much too important, and much too little understood, for that policy to be safe. It led to the half-considered "savings" clause in ERISA, for instance, to bad law on federal recognition of receivership orders, and to pointless disputes about federal superpriority of claims.

More recently, Washington has become a regular stop on the insurance regulatory circuit, and the reputation, and credibility, of insurance regulation has increased appreciably. It is cliche that these efforts have been meant to "fend off federal regulation of insurance", but that really distorts the message. They have served to point out that, if Congress ventures into insurance regulation, it cannot do so without taking responsibility for the result. The next time Congress authorizes something like METS and MEWA's, it had better be prepared to establish rules that prevent the development of regulatory lacunae between state and federal prerogatives. It can no longer hope to write policy for insurance regulators, without providing them tools with which to enforce it, and taking the political heat if they aren't effective. Insurance regulation tends to produce unintended consequences, which state officials have gotten relatively good at predicting. The sea change which accompanies Gramm-Leach-Bliley was the status of

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Other News & Notes

By Charles Richardson

By the time you all read this column, the ABA/IAIR "Insurance Insolvency Revisited: 1999" seminar in San Francisco on December 3-4 will be history, and each of you will be steeped in insolvency law and practice up to your eyeballs. The agenda looked impressive going in; I'm sure the program got glowing reviews coming out. Therefore, let's digress a bit from the steady diet of pure rehabilitation/liquidation principles and think more cosmically about the state of the industry in which we toil.

Banks, Banks, Banks

It happened. The warring factions made peace after almost 20 years of friction, and the walls of Glass-Steagall have been shattered. In early November, Congress passed S.900, the Gramm-Leach-Bliley Act, and President Clinton signed it with much financial modernization fanfare on November 12. When the Act becomes effective in February, banks and insurance companies can engage in public courtship and marriage rather than in those nasty little contractual affairs done under the cover of darkness since the $70 billion Travelers-Citicorp deal was announced in 1998.

Every trade organization and insurance practitioner in the world is summarizing the 144-page act and pontificating on what it will mean for the financial services marketplace over the next decade. For me, here are the key points to remember as we look at the legal landscape once the dust settles:

- The new law allows national banks, insurers and securities firms to affiliate, with some restrictions on how the affiliations may be structured. One limitation is that bank holding companies may acquire insurance companies, but national banks may not, because of the perceived threat that bank ownership would pose to the FDIC safety net. While subsidiaries of national banks are not permitted to underwrite insurance, they are permitted to sell insurance of all kinds.
- The law preserves state regulation of insurance, at least for now, although many worry that creeping (and creepy) federal encroachment will become the name of the game.
- On the well-publicized privacy front, the Act requires clear disclosure by all financial institutions of their privacy policy regarding the sharing of non-public personal financial information with affiliates and third parties. It also requires that consumers be given notice and an opportunity to block the financial institution's sale or sharing of such information with nonaffiliated third parties. The states are permitted to enact greater privacy protections, and some observers expect the legislative battle now to shift to the states.
- It allows mutual companies domiciled in states that have not enacted mutual holding company legislation to redomesticate to states that have as part of a reorganization. The Clinton Administration belatedly objected to this provision, with Treasury Secretary Lawrence Summers warning legislators that the provision "could allow mutual insurance companies to avoid state law protecting policyholders, enriching insiders at the expense of consumers."
- The Act provides for the creation of a national agents licensing body (National Association of Registered Agents and Brokers) if a majority of the states have not, within three years, adopted uniform agent licensing requirements or reciprocity rules. Among other things, a majority of the states must adopt uniform suitability criteria for the sale of insurance products, including annuities. The NARAB would be subject to NAIC oversight.
- Supporters of the new law say it will allow U.S. financial institutions to be more competitive in the international marketplace and will give consumers one-stop shopping for financial services at a lower price. Consumer groups doubt that any new financial giants will pass along cost savings to the average customer and are especially concerned about privacy issues. They also worry that the financial institutions will find a way around the requirements of the Community Reinvestment Act.

Now that the law has passed, many doubt that we'll see dramatic consolidation of the sort predicted after the Citigroup deal was announced. The current belief is that banks and insurers have been getting around Glass-Steagall for a number of years, through joint ventures and other cooperative arrangements, and that they'll continue in the same vein for awhile. To the extent that there are acquisitions, most people seem to think that the banks will be the buyers and that they will likely focus on the life insurers, since banks take credit risk, interest rate risk and liquidity risk; life insurance products, especially annuities, involve similar risks.

Litigation, Litigation, Litigation

The $1.2 billion judgment in October in Illinois against State Farm for supposedly using "inferior" generic auto parts on policyholders' vehicles has now been followed by a copy-cat

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IAIR's 2000 Educational Events

The American Bunkruptcy Institute
Pre-Seminar
Spring National Meeting
April 27, 2000
Washington, D.C.

In Association with IAIR

TRIAGE FOR MANAGED CARE
Law and Practice of
Managed Care Organization Insolvency

Additional information on this seminar will be posted to IAIR's website as it becomes available.

IAIR/NCIGF/NOLHGA

Joint Meeting
November 16-17, 2000
La Maisonette
San Antonio, Texas

For more information about IAIR's educational programs, visit our website at www.iair.org

IAIR NEWS

from the Executive Director

IAIR Reception: The IAIR Reception for March, 2000 in Chicago will be held on Saturday evening from 5:30 to 7:30 p.m. The Board of Directors has decided to implement this change to see if it better fits into members' schedules. Keep this scheduling change in mind when making your travel plans for Chicago.

Recruiting Discount: 40 members took advantage of the 20% recruiting discount towrads 2000 dues. However, the following individuals recruited the most number of new members:

Robert Craig - 4
James Gerber - 3
Douglas Hartz - 3
James Stinson - 3

Thank you all for your efforts.

E-mail Addresses: In an effort to cut costs, IAIR is increasingly using e-mail. If you are not receiving e-mail transmissions from us, it is because we do not have your e-mail address. Please forward it to IAIRHQ@aol.com as soon as possible.

Certification Presented

Elizabeth Lovette, Chair of Ethics & Accreditation Committee, presents the CIR plaque to Philip J. Singer at the San Francisco meeting.

Congratulations to the new AIR
Elizabeth Fuller, AIR

and

A Special Thank You To
Gary Hernandez and
Sonnenschein Nath & Rosenthal
for the use of their offices for Board & Committee meetings in San Francisco

Health Maintenance Organization Insolvency: Bankruptcy Jurisdiction or State Proceedings

By Lewis E. Hasset and Jessica F. Pardi

The Constitution of the United States accords Congress the authority to enact federal laws governing bankruptcies. U.S. Const. art. I, § 8, cl. 4. Because the Constitution does not accord exclusive bankruptcy authority to the federal government, states are free to enact their own insolvency laws unless Congress has enacted an applicable federal law. *Brown v. Smart*, 145 U.S. 454 (1892); *Atlanta Flooring & Installation Co. v. Russell*, 146 F.2d 884 (5th Cir.), *cert. denied*, 325 U.S. 862 (1945). In accordance with its Constitutional mandate, Congress has enacted a federal bankruptcy law according exclusive jurisdiction to federal courts in most circumstances. *See* 11 U.S.C. §§ 101 *et seq.*; 28 U.S.C. § 1334.

Bankruptcy Code Does Not Cover Domestic Insurance Companies

The Bankruptcy Code of 1978 expressly provides that "a domestic insurance company" may not be the subject of a federal bankruptcy proceeding. 11 U.S.C. § 109(b)(2). The exclusion of insurers from the federal bankruptcy court process is consistent with pre-existing federal policy generally allowing states to regulate the business of insurance. *See* 15 U.S.C. § 1012 (McCarran-Ferguson Act).

In accordance with the exclusion of insurance companies from the federal bankruptcy courts, states administer insurer insolvencies in their own courts. Most states have now enacted some version of the Model Insurer Rehabilitation and Liquidation Act (Model Insolvency Act) drafted by the National Association of Insurance Commissioners (NAIC). In *U.S. Department of the Treasury v. Fabe*, 508 U.S. 491 (1993), the Supreme Court recognized state regulation of insurer insolvencies as the "business of insurance" subject to reverse preemption under the McCarran-Ferguson Act. It held that a state statute giving higher priority to policyholders trumped the general federal statute giving higher priority to claims of the federal government.

A debate has arisen as to whether the insolvency of a HMO is to be administered under the federal bankruptcy laws or under state laws governing insurer insolvencies.

The Dual Nature of HMOs

A health maintenance organization (HMO) is an organization of health providers wherein each member pays a premium in exchange for medical care. As such, a HMO possesses some attributes of an insurer, but in other ways is distinguishable. Like an insurer, a HMO spreads risk, "both across patients and over time for any given person." *Anderson v. Humana, Inc.*, 24 F.3d 889 (7th Cir. 1994). Additionally, in some states the rates that a HMO may charge are supervised by the state insurance commissioner using actuarial computations. *Beacon Health, Inc.*, 105 B.R. 178, 183 (Bankr. D. N.H. 1989). Unlike an insurer, a HMO provides actual medical care and does not provide indemnification insurance. *Estate of Medcare HMO*, 998 F.2d 436, 445 (7th Cir. 1993). In most instances, a subscriber is not personally liable to the providers, or at least to the participating providers, and such participating providers do not have recourse against the subscribers. *See* Colette B. Resnik, "Maxicare as a Guide for Health Maintenance Organizations in Bankruptcy." 8 Bankr. Dev. J. 271, 281 (1991) (Resnik). Not surprisingly, a debate has arisen as to whether the insolvency of a HMO is to be administered under the federal bankruptcy laws or under state laws governing insurer insolvencies. *Resnik* at 271.

Federal Bankruptcy Jurisdiction Over HMOs is Largely Controlled By State Law Classifications

The NAIC has promulgated a Health Maintenance Organization Model Act (Model HMO Act), which expressly states that insolvency proceedings of HMOs are to be administered in state courts under the supervision of the commissioner of insurance. *See* Model HMO Act, § 21(A). That section states as follows:

"A rehabilitation, liquidation or conservation of a health maintenance organization shall be deemed to be the rehabilitation, liquidation or conservation of an insurance company and shall be conducted under the supervision of the [commissioner] pursuant to the law governing the rehabilitation, liquidation and conservation of insurance companies. The [commissioner] may apply for an order directing the [commissioner] to rehabilitate, liquidate or conserve a health maintenance organization upon any one or more grounds set out in [cite rehabilitation law], or when in the [commissioner's] opinion the continued operation of the health maintenance organization would be hazardous either to the enrollees or to the people of this state. Enrollees shall have the same priority in the event of liquidation or rehabilitation as the law provides to policyholders of an insurer."

Similarly, the Model Insolvency Act expressly states that "prepaid health care delivery plans" are subject to state-mandated insolvency proceed-

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HEALTH MAINTENANCE ORGANIZATION INSOLVENCY *(Continued from page 7)*

ings. Model Insolvency Act, § 2(G). Some states, such as Georgia, have clarified the Model Insolvency Act by expressly stating "health maintenance organizations" are covered by state insolvency proceedings. *See* Ga. Code Ann. § 33-37-2(7).

Accordingly, at least those states that have adopted the above provisions of the Model HMO Act and the Model Insolvency Act intend to preclude federal bankruptcy court jurisdiction over HMOs. The question is whether the federal bankruptcy courts will respect that assertion of jurisdiction. Upon the filing of a petition for relief under the federal Bankruptcy Code, the court issues an automatic stay, that effectively prevents a parallel state proceeding. *See* 11 U.S.C. § 362. As a result, the federal courts will determine ultimately whether a HMO's insolvency is administered in the federal bankruptcy court or the state court.

Federal courts have promulgated three different tests for determining whether an entity is one of those excluded from bankruptcy court jurisdiction under 11 U.S.C. § 109(b).[1] *See Estate of Medcare HMO*, 998 F.2d 436 (7th Cir. 1993). The first test, known as the "state classification test," looks to the classification of the entity under state law. *Cash Currency Exchange Inc. v. Shine*, 762 F.2d 542 (7th Cir. 1985). Under that test, the threshold inquiry is whether state law classifies the entity as one specifically excluded from being a debtor in bankruptcy under section 109(b)(2) of the Bankruptcy Code. *Estate of Medcare HMO*, 998 F.2d at 438. If a state does so classify the entity, the inquiry ends, and the insolvency will be handled at the state court level. *Id.* If state law does not make that classification, the court must examine whether, under state law, the entity is substantially equivalent to those excluded from bankruptcy. *Portland Metro Health, Inc. v. Driscoll*, 15 B.R. 102 (Bankr. D. Or. 1981).

The second test, known as the "independent classification test," requires the court to examine the language of section 109 and to determine whether, as a matter of federal statutory construction, the entity is excluded from being a debtor in bankruptcy. *Cash Currency Exchange*, 762 F.2d at 551-552. Whereas the state classification test focuses on state law, the independent classification test focuses on the meaning of a federal statute, that is, section 109(b) of the Bankruptcy Code.

Federal courts have promulgated three different tests for determining whether an entity is one of those excluded from bankruptcy court jurisdiction.

Under the third test, known as the "alternative relief test," the court examines Congressional intent, public policy and practicality to determine whether federal bankruptcy relief is a satisfactory alternative to the established state procedure for handling the insolvency.. *In re Republic Trust and Savings Co.*, 59 B.R. 606, 614 (Bankr. N.D. Okla. 1986). Thus, the court may consider whether a bankruptcy proceeding is a satisfactory method, when compared with available state and federal non-bankruptcy methods, of reorganizing or liquidating an entity. *Id.* at 614. Factors such as time and expense may be considered. *Id.*

The court must consider the state law in effect on the date of filing of the bankruptcy petition. *In re Michigan Master Health Plan, Inc.*, 90 B.R. 274 (Bankr. E.D. Mich. 1985). As a result, subsequent amendments to state law cannot divest a bankruptcy court of jurisdiction existing on the dates of the petition. *Id.* at 276.

In a series of cases known as the "Maxicare cases," the United States Bankruptcy Court for the Central District of California repeatedly held that a HMO is not a "domestic insurance company" and, therefore, is eligible to be a bankruptcy debtor under section 109 of the Bankruptcy Code.[2] In those cases, the court applied all three of the jurisdictional tests.

In *In re Maxicare Health Insurance Co.*, 104 B.R. 279 (Bankr. C.D. Cal. 1989), the bankruptcy court found the state classification test to be inconclusive. The court reasoned that, although Wisconsin law expressly classified HMOs as domestic insurers, a functional analysis of the HMO at issue did not lead to classifying such entity as a domestic insurer. *Id.* at 283. The court then applied both the independent classification test and the alternative relief test and found that both of these tests weighed in favor of bankruptcy court jurisdiction. *Id.* at 288.

The district court reversed that decision in *In re Family Health Services, Inc.*, 143 B.R. 232 (C.D. Cal. 1992). The court held that it was "not appropriate to use a functional analysis . . . [when] state law unequivocally does classify HMOs as insurance companies." *Id.* at 232. The court, however, made clear that not all HMOs are excluded from bankruptcy relief, only those HMOs domiciled in states which classify and regulate HMOs as insurance companies. *Id.*

The remaining Maxicare cases have been distinguished by other courts, which have noted that the Maxicare cases involved a national network of HMOs in over forty states. In such circumstances, it may be appropriate to weigh the state classifi-

cation test against federal bankruptcy policy.

In *Medcare*, 998 F.2d at 442, the court rejected the three-part test, holding that the classification under state law controls, unless such state law is found to frustrate the purposes of the Bankruptcy Code. The court stated:

"In essence, then, there should not really be three separate tests for ascertaining whether an entity is excluded from the protection of the Bankruptcy Code. Rather, absent express classification under section 109 or some other federal statute, the classification of an entity should generally follow the law of the state of its incorporation, so long as that classification does not frustrate the purposes of the Code."

Id. at 442. Noting that Illinois law expressly classifies HMOs as insurers, the court concluded that an Illinois HMO was not subject to a federal bankruptcy proceeding. *Id.* at 447. *See also In re Beacon Health, Inc.*, 105 B.R. 178 (Bankr. D. N.H. 1989) (holding that a New Hampshire HMO is a domestic insurer and is therefore ineligible to be a bankruptcy debtor).

As legislatures have amended state statutes to satisfy the "state classification test," federal courts have become more likely to bar bankruptcy court jurisdiction over HMOs. *See* Craig P. Druehl, "Note and Comment: HMO and Insurance Insolvency: The Benefits and Detriments of a Federal System," 23 Am. J. L. Med. 487, 494 (1997) (hereafter "Druehl"); Patrick Collins, "HMO Eligibility for Bankruptcy and The Case for Federal Definitions of 109(b)(2) Entities," 2 Am. Bank. Inst. L. Rev. 425 (1994). Most recently, in *In re Master Health Plan, Inc.*, No. MC197-021, 1997 U.S. Dist. Lexis 22880 (S.D. Ga. June 18, 1997), the district court refused to stay the state court's administration of an HMO insolvency. Adopting the Seventh an Circuit's emphasis on the state classification test, the court cited several provisions of Georgia law which appeared to classify HMOs as insurers for most purposes. Specifically, the court cited a Georgia statute, which was similar to section 21(A) of the Model HMO Act. *See* Ga. Code Ann. § 33-21-12(7). The court also cited other provisions of the Georgia Insurance Code that defined "insurer" to include HMOs. *See* Ga. Code Ann. § 33-1-2(4).

One of the strongest arguments against classifying a HMO as an insurer is that a HMO does not indemnify against loss.

One of the strongest arguments against classifying a HMO as an insurer is that a HMO does not indemnify against loss. In *Master Health*, the court found that argument appealing, but not dispositive. *Master Health* at 6. The court held that the absence of that essential feature of insurance did not mandate federal bankruptcy jurisdiction finding that the absence of an indemnity provision "is not enough to overcome Georgia's obvious intent to classify HMOs as insurance companies." *Id.* Essentially, the court applied the state classification test and found that the intent of Georgia law was clear, i.e. to avoid federal bankruptcy jurisdiction over HMOs, thereby precluding any inquiry into whether HMOs are in fact sufficiently akin to insurers to preclude bankruptcy jurisdiction.

Conclusion

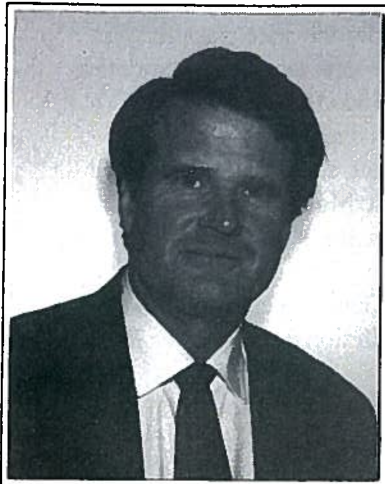
Courts seem to prefer testing bankruptcy court jurisdiction over HMOs under the state classification test. Thus, state legislatures can effectively preclude federal bankruptcy court jurisdiction over HMOs by carefully crafting state stautes. The Model HMO Act and the Model Insolvency Act contain language supporting state court jurisdiction. The definitional language added by Georgia certainly promoted state jurisdiction in the *Master Health* case.

Notwithstanding the trend towards state court jurisdiction over HMO insolvencies, HMOs likely will continue to seek federal bankruptcy protection. Several commentators advocate federal bankruptcy jurisdiction over HMOs. *See Resnik* at 273-289; *Druehl* at 502-509. Accordingly, these issues will continue to be subjects of litigation and legislative action.

Lewis E. Hassett is a partner with the Atlanta and Washington, D.C. law firm of Morris, Manning & Martin, L.L.P. His practice includes the representation of receivers and reinsurers in insurer insolvency proceedings and related litigation. Mr. Hassett also represents insurers and reinsurers in matters involving product torts, business torts, RICO claims and reinsurance disputes. He is a 1979 graduate of the University of Virginia School of Law.

Jessica F. Pardi is an associate with Morris, Manning & Martin, L.L.P. She is a member of the firm's insurance group and is a 1996 graduate of the University of Virginia School of Law.

Meet Your Colleagues



ALEXANDER T. FARLEY

Alexander T. Farley is the President of American Insurance Management Group, Inc. (**AIM**), which he founded in 1990. **AIM** specializes in management consulting and providing technical services to insurers, reinsurers and regulators. With over twenty-three years of industry experience, Alec has developed skills in strategic planning, financial restructuring, reinsurance company operations, marketing and distribution.

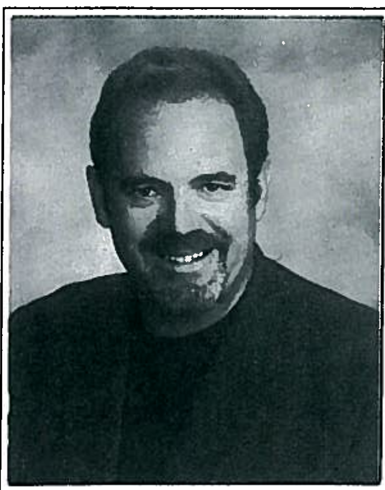
Alec founded **AIM** to help regulators assess management, operations, strategies and the true financial condition of potentially troubled companies. This review gives insurance departments the ability to determine the degree of the problem, whether the company can be saved, what is needed to save it and can management do the job?

Alec has been an Administrative Supervisor of seven property/casualty and life/health companies and the Deputy Rehabilitator of an HMO. Taking over management of the HMO as the Deputy Rehabilitator, he focused his team on assessing the HMO's ultimate liabilities, maintaining the provider network, assuring continuity of care for the members and reengineering internal operations, particularly for claims management.

Next, he developed a rehabilitation plan that allowed for 100% payment of provider claims while in rehabilitation, which would hopefully allow for the sale of the membership plan. Four months after entering rehabilitation, the plan was sold for over $5 million benefiting the estate. After much preparation for seemless transfer of the members to the new plan, the HMO was placed in liquidation with all undisputed post rehabilitation claims having been paid within thirty days.

Previously, Alec was Vice President of Aon Risk Consultants, a senior consultant with Tillinghast in its management and operations practice and an officer of Alexander Reinsurance Intermediaries, Inc., now Aon Re. He started his career as national accounts insurance broker for Rollins Burdick Hunter.

Alec has a BA from Connecticut College with a major in government and minor in economics. He is actively involved with fund raising and other alumni activities for his college and has been a volunteer with the American Red Cross and the Philadelphia Special Olympics. Alec lives in Philadelphia with his wife and three young children.



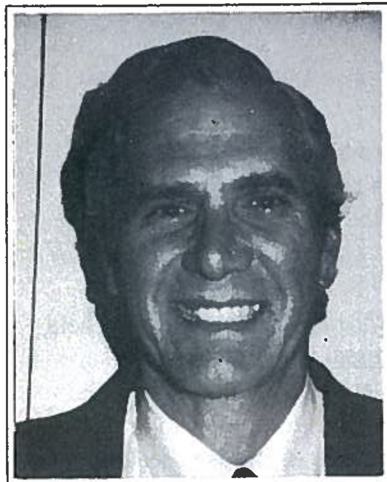
ROBERT LOISEAU, JD, CIR

Bob is a Principal in the Houston-based management firm of Jack M. Webb and Associates, Inc. and moved to Austin, Texas in 1993 to open its Austin office. He has worked exclusively in the insolvency arena since the early 1980's and his experience includes management of Chapter 11 cases, savings and loans receiverships, and, currently, multi-state insurance receiverships. Bob and his colleagues at Webb & Associates are now pursuing opportunities in the ailing health care and nursing home industries, and plan expansion into markets outside of Texas next year.

During college and law school, Bob worked for Anheuser Busch at its Houston Busch Gardens. He fondly remembers those years, not only because of the free Budweiser, but because he finds that most receiverships, especially in their early stages, are remarkably similar to the circus-like environment of amusement parks.

Since joining IAIR in 1997, Bob has become very active in the association's affairs, serving on the Millennium, Marketing and Accreditation & Ethics Committees, and on Air's Managed Care Task Force. Bob has also been a speaker at several NAIC/IAIR Roundtables where he spoke on such compelling topics as early access and ERISA plan insolvency.

An avid sailor, Bob initially suffered withdrawal from salt water sailing when he moved from the Gulf Coast to Central Texas, but soon adapted to sailing in nearby Lake Travis. He is nearing completion of a hands-on, total restoration of a classic sloop, *Footloose*, a project which has already taken more than four years. He has no idea what he will do with all his spare time when the boat is finished.



GRIFFITH T. PARRY

Griff Parry is an insurance consultant who resides in Swampscott, Massachusetts, a suburb of Boston. He is a graduate of Trinity University and Duke University School of Law. He is admitted to practice law in New York, New Jersey, Maryland, Texas, and hopes to add Massachusetts to this list soon. Griff holds the professional designations of CPCU and FLMI. He is a charter Associate Member of IAIR and a member of ARIAS-US.

Griff has worked in the legal departments of insurers and reinsurers, including Metropolitan Life, North American Re, Bellefonte Re, Ranger, and Delta America Re. For the past twelve years Griff has dealt primarily with the problems of insolvent reinsurers. This work has included litigating and supervising litigation against former officers and directors and accountants of insolvent reinsurers, administering claims of creditors of insolvent reinsurers, and collecting reinsurance recoverables for the estates of insolvent reinsurers. While working for a law firm that represented the liquidator of Integrity Insurance Company, Griff testified before the U.S. House of Representatives' Commerce and Energy Committee regarding the dangers of giving broad underwriting authority to MGA's.

With respect to arbitrations, Griff has served as an arbitrator on over twenty panels where decisions were rendered by reinsurance arbitration panels. Griff has also served on numerous other reinsurance arbitration panels. In addition to serving as a party appointed arbitrator, Griff has provided counsel to insurers involved in arbitration proceedings. Griff has also served as an arbitrator in arbitrations conducted under the auspices of the American Arbitration Association and is a member of its panel of arbitrators.

Griff's wife, Deborah, works for Baring Assets Management where she sells financial asset management services for insurance companies' international and offshore funds. This enables Griff and Deborah to enjoy traveling together to such insurance related functions as NAIC meetings and National Association of Variable Annuity (NAVA) conferences. Despite the temptations afforded by such travel, Griff and Deborah have managed to stay remarkably in love and reasonably fit.

ALEX D. MOGLIA

Alex D. Moglia is president of Alex D. Moglia & Associates, Inc., an international turnaround and crisis management firm. Mr. Moglia's firm works with shareholders, management and creditors of companies in transition by reorganizing operations, reducing expenses, increasing profitable revenues, rescheduling bank and trade debt and/or injecting new debt and equity capital. If necessary, Alex D. Moglia & Associates, Inc. helps sell the company's assets through a public or private sale.

Recently, Mr. Moglia was part of a team which visited Romania and Croatia for the purpose of advising key decision-makers involved in the restructuring and privatization of those countries' economies.

Mr. Moglia has served as state and federal receiver in various health-care company insolvencies. He is a member of the panel of federal bankruptcy trustees. Mr. Moglia is a member of the Board of Directors of the American Bankruptcy Institute and chaired its Finance & Banking Committee. He has held senior management positions with Continental Illinois National Bank and CNW Corporation, a former New York Stock Exchange company with highly diversified subsidiaries. Initially, he was a corporate attorney with Winston & Strawn in Chicago. Mr. Moglia writes and speaks frequently on issues of insolvency and bankruptcy.

Mr. Moglia has a Juris Doctor degree from the University of Chicago School of Law and attended the University of Chicago Graduate School of Business. He has a Bachelor of Science of Foreign Service degree from Georgetown University, Washington, D.C. He was born in Argentina, lived in Brazil, and speaks Spanish, Portuguese, French and Italian.

Federal Lawsuits Against A Receiver: Dismissal Strategies In A Post-Quackenbush World

By William M. Sneed

Litigation involving insurance company receiverships frequently generates disputes regarding the appropriate forum, with the dueling forums usually including the state receivership court and a federal court, or (depending on the contract at issue) an arbitration panel. For instance, the most recent issue of Mealey's Litigation Report: **Insurance Insolvency** (October 6, 1999) features at least three different cases where litigants are disputing where their dispute should be resolved. *See, e.g., Peoples Benefit Life Ins. Co. v. Dale*, No. 3:99 CV 537 BN (S.D. Miss.)(federal court or state receivership court); *LaVecchia v. Munich Reinsurance Co.*, No. 99-5611 (3d Cir.)(arbitration panel or remand from federal court to state court); *Koken v. Cologne Reinsurance (Barbados) Ltd.*, No. 593 M.D. 1997 (Pa. Cmwlth.)(arbitration panel or state receivership court). Mealey's Litigation Report: **Insurance Insolvency** (October 6, 1999) pp. 4, 9, 10.

A receiver's obligation to arbitrate raises specific statutory issues, depending on the state law at issue, as well as the applicability of different federal statutes respecting arbitration, such as the Federal Arbitration Act (9 U.S.C. § 1 *et seq.*) and the New York Convention (9 U.S.C. § 201 *et seq.*). An article by James H. Moody III and Stephanie A. Pickels in the May 5, 1999, issue of Mealey's Litigation Report: **Insurance Insolvency** provides an incisive analysis of the arbitration issues. This commentary addresses the more general subject of a receiver's ability to prevent creditors of an insolvent insurer's estate from suing the receiver or the insolvent insurer in a federal court, in derogation of the claims process supervised by the state receivership court (and often also in derogation of a state court anti-suit injunction).

Up until a few years ago, the receiver had a ready remedy in the form of the *Burford* abstention doctrine, whereby federal courts would abstain from exercising their jurisdiction in deference to the state proceedings. *See Burford v. Sun Oil Co.*, 319 U.S. 315 (1943). *Burford* abstention is appropriate in cases involving difficult questions of state law bearing on policy problems of substantial public import whose importance transcends the result in a specific case at issue, or where federal adjudication of a case would disrupt state efforts to establish a coherent policy with respect to matters of substantial public importance. *See New Orleans Public Serv., Inc. v. Council of City of New Orleans*, 491 U.S. 350 (1989). Historically, federal courts consistently approved *Burford* abstention in actions against insurance companies subject to state delinquency proceedings. *See, e.g., Munich Am. Reinsurance Co. v. Crawford*, 141 F.3d 585, 589 n.2 (5th Cir. 1998); *Lac D'Amiente du Quebec Ltee v. American Home Assurance Co.*, 864 F.2d 1033 (3d Cir. 1988).

The MHC Task Force meets in San Francisco

Burford abstention practice has changed in recent years, however, following the U.S. Supreme Court's decision in *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706 (1996) ("*Quackenbush*"), where the Court held that a dismissal under the *Burford* doctrine is appropriate only when the federal court has discretion to grant or deny relief, such as in cases seeking declaratory or equitable relief, whereas a stay pending state court resolution may be in order when the case involves legal relief, such as a claim for damages.

A typical creditor of an insolvent insurer, such as a policyholder or a ceding company, would likely assert a contractual damages claim against the insolvent estate. Since this type of claim may at first glance appear to be classically "legal" in nature and *Quackenbush* limits the applicability of *Burford* abstention in such cases, what can a receiver do to direct such claims asserted in the federal court to the state court receivership proceeding?

One alternative, suggested in the *Quackenbush* decision, is a stay based on *Burford* abstention principles. *Feige v. Sechrest*, 90 F.3d 846 (3d Cir. 1996), is an example of this approach. Certain drawbacks come to mind, however. Some creditors may argue that a stay pending resolution of the state receivership proceedings is tantamount to a dismissal, which is what the *Quackenbush* court held was not an appropriate use of the *Burford* doctrine. Other creditors may maintain that a stay is appropriate only if unsettled issues of state law need to be and will be resolved in the state receivership proceeding, citing certain language in *Quackenbush* for support. *Quackenbush*, 517 U.S. at 730-731.

Recently, the federal court in Peoples Benefit Life Ins. Co. v. Dale, No. 3:99CV537 BN (S.D. Miss. Dec. 29, 1999), dismissed declaratory relief claims against a receiver on Burford abstention grounds, held that Burford dismissal of damages claims against the receiver was not appropriate, but nonetheless stayed all such claims in deference to the state receivership court proceedings, over the plaintiffs' objection.

A second alternative is to explore reverse preemption under the McCarran-Ferguson Act, 15 U.S.C. § 1011 *et seq*. McCarran-Ferguson provides for state law supremacy in the regulation of insurance and enforces this policy by preempting federal laws which encroach on state authority in the area. Specifically, § 2(b) of the McCarran-Ferguson Act reads as follows: "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance..., unless such Act specifically relates to the business of insurance..." 15 U.S.C. § 1012(b). McCarran-Ferguson preemption analysis generally raises three issues: (1) whether the state law in question qualifies as a law "enacted ... for the purpose of regulating the business of insurance"; (2) if so, whether the federal law in question invalidates, impairs, or supersedes the state law; and (3) whether the federal law in question specifically relates to the business of insurance. Recently, two federal courts refusing to find *Burford* abstention appropriate instead found reverse preemption under McCarran-Ferguson. *See, e.g., Davister Corp. v. United Republic Life Ins. Co.*, 152 F.3d 1277 (10th Cir.1998)("*Davister*"); *Munich Am. Reinsurance Co. v. Crawford*, 141 F.3d 585 (5th Cir. 1998)("*Munich*").

Both *Davister* and *Munich*, however, concerned reverse preemption of the Federal Arbitration Act. Assuming there is no arbitration issue, the question becomes what federal statute can McCarran-Ferguson reverse preempt to direct the creditor's case to the state receivership court. The answer is the federal statute conferring federal jurisdiction over the creditor's case, ordinarily the diversity jurisdiction statute, 28 U.S.C. § 1332. The same analysis that led the courts in *Davister* and *Munich* to find that the Federal Arbitration Act impaired state laws respecting insurance company insolvencies could apply to the diversity statute. However, federal courts have been reluctant to find McCarran-Ferguson reverse preemption of the diversity statute, usually without any serious analysis of the issue. *See, e.g., Munich Am. Reinsurance Co. v. Crawford*, 141 F.3d 585 (5th Cir. 1998), *citing Martin Ins. Agency, Inc. v. Prudential Reinsurance Co.*, 910 F.2d 249 (5th Cir. 1990), *citing Grimes*

(Continued on page 20)

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Mike Stinziano, Ph.D.
Vice President
Chicago, Illinois
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Receivers' Achievement Report

Ellen Fickinger

Reporters: Northeastern Zone - J. David Leslie (MA); William Taylor (PA); Midwestern Zone - Ellen Fickinger (IL); Brian Shuff (IN) Southeastern Zone - Belinda Miller (FL); James Guillot (LA); Mid-Atlantic Zone - Joe Holloway (NC) Western Zone - Mark Tharp (AZ); Amy Jeanne Welton (TX); Melissa Eaves (CA) International - Philip Singer (England); John Milligan-Whyte (Bermuda)

Our achievement news received from reporters covering the second quarter of 1999 is as follows:

Melissa Kooistra Eaves (CA) reported that in July, the Conservation & Liquidation Office (CLO) in California announced the appointment of Richard G. Krenz as Interim Chief Executive Officer. During the second quarter of 1999, the CLO distributed $11,874,569 to claimants of 6 different estates (**AIM Insurance, Old American, TMIC, Great Falls, Summit Title and Oshima Reinsurance**).

Mike Rauwolf (IL) continues to provide updates on Companies under OSD supervision. The company is managing the reinsurance run-off of **American Mutual Reinsurance Company (AMRECO)**. Total claims paid inception to date; Loss & LAE $30,449, Reinsurance payments $126,366,921 and LOC Drawdown disbursements $9,613,386. **Centaur Insurance Company**, another company under OSD supervision, continues the run-off of their business. Total claims paid inception to date; Loss and LAE $50,877,883, Reinsurance payments $4,945,493 and LOC Drawdown disbursements $13,876,555.

We continue to receive updates on the rehabilitation of **Fidelity Mutual Life Insurance Company (FML)** from **Bill Taylor (PA)**. Policyholder death benefits and annuity payments continue to be paid at 100%. Crediting rates are at or above policy guarantees. The Commonwealth Court authorized payment of all approved creditor claims if the creditors are willing to waive any interest or penalties, which may be applicable. All of the guaranty associations settled for immediate payment of outstanding assessment claims. However, the Louisiana Guaranty Association has appealed the denial of their expense claim. No guaranty associations have ever been asked to fund any aspect of **FML** obligations and the Louisiana Guaranty Association has not provided any information about expenses incurred in relation to **FML**; however, their appeal has recently been assigned to a claims referee.

Further, on August 5th, the Rehabilitator filed a petition to establish Claims Bar Date to effectively determine the date as of which any new or contingent claims would prejudice the orderly administration of the estate. Notice of the filing was recently mailed and the objection deadline is November 11. The Policyholder Committee has indicated that they will object to the Bar Date Petition insofar as it allows the barring of claims against any person or entity other than **FML**. The Bar Date Petition proposed barring claims that would affect the assets of **FML**, which would include claims against, related entities and indemnified persons. Hearings on the Third Amended Rehabilitation Plan and the accompanying Stock Allocation Report concluded on September 21. The hearing process was unusual in that direct testimony and objections to that testimony were all submitted to the Court in writing. The hearings only consisted of cross-examination of the witnesses who had filed testimony. Just prior to the beginning of the hearings, all **FML** rehabilitation matters were reassigned to a different judge.

Alan Gamse (DC) reported on the status of **Capital Casualty Insurance Company**, in liquidation. The Superior Court of the District of Columbia authorized an early access distribution in the amount of $200,000 to the District of Columbia Insurance Guaranty Association. The order issued during the Second Quarter, 1999, but the draft in payment of same was not issued until the Third Quarter, 1999, when funds became liquid.

And, finally, **James Gordon (D)** reports that collections during the second quarter of 1999 for rental income totaled $255.00 for **Trans-Pacific Insurance Company, et al.** Collections during the second quarter of 1999 for **Grangers Mutual Insurance Company** totaled $172,303.19.

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Size	Width x Height	Price/Newsletter Issues 1x	2x	3x	4x
1/8 page	2-1/4" x 2-3/8	$100	$ 90	$ 80	$ 70
1/6 page	2-1/4" x 4-7/8	$150	$130	$110	$ 90
1/3 page	2-1/4" x 9-3/4	$210	$190	$170	$150
1/2 page	7-1/4" x 4-7/8"	$275	$255	$235	$215
1/2 Island	4-7/8" x 7-1/4"	$325	$305	$285	$265
2/3 page	4-7/8" x 9-3/4"	$400	$380	$360	$340
Full page	7-1/4" x 9-3/4"	$530	$510	$490	$470

Please contact the IAIR Office, 312/961-4199, for more information today!

RECEIVERS' ACHIEVEMENTS BY STATE

Georgia (Harry L. Sivley, CIR-ML, State Contact Person)

Use and distributions made to policy/contract creditors and Early Access

Receivership Estates Closed	Year Action Commenced	Licensed	Category	Dividend Percentage	*Amount*
Confederation Life & Annuity	1994	Y	Life	100%	
Georgia Life & Health	1992	Y	Life	Class I - 100%	(4,000.68)
				Class II - 100%	(271,387.50)
				Class III - 61%	(290,695.55)
Hagan & Associates	1990	Y	Life & Health	Class I - 100%	(2,892.82)
				Class II - 4%	(68,075.93)

Illinois (Mike Rauwolf, State Contact Person)

Use and distributions made to policy/contract creditors and Early Access

Receivership	*Amount*
Amreco	$1,023,618.00
Centaur	$61,047.00
Coronet	$5,102.00
Edison	$14,531.00
InterAmerican	$750,000.00
Merit	$115,837.00
Millers	$270,575.00
Pine Top	$26,211.00
Prestige	$618.00
State Security	$24.00
Total	**$2,267,563.00**

Maryland (James A. Gordon, State Contact Person)

Use and distributions made to policy/contract creditors and Early Access

Receivership	*Amount*
Trans-Pacific Ins. Co. et al	$5,286,345.85
Grangers Mutual Ins. Co.	$138,038.92 (MD)
	$71,854.84 (DC)
	$27,958.88 (GA)
	$19,961.08 (TN)
Total	**$5,544,159.57**

Pennsylvania (William S. Taylor, State Contact Person)

Use and distributions made to policy/contract creditors and Early Access

Receivership	*Amount*
Corporate Life Insurance Co.	$5,000,000.00
Life Assurance Co. of PA	$2,000,000.00
Summit National Life Ins. Co.	$73,240.00
Total	**$7,073,240.00**

THE PRICEWATERHOUSECOOPERS GUIDE TO LONDON MARKET INSOLVENCIES FROM 1989
September 1999 – 4th Edition

Company	Run-off Agent	Company's/Run-off Agent's Details
Aneco, Bristol Re	PricewaterhouseCoopers	PO Box HM1171, Hamilton, HM EX, Bermuda Tel: (1) 441 295 2000 Fax: (1) 441 295 1242
Andrew Weir, Bryanston, Trinity	Bridgeway Management	Bridgeway House, Whitfield Street, Gloucester GL 1 1NA Tel: (44) 1452 428000 Fax: (44) 1452 301387
Anglo American	Claims Management Group	Ibex House, 42-47 Minories, London EC3N 1HN Tel: (44) 207 680 0101 Fax: (44) 207 680 0202
BAI (Run-off)	Whittington Insurance Services	8 Heritage Court, Lower Bridge Street, Chester CH1 1RD Tel: (44) 1244 346162 Fax: (44) 1244 347640
Bermuda Fire & Marine, KWELM	KWELM Management Services	John Stow House, 18 Bevis Marks, London EC3A 7JB Tel: (44) 207 645 4700 Fax: (44) 207 645 4777
Black Sea and Baltic		65 Fenchurch Street, London EC3M 4EY Tel: (44) 207 509 2000 Fax: (44) 207 702 3557
Chancellor	MRC Consultants	9 St Clare Street, London EC3N Tel: (44) 207 680 4037 Fax: (44) 207 680 0793
CAL, Charter Re, Fremont (UK)	PricewaterhouseCoopers	3 St. Philips Central, Bristol BS2 0XJ Tel: (44) 1179 724553 Fax: (44) 1179 713596
English and American, NEMGIA, ICS (UK)	Participant Run Off	Bruton court, 38 Bruton Way, Gloucester GL1 1DA Tel: (44) 1452 782500 Fax: (44) 1452 782582
Hawk	Clark Computer & Management Services	6-8 High Street, Shoreham-by-Sea, Sussex BN43 5DA Tel: (44) 1273 454064 Fax: (44) 1273 440515
ICS Re, RMCA Re	RMCA	137 Cecil Street, ICS Building, Singapore 069537 Tel: (65) 221 0022 Fax: (65) 224 6016
London & Overseas, OIC Run-Off	Bridgeway Management	56-59 Fenchurch Street, London EC3M 4AC Tel: (44) 207 488 3422 Fax: (44) 207 481 2384
Monument	Richards & Pearson	Forum House, 15-18 Lime Street, London EC3M 7AQ Tel: (44) 207 283 9142 Fax: (44) 207 623 5780
North Atlantic	North Atlantic Run Off Services	Harlands Road, Haywards Heath, West Sussex RH16 1YG Tel: (44) 1444 414177 Fax: (44) 1444 450458
Pan Atlantic	Robson Rhodes	186 City Road, London EC1V 2NU Tel: (44) 207 251 1644 Fax: (44) 207 253 4629
Pine Top		130 Minories, London EC3N 1NT Tel: (44) 207 680 0620 Fax: (44) 207 680 0630
Scan Re		44-46 Old Steyne, Brighton BN1 1NH Tel: (44) 1273 204621 Fax: (44) 1273 325326
Sovereign	Participant Run Off	Friars Street, Ipswich, Suffold, IP1 1TA Tel: (44) 1473 223748 Fax: (44) 1473 223583
Stockholm Re (Bermuda)	Powerscourt Group	Windsor Place, 18 Queen st., Hamilton HM11, Bermuda Tel: (1) 441 295 8495 Fax: (1) 441 292 1196
UIC	Chiltington International	8-10 St Saviors Wharf, Mill Street, London SE 12BE Tel: (44) 207 252 0316 Fax: (44) 207 252 0306
United Standard		Durgates, Wadhurst, East Sussex TN5 6DF Tel: (44) 1892 784157 Fax: (44) 1892 784682

THE PRICEWATERHOUSECOOPERS GUIDE TO LONDON MARKET INSOLVENCIES FROM 1989

Provisional Liquidation	Date of Provisional Liquidation	Provisional Liquidators
Anglo American	11 March 1997	KPMG
BAI (Run-off)	30 July 1998	PricewaterhouseCoopers
Black Sea and Baltic	24 August 1998	PricewaterhouseCoopers
Charter Re	23 June 1994 (Scheme Meeting 22 September 1999)	PricewaterhouseCoopers
Hawk	21 December 1995	PricewaterhouseCoopers
ICS (UK)	14 October 1993	PricewaterhouseCoopers
Municipal General	9 March 1994	Mazars Neville Russell
North Atlantic	6 March 1994	PricewaterhouseCoopers
Pan Atlantic	23 August 1996	Robson Rhodes
Sovereign	11 July 1997	KPMG
UIC	12 August 1996	Robson Rhodes
United Standard	15 May 1996	PricewaterhouseCoopers

Run-Off Scheme of Arrangement	Current Payment Percentage	Scheme Administrators
Andrew Weir	20%	PricewaterhouseCoopers
Bermuda Fire & Marine	5%	Ernst & Young
Bryanston	25%	PricewaterhouseCoopers
Chancellor	10%	Deloitte & Touche
English & American	17%	KPMG
KWELM	K-24%, W-16%, E-26%, M-16%	PricewaterhouseCoopers
London & Overseas*	25%	PricewaterhouseCoopers
Monument	36.9%	PricewaterhouseCoopers
OIC Run-off (formerly Orion)*	25%	PricewaterhouseCoopers
Scan Re	20%	Ernst & Young
Trinity	47.5%	PricewaterhouseCoopers

Valuation Scheme of Arrangement	Status	Scheme Administrators
Fremont (UK)	Valuation Scheme – dividend 25%	PricewaterhouseCoopers
ICS Re	Valuation Scheme – dividend 75%	PricewaterhouseCoopers
Pine Top	Valuation Scheme	Ernst & Young
RMCA Re	Valuation Scheme – dividend 75%	PricewaterhouseCoopers

Liquidation	Status	Liquidators
Aneco	Liquidation	PricewaterhouseCoopers
Continental Assurance Co. of London	Liquidation	PricewaterhouseCoopers
National Employers Mutual General	Liquidation – dividend 22%	KPMG
Stockholm Re (Bermuda)	Liquidation	Deloitte & Touche
Bristol Re	Liquidation	PricewaterhouseCoopers

*Certain claims are presently being paid in full by OIC Run-off (formerly Orion) and London & Overseas.

The information contained in this guide may change. While every effort has been made to ensure accuracy, information contained in this guide may not be comprehensive or may have been omitted which may be relevant to a particular reader. Recipients should not act on the basis of this guide without seeking professional advice.

REFORM OF PRIVITY OF CONTRACT

By Ambereen Salamat, D J Freeman

The Contracts (Rights of Third Parties) Act 1999 received Royal Assent on 11 November 1999 and is now thereby in force. It reforms privity of contract - a fundamental principle of English law. Under that principle, a person could only enforce a contract if that person was a party to it. In the case of contracts of insurance and reinsurance, the promisor provides the cover and the premium is provided by the promisee. As the law stood, even if a contract was made with the express purpose of conferring a benefit on a third party that third party acquired no contractual right.

Over the years there has been considerable dissatisfaction with the privity rule and it no longer applies in many common law jurisdictions. Even in England, parliament had intervened in certain instances and given third parties statutory rights of action (e.g., the Third Parties (Rights Against Insurers) Act 1930). The judiciary had also created various exceptions to the privity rule. One example is by the use of a trust, which has been utilised in the context of life insurance.

The changes to contract law that are now brought about by the new legislation will bring English law more closely into line with that of other EU member states. The new law, which implements most of the recommendations of a Law Commission report published in 1996, will not affect existing contractual arrangements. The Act will only apply to contracts, which are entered into during the six months after Royal Assent if the contract expressly provides for it to do so. Where there is no such express provision it will apply to contracts entered into after the end of the six-month period. There is a very limited category of contracts to which the Act does not apply (e.g., bills of exchange, promissory notes

and other negotiable instruments).

The purpose of this article is to provide an overview of the new legislation and to consider its implications in the context of insurance insolvency.

The changes to contract law that are now brought about by the new legislation will bring English law more closely into line with that of other EU member states.

Overview of the Act

Under the Act, a person who is not a party to a contract may, in his own right, enforce a contract term if the contract expressly provides that the party may do so or the term purports to confer a benefit on that party. In the latter case, this is so unless it appears, on a true construction of the contract, that the contracting parties did not intend the third party to have the right to enforce it.

The Act only confers a right on a third party to enforce a contract term if that third party is expressly identified in the contract by name, or is a member of a class, or answers to a particular description. The third party need not, however, be in existence when the contract is entered into. Further, the contract cannot impose obligations or burdens on a third party.

Third parties will only be able to enforce a contract term in accordance with and subject to all relevant terms of the contract. A third party shall have the same remedies available in an action for breach of contract that it would have had if that third party had been a party to the contract. The normal rules of law applicable to those remedies (e.g., causation, remoteness and the duty to mitigate one's loss) will apply equally to the third party claim.

Where a third party has a right to enforce a contract term, the contracting parties may not, without his consent, cancel the contract or vary it in such a way as to extinguish or alter his right to do so, if: the third party has communicated his assent to the term to the promisor, by words or conduct; or the promisor is aware that the third party has relied on the term; or the promisor can reasonably be expected to have foreseen that the third party would rely on the term and he has, in fact, done so.

It should be noted that a Court or arbitral tribunal has power to give directions to authorise the contracting parties to cancel or vary the contract without the third party's consent. However, this power is only exercisable in limited circumstances.

The Act sets out a number of protections to ensure that the third party is in no better legal position than the promisee under the contract. In a claim by the third party, the promisor may rely on any defence or set-off arising from the contract and relevant to the term being enforced, which would have been available to him had the claim been brought by the promisee.

Further, the promisor may also rely on any defence or set-off, or make any counter-claim, where this would have been possible had the third party been a party to the contract.

The Act goes on to provide that the right of a third party to enforce any contract term does not affect the right of the promisee to do so. However, where the promisee has recovered damages or an agreed sum from the promisor in respect of the third party's loss, or the expense to the promisee in making good that loss, the Court or arbitral tribunal shall reduce any award to the third party enforcing a contractual term to take account of the sum already recovered.

The Act raises a number of issues (e.g., how does a third party find out about his rights under a contract to which he is not a party?). There is no statutory obligation to provide such information. Some of the issues that arise are particularly relevant in the context of insurance insolvency, including but not limited to cut-through clauses and set-off, as discussed below:

Cut-Through Clauses

Cut-through clauses purport to entitle the original policyholder to proceed directly against a reinsurer to recover a claim, which the insurer cannot or will not pay. Such clauses may be found in endorsements to an insurance policy or in the contract of reinsurance itself. In either case, there is doubt as to the enforceability of such clauses, as, amongst other reasons, there is no privity of contract between the policyholder and the reinsurer.

Although the Act will allow non-parties to benefit from other people's contracts thereby overcoming the privity of contract restriction, it remains doubtful whether cut-through clauses are effective, as they would enable insolvent debtors to override the principle of pari passu treatment of unsecured creditors. This is another fundamental principle of English law under which all unsecured creditors of an insolvent company should receive equal treatment through pro rata distribution of the limited funds available. It is unlikely that the Act is intended to have this effect but the issue is not specifically addressed.

As set out above, the Act does provide limited protection to a promisor from double liability. Where a promisee has recovered damages or an agreed sum from the promisor in respect of the third party's loss, the Court or arbitral tribunal may reduce any award to the third party enforcing a contract term to take account of the sum already recovered. There is no corresponding protection in respect of a claim by a promisee where the promisor has paid the third party. This may have an impact on the practical application of any cut-through clause. In the event that the original policyholder proceeds directly against a reinsurer, it is unlikely that the reinsurer will make a payment without first obtaining a discharge of liability from the insurer.

Kevin Harris, Dick Darling and Liz Lovette networking at the IAIR reception in San Francisco.

Should the insurer be insolvent, this will be difficult, if not impossible, to obtain from the provisional liquidator.

Set-Off

Issues relating to set-off commonly arise in any insolvency, with insurance insolvency being no exception. In essence, the promisor can use a potential defence or set-off which would have been available as against the promisee, as well as against the third party; however, the detailed provisions of the Act are complicated and are likely to be difficult to apply in practice.

Third Party (Rights Against Insurers) Act 1930

This 1930s Act provides a statutory exception to the privity rule and to the principle that all unsecured creditors of an insolvent company are to be treated on a pari passu basis. However, the 1930s Act does not apply to reinsurance arrangements. It confers rights on third parties to sue an insurer direct in circumstances where the insured has become insolvent. The third party rights are only exercisable once the third party has established the insured's liability to him. The legislation is therefore of limited value in practice as the third party may have to bring up to three different sets of legal proceedings to enforce rights under the 1930s Act. This is because the Courts have held that a third party cannot claim against an insurer until the case against the insolvent insured has been proved. The third party may have to make an application to restore the company to the register in order to pursue a Court case against it. Having undertaken those two sets of proceedings, the third party may then find that there is no insurance or that the insurer refuses to pay out so that the third party has to take a set of proceedings against it.

The Law Commission has recently recommended substantial reform of this 1930s legislation. It is proposed that the law should be amended to enable the third party to bring a claim against the insurer without first having to prove the insured's liability. The effect would be that the third party could prove the claim against the insured and the claim against the insurer in one set of proceedings.

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FEDERAL LAWSUITS AGAINST A RECEIVER

(Continued from page 13)

v. Crown Life Ins. Co., 857 F.2d 699 (10th Cir. 1988); *Commissioner of Insurance v. DMB Kyoto Plaza Shopping Center, L.L.C.*, 42 F. Supp. 2d 726, 734 (W.D. Mich. 1998). *But see U.S. Financial Corp. v. Warfield*, 839 F. Supp. 684, 690-691 (D. Ariz. 1993) (questioning the reasoning of *Grimes* and holding the federal supplemental jurisdiction statute (28 U.S.C. § 1967) reverse preempted by McCarran-Ferguson in a case involving an insolvent insurer subject to state receivership proceedings).

Another alternative is the authority holding that all claims against an insolvent estate are necessarily equitable in nature, even if such claims would be legal in nature outside of insolvency. In *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 58 (1989), the Supreme Court noted that claims against a bankrupt estate, even if legal in nature outside of bankruptcy, are triable in equity. "[A]lthough petitioner might be entitled to a jury trial on the issue of preference if he presented no claim in the bankruptcy proceeding and awaited a federal plenary action by the trustee, . . . when the same issue arises as part of the process of allowance and disallowance of claims, it is triable in equity." 492 U.S. at 58, *citing Katchen v. Landy*, 382 U.S. 323, 336 (1966). "[T]he proceedings of bankruptcy courts are inherently proceedings in equity. ... '[A] claim of debt or damages against the bankrupt is investigated by chancery methods.'" *Katchen*, 382 U.S. at 336-337. These principles resurrect the *Burford* abstention doctrine in cases involving federal lawsuits against an insurance company receiver: a claim against the insolvent estate is necessarily equitable in nature and therefore appropriate for *Burford* dismissal under *Quackenbush.*

A final alternative is dismissal under the *Colorado River* doctrine based on fundamental comity concerns and out of deference to the parallel state court receivership proceedings because dismissal would give "regard to conservation of judicial resources and comprehensive disposition of litigation." *Colorado River Water Conservation v. United States*, 424 U.S. 800, 817 (1976). Familiar responses to a *Colorado River* motion include (a) that federal courts have a "virtually unflagging" obligation to exercise the jurisdiction given to them, (b) that the state court receivership proceedings do not qualify as "parallel" litigation, and (c) that the *Quackenbush* restriction of *Burford* abstention based on the discretionary/non-discretionary nature of the relief sought also applies to the Colorado River doctrine.

Conclusion

Disputes over forum will always be with us. The specific arguments change over time, however, as familiar doctrines are refined and modified, often by Supreme Court pronouncement. The impact of the *Quackenbush* decision on the *Burford* abstention doctrine is still being felt; and practitioners in this area should anticipate future court decisions which direct federal court lawsuits against an insolvent insurer or its receiver to the state court receivership proceeding, notwithstanding *Quackenbush.*

William Sneed is a litigation partner in the Chicago office of Sidley & Austin, where he practices insurance insolvency, reinsurance and insurance regulatory law. He presently represents receivers in Illinois, Mississippi, Missouri, Utah and England. Bill is one of two IAIR members responsible for producing the Reinsurance Arbitrators Directory found in the IAIR Membership Directory and at http://www.iair.org.

WANTED

Your Articles for *The Insurance Receiver*

If you have an article you would like to submit for publication in *The Insurance Receiver*, please submit it in MS Word 6.0, or Wordperfect 5.0 or 5.1 and send via e-mail to Paula Keyes at IAIRhq@aol.com.

Article(s) must be received by the first of the month, one month prior to publication date. All submissions become property of IAIR and may or may not be chosen for publication.

INSOL INTERNATIONAL

"After a great deal of debate and consideration, the IAIR board has decided that IAIR will no longer be a member organization of INSOL International. As we reviewed the issue we found that a great number of IAIR members were already INSOL members through other organizations resulting in duplication and, to some extent, unnecessary additional costs.

As part of our negotiations with INSOL it was agreed that any IAIR member who would like to, might continue as an individual member of INSOL."

This is an excerpt from a letter by Robert Craig, IAIR's President, that was sent to members with the 2000 Dues Invoices in an effort to outline the following benefits of continuing your membership in INSOL.

Membership Benefits

Members of INSOL International are entitled to the following benefits through their membership of the Association:

Conferences

Members of INSOL may attend both the Quadrennial Congress, which is held every four years and the regional conferences, which will be taking place yearly after 2001 at preferential rates. The saving on, for example, the Quadrennial Congress is in the region of US$150 per delegate.

The conferences give you the opportunity to network with colleagues from your own country and worldwide. Delegates from over 43 countries attended the 1997 Quadrennial Congress and when the INSOL Quadrennial Congress comes to London in 2001, we are expecting over 1000 delegates.

We are constantly striving to develop technical programmes that are at the cutting-edge in their content and presentation.

International Insolvency Review

The IIR is a unique publication containing technical articles on many aspects of international insolvency. The Editor is Professor Ian Fletcher, Professor of Commercial Law, Queen Mary & Westfield College, University of London. John Wiley & Sons publish it three times a year.

The institutional subscription rate is US$445 but the INSOL member's rate is only US$135.

INSOL World

INSOL World, our member's newsletter, is currently printed three times a year. This will be increasing to quarterly next year. The newsletter features current events and developments concerning the profession worldwide, our Member Associations and INSOL International.

It frequently includes items of technical news not covered elsewhere.

Website

The website at www.insol.org is updated regularly to give the members current information regarding INSOL International. We have a new "INSOL 2001" section giving information on the forthcoming Quadrennial Congress offering you links to associated sites.

The Forum is a password-protected section of the site, which enables members to ask questions of their colleagues on any technical matters, without this being accessible by the public. The Forum offers an invaluable quick method of canvassing the opinion of your colleagues from other jurisdictions.

The site has many links to other insolvency-associated sites.

Membership Directory

The next annual Membership Directory will be published in November 1999. This will be the focal point of reference for organisations and individuals working in the business-rescue and insolvency profession in over 60 countries throughout the world. In addition to full member listings, it will contain:

- Details of professional firms who work for insolvency professionals and banks both domestically and outside their home countries.
- Details of firms who wish to be seen as international players: from specialist insolvency firms and accountants to solicitors, barristers and service-suppliers.
- Details about INSOL and its Member Associations
- A brief overview of the global insolvency marketplace
- A geographical index of all members and their firms.

Sheraton & Westin Hotels – INSOL Corporate Rate

INSOL members are entitled to the benefit of discounts of up to 20 % off their minimum rack rates at all Sheraton & Westin Hotels worldwide.

Other corporate discounts are being negotiated.

INSOL Secretariat

The Secretariat based at the headquarters of INSOL in London is available to help members with contacts in particular parts of the world or try to assist in providing answers on particular questions.

The office can provide a base for meetings if a member is in London on business. Additionally, archive files of conference papers are held in our library for our members.

Conclusion

If you are not already a member of INSOL through another organization, you can become a member by submitting an additional $40.00 to IAIR as included on the 2000 Membership Dues Invoices recently mailed to members.

REFORM OF PRIVITY OF CONTRACT

(Continued from Page 19)

Further, it is proposed that it would no longer be necessary to resurrect defunct companies in order to pursue claims under the 1930s Act.

Given the fact that the reform of both the privity of contract rule and also the 1930s legislation stem from the Law Commissions, there appears to be no consideration of the inter-relationship between the two sets of proposals.

Conclusion

There is no doubt that the Contracts (Rights of Third Parties) Act 1999 will provide a greater number of options in structuring insurance arrangements. A number of issues that arise as a result of this legislation can be addressed by inserting clear provisions into contracts. That said, the legislation raises a number of unanswered questions and the inclination may be to exclude its application. If that is the case, it will be some time before these issues are resolved.

Ambereen Salamat, D J Freeman

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Karen Weldin Stewart and Stephen Phillips in front of the IAIR display unit.

OTHER NEWS & NOTES

(Continued from page 5)

class action lawsuit, again in Illinois, against State Farm and six other insurance companies (CNA, Allstate, Safeco, Liberty Mutual, USAA and GEICO) on similar repair part deception theories. All this portends ill for the insurance industry and is just one more indication of the virtually impossible-to-quantify risks which any industry, particularly ours, faces these days at the hands of consumers and their plaintiff counsel advocates.

Jail, Jail, Jail

If you do the crime, you serve the time. In November, four more people associated with the looting of National Heritage Life, in liquidation in Delaware, were convicted by a jury in Orlando. The charges included racketeering, wire fraud, money laundering and interstate transportation of stolen property. The jury deliberated two weeks after a nine-month trial before finding the defendants guilty. The probe of the failure had lasted five years. There was evidence that more than $450 million was lost when National Heritage Life was declared insolvent in 1994. The allegations made by prosecutors centered around a maze of transactions and schemes that involved diversion of cash, phony credit lines and the sale of fraudulent mortgage-backed securities. Dozens of people had already pleaded guilty.

While the Martin Frankel saga is the most recent example of insurance company fraud that can force companies into the tank, the National Heritage convictions serve as a reminder that state and federal regulators are not going to let those responsible skate.

Ipe Jacob and Kate Sliwinska at the IAIR reception in San Francisco.

SAN FRANCISCO MEETING RECAP

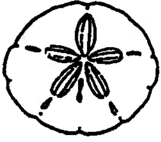
(Continued from Page 4)

state regulators, not as defensive and ideological defenders of states' rights, but as experts capable of identifying and fairly explaining the implications of deceptively simple decisions.

A consequence of this approach has been an increasing degree of respect for the complexity and capacity of state regulation inside the Beltway. Given the opportunity, federal officials clearly did not want the jobs of liquidating bankinsurers, of determining the solvency of HMO's, or of deciding market conduct complaints. If the states refused to accept responsibility for those items without authority to dispose of them, then the solution was not a federal scheme, but statutory recognition of state authority. A half dozen NAIC committees have received delegations from various federal agencies. The communications have been routine and formal, and the responses from our side have been sort of tongue-tied, but the message is clear: OCC won't reinvent risk-based capital unless the states abdicate their responsibilities. HCFA won't seek to wind up HMO's unless the states run and hide. They won't always see a conflict coming, but when they are told about it, they will seek to avoid it in a way that protects the state/federal partnership.

But just as Congress needed to be compelled to accept political responsibility for its popular mandates, state regulators must invest the time and money to understand the federal environment. Insurance financial examiners need to learn banking regulations, and market conduct regulators need to understand Medicaid. If those communications are not reciprocal and carried on at multiple levels, we will revert to the bad old days within eighteen months — and deserve it.

Speaking of HMO's, the reports keep getting scarier. NAIC staff loaded up 424 HMOs' financials into the new HORBC model, and came up with 107/424 companies below company action level, and 46 below control levels. When an early iteration of the Life RBC resulted in even vaguely similar results, they adjusted the formula. No such move this time. In fact, it is getting criticized because it permits undiscounted recognition of illiquid assets, supposedly used to deliver medical care but of no use in paying salaries, expenses, or claims. Even scarier is the fact that 210 of those HMO's (and the considerable majority of the action levels) had capital and surplus below $5 million. Granting that, if HORBC had actually been in effect, at least some of those companies would have adjusted their balance sheets to steer out of trouble, there may not be much you can do if your surplus is $5 million, and you own a $10 million CAT scanner. A high percentage of HMO's are either very small or very lean, and sometimes both.



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